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POSTAL REGULATORY COMMISSION

Postal Regulatory Commission

Annual Compliance Determination





U.S. POSTAL SERVICE PERFORMANCE
FISCAL YEAR 2008

March 30, 2009

Dan G. Blair
Chairman

On behalf of the Postal Regulatory Commission, I am pleased to present the Annual Compliance Determination (ACD) of the performance of the U.S. Postal Service for Fiscal Year 2008. This Determination is our second annual review of the Postal Service's compliance with requirements of the Postal Accountability and Enhancement Act (PAEA). Our review focuses on pricing results, service performance, and financial transparency and compliance.

The FY 2008 ACD review comes at a critical juncture, as the Postal Service struggles to remain financially viable and self-sustaining in the face of a declining economy and reduced demand for postal products. The Postal Service's liquidity in the near future is threatened by the significant decline in overall mail volumes and revenues, and costs which are not declining as rapidly as revenue.

Based on our review of information provided by the Postal Service, the Commission deems the Service to be in compliance with the PAEA. However, we do have concerns regarding the Postal Service's practice of changing cost methods in both the price adjustment and compliance proceedings; the low level of revenue generation by Negotiated Service Agreements (NSAs); and the limited volume of mail for which service standards are measured – recognizing that full implementation of the Intelligent Mail barcode (IMb) begins in May of 2009.

The Commission urges the Postal Service to move forward on its network reorganization plan as a means of addressing costs. In addition, we expect to see additional data regarding the total number of collection boxes in the United States. The PAEA indicates the importance of the collection function in mail service, and collection boxes are an essential component.

We commend the Postal Service for its positive service and performance results in the face of declining revenues and volumes and their effort in compiling the essential cost and volume data required for this report. The Commission's ongoing regulatory oversight of postal operations and finances is critical as the Postal Service continues to implement the reforms envisioned by the PAEA. These reports provide customers, stakeholders, and the Postal Service with valuable information on which to assess annual performance.

I wish to thank Vice Chairman Nanci Langley, and Commissioners Ruth Goldway, Tony Hammond and Mark Acton for their valuable work and input in preparation of this report. On behalf of my fellow Commissioners, I want to acknowledge the Commission's dedicated and expert staff for the timely completion of this analysis under highly challenging time constraints. Our efforts to perform our work could not be accomplished without the significant and substantial contributions of the Commission's staff.

Dan G. Blair

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PRINCIPAL FINDINGS

Overall Result

The Postal Regulatory Commission finds that the Postal Service was severely impacted by the recession and continued diversion of mail to the internet which resulted in declining volumes and revenues during Fiscal Year 2008. The Postal Service experienced a $2.8 billion loss during the year.

The Postal Service plans to adjust prices on May 11, 2009. These adjustments ameliorate the need for the Commission to take immediate remedial action on prices and services.

Financial and Pricing Results

The Postal Service experienced a $2.8 billion net loss in Fiscal Year 2008. Contributing factors leading to this loss include:

- A Congressionally-mandated $5.6 billion payment into the Postal Service Retiree Health Benefit Fund;
- The decrease in mail volume of 9.5 billion pieces, or 4.6 percent, from FY 2007;
- A decline in Total Factor Productivity (-0.5) for the first time in 9 years despite the elimination of fifty million workhours;
- An increase in operating revenue of only 0.2 percent despite average price increases in May 2008 near the 2.9 percent cap; and
- A $1.1 billion loss from ten market dominant products that did not cover attributable costs, such as:
  - $437 million from Periodicals Mail which used nearly all of the limited price increase authority in May 2008;
  - $218 million from Standard Regular Flats Mail which had a below average increase in May 2008.

Worksharing discounts generally did not exceed avoided costs.

- Where discounts exceeded avoided costs, they were either justified by an exception in the PAEA or have been resolved in the planned May 2009 price changes.
- The Postal Service unilaterally modified established methodologies for analyzing workshare discounts for First-Class Automation Letters presorted to Mixed Area Automated Distribution Center (MAADC) and raised workshare issues to be resolved through a Commission proceeding initiated on March 16, 2009 by order No. 192.

Volume-based Negotiated Service Agreements (NSAs) for market dominant products essentially broke even in FY 2008 and made a positive contribution over the last two years.

Competitive products, as a whole, generated revenue that covered attributable costs, made the required 5.5 percent contribution to institutional costs and generated $14 million in net profit subject to an imputed Federal tax.

- Seventeen competitive NSA contracts approved in FY 2008 are expected to improve net Postal revenues.
- Five competitive international products did not cover their attributable costs with a combined loss of $48 million in FY 2008 but each is expected to make a contribution with the January 2009 price changes as required by the PAEA.

The decline in the volumes of flat-shaped mail and equipment problems in the Flats Sequencing System (FSS) prompt concerns over delays in the achievement of projected cost savings. The Commission will monitor the implementation and assess outcomes in future compliance reports.

Service Performance

Speed of delivery performance improved for the 20 percent of mail measured.

- First-Class single-piece service exceeded the Postal Service's planned and prior year performance for Overnight, 2-day and 3-day delivery standards.
- Single-piece First-Class Mail International performance improved by two percentage points as measured by the Postal Service. However, the Universal Postal Union measurement is significantly lower.
- Package Services' performance improved from 57.7 percent on-time in FY 2007 to 63.9 percent nationally.

A measurement system based on the Intelligent Mail barcode (IMb) was pilot tested in FY 2008 and is planned for implementation in May 11, 2009.

- It will eventually expand performance measurement to nearly all domestic mail.
- Availability of meaningful measurement information depends on the extent of mailer participation in the IMb Program.
- The Commission will monitor and assess progress in future determinations.

The Postal Service provided improved Customer Service Satisfaction data in FY 2008.

- Surveys were expanded and included results from residential, small businesses, and large commercial accounts.
- Ratings from residential and small business respondents were generally less favorable than from National and Premier commercial accounts.

CHAPTER I — EXECUTIVE SUMMARY

The Postal Accountability and Enhancement Act of 2006 (PAEA) was enacted to improve transparency and accountability of the United States Postal Service. The PAEA directs the Postal Regulatory Commission to review Postal Service performance every Fiscal Year. The Postal Service has 90 days to collect, audit, and submit data the Commission determines necessary. The Commission has an additional 90 days to solicit comments from the public, evaluate the data, and provide a written determination of Postal Service compliance with applicable statutory policies.

This report assesses the Postal Service's FY 2008 performance. It focuses on three main areas: financial condition, strategic goals, and pricing policies. The PAEA identifies multiple policy considerations that apply to these three areas. To the extent possible, the Commission identifies the most relevant statutory objectives and factors, and, where necessary, balances the importance of each.

Fiscal Year 2008 presented many challenges for the Postal Service. The national economic downturn exacerbated existing declining volume trends. Postal revenues barely increased despite a mid-year rate increase, and the Postal Service recorded a $2.8 billion loss. The Postal Service has indicated that it is responding to these losses by reducing costs and designing 2009 rate increases to improve financial stability in the future.

The Commission recognizes that in a number of areas the policy requirements, objectives and factors of the PAEA were not fully satisfied in 2008. However, the Commission finds that the Postal Service has initiated actions to address these problems. While no immediate action by the Commission is appropriate at this time, this report identifies several issues that need to be addressed in the near term.

Financial Condition

In the third quarter of FY 2008, mail volume began to drop precipitously. The financial impact was nearly immediate as a first quarter positive net income of $0.7 billion turned to a loss of $1.1 billion for the third quarter and further declined with a $1.7 billion loss in quarter four. The net result for the year was a $2.8 billion loss. However, without the required $5.6 billion payment to the Retiree Health Benefits Fund created by the PAEA, the Postal Service would have generated a profit of $2.8 billion.

The Postal Service responded to the deteriorating financial situation by reducing workhours by 50 million over previous year levels, a 3.6 percent reduction. However, this cost cutting effort was not enough to offset the 4.6 percent decrease in volume. Operating revenues increased by only 0.2 percent despite a 2.9 percent increase in rates implemented in May 2008. As a result of volume dropping faster than workhours, total factor productivity declined for the first time in nine years. The decline was 0.5 percent which is relatively small given the challenges the Postal Service faced.

Strategic Goals

The Commission is specifically charged by the PAEA with examining the Postal Service's performance in terms of speed of delivery, reliability, and customer satisfaction. Improved service performance is also a strategic goal of the Postal Service as identified in the Postal Service's Annual Comprehensive Statement and its Annual Compliance Report.

Single-Piece First-Class Mail service improved during FY 2008 and, according to data filed with the Commission, exceeded the Postal Service's planned achievements for the year, as shown in Table I-1. Performance for such mail with an overnight delivery standard increased by nearly one percentage point over the previous year to an all time high of 96.5 percent.

Table I-1
Speed of Delivery Performances for FY 2007 and FY 2008

Fiscal Year	First-Class Single-piece Mail Meeting Standard: Overnight Percentage On-Time	2-day Percentage On-Time	3-day Percentage On-Time	Package Services Meeting Standard: Percentage On-Time
2007 Actual	95.6	92.4	89.6	57.7
2008 Actual	96.5	94.1	91.7	63.9
2008 Plan	96.0	92.8	90.5	--

Source: United States Postal Service FY 2007 Annual Compliance Determination at 53.
United States Postal Service FY 2008 Annual Compliance Report at 13.
United States Postal Service FY 2008 Comprehensive Statement on Postal Operations at 53.

Service performance for Package Services also increased during the year. However, significant room for improvement remains.

During FY 2008, the Postal Service expanded the measurement system for Single-piece First-Class Mail to cover service between all 3-digit ZIP code pairs within the United States and territories. However, the PAEA-mandated service measurements were not available for 80 percent of the mail volume. The Postal Service did make substantial progress during the year on developing a plan to measure nearly all types of mail starting in FY 2009. The planned system will combine internal measurements of mail flows from mailer applied Intelligent Mail barcodes (IMb) with external measurements of actual delivery. Success depends heavily on mailer participation in the IMb program. The Commission is concerned about accuracy of IMb data and will monitor program implementation in FY 2009.

The Postal Service measured customer satisfaction through a revamped series of surveys. Overall, respondents reported 94.1 percent satisfaction rating with First-Class Mail service and 85.7 percent satisfaction for Standard Mail service. Large commercial customers had higher satisfaction ratings than small business mailers.

The Commission views customer access, including retail facilities and collection boxes, as key components of customer service and will be monitoring changes in these areas.

Pricing Policies

Market dominant Products

A key objective of the PAEA is to provide the Postal Service pricing flexibility subject to the constraints of other factors and objectives of the Act. In particular, for market dominant products, price changes at the class level must not exceed a Consumer Price Index for All Urban Consumers (CPI-U) based cap; prices for individual classes and types of service should produce sufficient revenue to cover their attributable costs with a reasonable contribution to institutional costs; and worksharing discounts are not to exceed avoided costs unless at least one of the four exceptions cited in section 3622(e)(2) is satisfied.

The FY 2008 price changes satisfied the cap requirement for all classes of mail with a small amount of unused pricing authority banked for future use in each class. The ten market dominant products listed in Table I-2 did not cover their attributable costs despite the May 2008 price increases.

The two Periodicals products lost a combined $438 million. The FY 2008 Postal Service price changes for these products were intended to produce uniform across-the-board price increases slightly below the cap level. The Postal Service did not use pricing flexibility to set differential price increases that might have induced more efficient preparation of the mail. The cost coverage of Within County mail did improve from 85.8 percent in FY 2007 to 96.0 percent FY 2008, whereas Outside County mail achieved little improvement. The Postal Service maintains that its recently-proposed price changes for 2009 utilize the "flexibility of the container-bundle-piece price structure" to "limit price

Table I-2
Loss-Making FY 2008 Market Dominant Products

Product	Contribution ($ millions)	Cost Coverage	Percent Increase FY 2008	Percent Increase FY 2009
Inbound Single-Piece First-Class Mail	($101.81)	60.5%	3.09%*	4.14%
Standard Mail Flats	($217.83)	94.4%	0.86%	2.31%
Standard Mail NFMs & Parcels	($165.33)	79.7%	9.66%	16.43%
Periodicals In County	($3.73)	96.0%	2.63%	3.73%
Periodicals Outside County	($433.72)	83.6%	2.73%	3.97%
Single-piece Parcel Post	($64.02)	91.8%	3.30%	4.45%
Media and Library Mail	($58.02)	87.9%	4.54%	7.47%
Registered Mail**	($0.86)	98.5%	7.30%	8.69%
Stamped Cards**	($0.38)	72.4%	50.00%	0.00%
Total International Ancillary Services	($36.07)	42.5%	6.10%	6.39%
Total	($1,081.77)	88.1%		

* Increase inclul des outbound mail

** Part of Market Dominant Ancillary Services

Source: Table III-2, Docket No. R2008-1 Order No.66, and Docket No. R2009-2 Order No. 191.

increases for individual publications" while "creating relationships that will improve the efficiency of the Periodicals product."

In Standard Mail, pricing flexibility was used extensively. Below average price increases were adopted for the Standard Flats product. The Flats product subsequently ended the year with a $218 million loss whereas in previous years it had been profitable. The use of pricing to limit losses in the Standard Flats product is complicated by the statutory requirement that the average revenue per piece from Non-profit Flats must be 60 percent of the average revenue per piece from Commercial Standard Flats. Non-profit Flats have a cost coverage of 57.8 percent and the Commercial Standard Flats have a cost coverage of 102.1 percent.

For the planned May 2009 rate increases, the Postal Service continues the policy of below average increases for Standard Flats mail. In the future, the Postal Service should either reduce the costs of handling flats or develop a pricing strategy which increases prices sufficiently to recover costs within a reasonable timeframe. The justification for the lower-than-average pricing increases provided by the Postal Service may be applicable for a limited period of time. The Postal Service should provide a long term strategy to address continued pricing preferences for a product line that lost $218 million.

Inbound Single-Piece First-Class Mail International rates are set by international treaty through the Universal Postal Union (UPU) and can only be changed by modification of the UPU conventions every four years. Working to make changes in the UPU prices is the responsibility of the Department of State with input from the Commission. Efforts are underway to achieve a better alignment of rates and costs as a result of resolutions adopted at the 2008 UPU Congress.

For the remaining seven loss-making products in Table I-2, the Postal Service increased prices in May 2008 by an amount above the average for their classes in an attempt to mitigate the losses known to exist at the start of FY 2008. In some cases, the Postal Service cited the need to limit increases to avoid rate shock and unpredictable changes in price. This phase-in approach to realigning costs and prices is continuing for some of these products with the 2009 price changes.

During FY 2008, six market dominant, volume-based, multi-year Negotiated Service Agreements (NSAs) were active. Volume-based NSAs essentially broke even in FY 2008. During the last two years, they had a positive contribution.

Competitive Products

Revenue from each domestic competitive product covered its attributable costs in FY 2008. The revenue from five international competitive products did not cover costs. There is an explicit PAEA requirement that revenue from each competitive product must cover its costs. Rate increases approved in December of 2008 before the FY 2008 data on costs were available to the Commission were applied to ensure that all competitive products covered costs. Data subsequently available for FY 2008 indicate that for at least one product this may not occur.

Revenue from competitive products in FY 2008 exceeded the required 5.5 percent contribution to institutional costs by $14 million dollars. This net profit is subject to an imputed Federal tax. The Commission approved 17 NSAs covering competitive products, all of which are expected to add to contribution over the next year.

Worksharing Discounts

Section 3622(e) requirement for worksharing discounts to not exceed avoided costs was, for the most part, satisfied. A notable exception was First-Class automation letter discounts implemented in May 2008. These all were expected to satisfy the cost avoidance limitation, based on the data at the time. However, during the year, the cost avoidances for some of the discounts decreased. As a result, the automation letter discounts for Mixed Area Automation Distribution Center (AADC) presort and 3-digit presort exceeded FY 2008 avoided costs. The Postal Service resolved the 3-digit problem by lowering the discount to equal avoided costs in the planned May 2009 price adjustment.

For the mixed AADC letter discount, the Postal Service asserts that the decade-old established method of calculating avoided costs from the benchmark single-piece priced Bulk Metered Mail should be abandoned because the discounted rates and the benchmark are in different products. The Postal Service interpretation of the statute would exempt the mixed AADC letter discount rate from the limitations of section 3622(e). The Commission has initiated a proceeding to resolve this issue. Upon completion of that proceeding, appropriate action will be taken. The Postal Service must discontinue the practice of changing established analytical methods in data filed with the Commission in support of price adjustments and Annual Compliance Reports.

Additional methodology issues which the Commission believes should be resolved before the submission of the compliance data for FY 2009 are identified in the subsequent chapters of this report. These methodologies impact Standard Mail, volumes of Detached Address Labels (DALs) and calculations for First-Class and Standard parcels.

In conclusion, the Commission appreciates the cooperation by the Postal Service in providing data on operations which were used in the crafting of this determination to identify potential areas for improvement. Comprehensive data on volume and revenue from the Postal Service's Revenue, Piece, and Weight System were particularly helpful.

CHAPTER II — BACKGROUND

Introduction

Statutory context. The PAEA includes two provisions that form the framework for ongoing, systematic reporting and assessment of the financial and operational performance of the United States Postal Service. One provision — 39 § U.S.C. 3652 — addresses the Postal Service's filing. The statute refers to this as the Annual Compliance Report (ACR). The other provision — section 3653 — addresses the scope of the Commission's review and the nature of related findings. This is referred to as the Annual Compliance Determination (ACD). Together, these provisions establish the ACD and the ACR as integrated mechanisms for achieving the PAEA's objective of ongoing accountability, transparency and oversight.

Timing of report and review. The Postal Service's ACR is to be filed no later than 90 days after the end of each fiscal year, and the Commission's ACD is to be completed within the following 90 days. As the Postal Service's fiscal year ends on September 30, consistency with these statutory deadlines means that the ACR must be filed by late December. This, in turn, requires that the Commission's ACD be completed by late March.

Focus of ACD. Section 3652, requires the PRC to provide analyses of costs, revenues, rates and quality of service sufficient to demonstrate that all products — competitive and market dominant alike — complied, during the reporting year, with all applicable title 39 requirements. In addition, for market dominant products, the ACD is to provide other information. In general, this concerns product information, including mail volumes and related measures of quality of service, along with the level of service provided and the degree of customer satisfaction provided. For market dominant products with worksharing discounts, three additional matters are to be addressed: the per-item cost avoided by the Postal Service by virtue of such discount; the percentage of such per-item cost avoided that the per-item workshare discount represents; and the per-item contribution to institutional costs. 39 U.S.C. § 3652(a) and (b).

The Postal Service's ACR is to be accompanied by the most recent comprehensive statement and, pursuant to section 2803 and 2804 of title 39, its performance plan and program performance reports. 39 U.S.C. § 3652(g).

Commission responsibilities. Under section 3653, the Commission's corresponding responsibilities include providing an opportunity for comment on the Postal Service's submission and making a written determination as to whether any rates or fees in effect during the reporting year for products, individually or collectively, were not in compliance with applicable provisions of chapter 36 of title 39 or related regulations and whether any service standards in effect during the year were not met. Conversely, if no instance of noncompliance is found, the written determination is to be to that effect. 39 U.S.C. § 3653(a)—(c). The Commission is also to evaluate, as part of the annual ACD, whether the Postal Service has met the performance-related requirements of sections 2803 and 2804 of title 39 and may make recommendations to the Postal Service related to the protection or promotion of title 39 public policy objectives. 39 U.S.C. § 3653(d).

Procedural History

On December 29, 2008, the United States Postal Service, pursuant to section 3652, filed its ACR for Fiscal Year 2008 with the Commission. The reporting period, in conformance with the PAEA requirements, covers Fiscal Year 2008 (October 1, 2007 through September 30, 2008). The filing marked the Postal Service's second ACR submission since enactment of the PAEA. Like the first filing, the reporting period marked a period of transition, as PAEA implementation was still underway during FY 2008.

The ACR includes an extensive narrative discussion, along with a substantial number of detailed public and nonpublic appendices. The appendices cover four areas: the Cost and Revenue Analysis; the

International Cost and Revenue Analysis; cost models supporting worksharing discount analysis; and billing determinants. In conformance with section 3652(g), the Postal Service noted that its FY 2008 Comprehensive Statement was available online. One document in the ACR (identified as USPS-FY08-9) serves as a roadmap summarizing other materials in the submission and discusses methodology changes.

On December 31, 2008, the Commission issued an order providing notice of the Postal Service's filing; establishing Docket No. R2009-2 as a formal docket to consider the filing; and inviting public comment on the degree to which the Postal Service's operations and financial results comply with applicable policies of title 39.[1] It set January 30, 2009 as the deadline for comments and February 13, 2009 as the deadline for reply comments. The order appeared in the *Federal Register* on January 6, 2009. *See* 74 FR 473. The Commission appointed, pursuant to 39 U.S.C. §3653, public representatives to represent the interests of the general public. Notice of Appointment of Public Representatives, Docket No. ACR2008, January 6, 2009.

Methodology changes. In anticipation of filing its 2008 ACR, the Postal Service filed a motion with the Commission in early August seeking consideration of proposed changes in costing methodology. This led to a series of rulemakings culminating in the Commission's acceptance of 12 of the proposed 13 changes in methodology.[2] In addition, after the ACR was filed, the Commission issued an order identifying apparent methodological changes not considered in these rulemakings. It characterized the changes as falling into two broad areas: those affecting attributable costs, revenues, and volumes of postal products and those affecting worksharing costs. The Commission established January 21, 2009 as the deadline for responsive Postal Service filings using previously-accepted methodologies and providing justifications for changes. It also scheduled a technical conference on January 26, 2009 to afford interested persons an opportunity to gain a better understanding of the changes identified in the order and to seek clarification of Postal Service responsive filings. It authorized interested persons to include replies to the Postal Service's filings in their comments on other aspects of the ACR filing, thereby establishing January 30, 2009 as the operative deadline. [3]

Confidentiality. On December 12, 2008, the Postal Service filed a motion seeking the establishment of protective conditions for certain core costing materials associated with its ACR filing, along with a proposed draft of the conditions. The Commission denied the Postal Service's motion, in part, and proposed an alternative approach.[4]

Commission Requests for Additional Information. The Commission issued five formal information requests to the Postal Service during the course of this proceeding.[5] It also directed several informal inquiries to Postal Service staff seeking clarification of minor points. In addition to filing responses to the Information Requests, the Postal Service filed a series of notices revising and supplementing its original submission to reflect its responses.

Status of this report; procedural note. This report marks the issuance of the second ACD under section 3653 of title 39. It includes the second annual evaluation of whether the Postal Service has met the performance goals established under sections 2803 and 2804. It also includes recommendations related to the protection or promotion of public policy objectives in title 39.

The Commission appreciates the cooperation of the Postal Service and all who participated in the public comment process in facilitating timely issuance of this report. It acknowledges the additional demands that consideration of the Postal Service's Notice of Price Adjustment in Docket No. R2009-2, which occurred while this case was pending, placed on the Postal Service and all others.

Motions not granted are deemed denied, unless denial is inconsistent with the clear intent of this report.

[1] *See* Order No. 161, December 31, 2008.

[2] *See* Docket Nos. Docket No. RM2008-2; RM2008-6; RM2009-1 and RM2009-2 and related orders.

[3] Order on Apparent Methodological Changes and Setting Date for Technical Conference, January 12, 2008. This Order was later modified in limited respects pursuant to Request of the United States Postal Service for Modification of Commission Order No. 169 (January 16, 2009) and Order [No. 175] Granting Request for Modification of Order No. 169 (January 27, 2009).

[4] *See* Motion of the United States Postal Service Requesting Establishment of Protective Conditions to Govern Access to Certain Core Costing Documentation (December 12, 2008); Order No. 155 (December 23, 2008); and Response of the United States Postal Service to Commission Order No. 155 (December 29, 2008).

[5] *See* Commission Information Request No. 1 (January 14, 2009); Commission Information Request No. 2 (January 30, 2009); Commission Information Request No. 3 (February 6, 2009); Commission Information Request, No. 4 February 13, 2009; and Commission Information Request No. 5 (February 27, 2009).

CHAPTER III — POSTAL SERVICE FINANCIAL CONDITION

Summary of Findings: Key Points

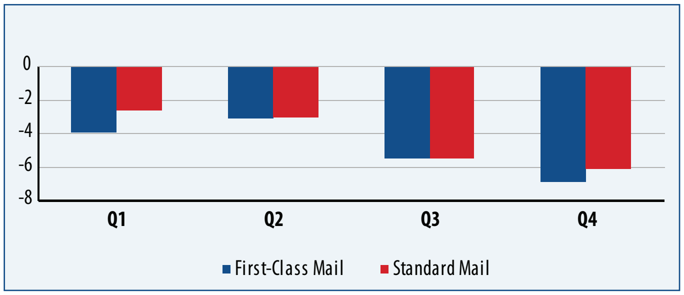
Primary concerns for Postal Service financial conditions are:

- $2.8 billion loss;
- 4.6 percent decline in total mail volumes is the steepest since the Great Depression;
- Possibility the Postal Service will not have enough cash to pay all bills by the end of FY 2009.

Fiscal Year 2008 was a financially challenging year for the Postal Service. The year began with revenues increasing, even though volumes for most products were declining. The increase in revenue was due to an average 7.6 percent rate increase enacted in the latter half of FY 2007. However, as the year continued, the effect of the worsening recession began to take a toll on Postal Service volumes and revenues. Figure III-1 shows that the rate of decline for First-Class and Standard Mail, the two largest classes of mail, accelerated during the second half of the year.

Figure III-1

Change in Volume (percent) from 2007 to 2008 by Quarter

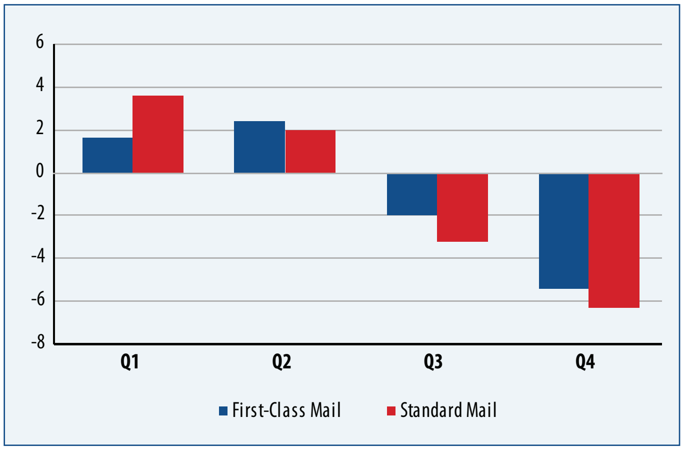


Source: Postal Service Revenue, Pieces, and Weight Report, Qtrs. 1-4, FY 2008

By the end of the fiscal year, total mail volumes had declined by 4.6 percent, or more than 9.5 billion pieces. Postal Service revenues also declined within the second half of the year, as the CPI-capped rate increase of 2.9 percent, implemented in May 2008, could not overcome the accelerating volume decline. Figure III-2 shows the change in revenue by quarter for First-Class and Standard Mail.

Figure III-2

Change in Revenue (percent) from FY 2007 to FY 2008 by Quarter



Source: Postal Service Revenue, Pieces, and Weight Report, Qtrs. 1-4, FY 2008

Overall, the Postal Service had a net loss of $2.8 billion in FY 2008 as compared to a net loss of $5.4 billion in FY 2007.[6] Total revenues increased $154 million over last year, or 0.2 percent. Although negatively affected by higher fuel prices total expenses declined $2.4 billion primarily due to a one-time reduction related to Retiree Health Benefit Fund expenses.[7] The higher fuel costs affected not only the costs of transportation but also significantly increased the cost of living index (COLA) used in all of the labor contracts. Even so, a reduction of more than 50 million workhours resulted in a decrease in total

[6] The loss in FY 2007 reflected PAEA expenses booked after the Act's passage.

[7] FY 2007 expenses included $3 billion due to the transfer of escrowed funds into the Retiree Health Benefit Fund.

Table III-1
U.S. Postal Service Income Statement FY 2008 ($ in Millions)

	FY 2008	FY 2007	$ Variance	Percent Variance
Mail & Special Services Revenue	$74,829	$74,715	$114	0.2%
Appropriations	103	63	40	63.5%
Total Operating Revenues	74,932	74,778	154	0.2%
Operating Expenses:				
Compensation and Benefits	53,585	54,186	(601)	-1.1%
Retiree Health Benefits	7,407	10,084	(2,677)	-26.5%
Transportation	6,961	6,502	459	7.1%
Other Expenses[1]	9,785	9,333	452	4.8%
Total Operating Expenses	77,738	80,105	(2,367)	-3.0%
Net Operating Income	(2,806)	(5,327)	2,521	
Interest and Investment Income	36	195	(159)	-81.5%
Other Interest Expense	(36)	(10)	(26)	260.0%
Net Income (Loss)	($2,806)	($5,142)	2,336	

[1] Other expenses includes supplies and services, depreciation, rents fuel and utilities, and vehicle maintenance, and any other non-personnel.

Source: Postal Service FY 2008 Form 10-K at 47.

compensation. Total costs for transportation and other expenses increased $459 million and $452 million, respectively. The Postal Service's Income Statement is presented in Table III-1.

Summary by Product

Table III-2 details the volumes, costs, revenues, and contribution to institutional costs. It is similar in form and content to the Cost and Revenue Analysis Report (CRA) provided by the Postal Service in its original filing both in the public format and the non-public format. It has been modified to take into account the Market Dominant and Competitive products established by the PAEA.[8] The table is developed from the same source documents for revenues, costs, and volumes used by the Postal Service for the CRA, with one major difference. The CRA includes imputed revenues and expenses that are developed in the International Cost Revenue Analysis (ICRA) report. For the ICRA, the Postal Service develops imputed revenues to account for a timing difference between the incurrence of costs associated with inbound International Mail and the receipt of revenue for that mail.[9] However, these "imputed" revenues are not included in several of

[8] The public CRA was filed as Library Reference USPS-FY08-1 and the non-public CRA was filed as Library Reference USPS-FY08-NP11.

[9] As an example, a letter received from a foreign postal administration during one fiscal year and the costs associated with entering, transporting, processing, and delivering that letter in the U.S. are captured during that fiscal year. However, depending on the "settlement" process, the Postal Service may not receive payment from the foreign postal administration for such processing and handling until some future fiscal year. As a result the ICRA imputes, or estimates, the expected revenues in an effort to associate revenues with the expenses of that letter. The calculation to impute total revenues for all inbound letter voume is to multiply inbound volumes and weights by an appropriate terminal dues rates for the relevant time period.

Table III-2

Fiscal Year 2008 Volume, Revenue, Cost and Cost Coverage by Class Current Classification (Products)

	Volume (000)	Revenue ($ 000)	Attributable Cost ($ 000)	Contribution to Institutional Cost ($ 000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
COMPETITIVE MAIL								
Total Competitive Mail and Services	1,574,923	8,381,705	6,599,814	1,781,891	532.198	419.056	113.141	127.0%
MARKET DOMINANT MAIL								
First-Class Mail								
Single-Piece Letters and Cards	35,355,570	14,938,955	8,890,630	6,048,325	42.253	25.146	17.107	168.0%
Presort Letters and Cards	51,935,871	17,151,016	5,725,140	11,425,875	33.023	11.023	22.000	299.6%
Flats	3,379,740	4,063,827	2,571,247	1,492,580	120.241	76.078	44.163	158.0%
Parcels	605,522	1,122,205	1,079,828	42,378	185.329	178.330	6.999	103.9%
Outbound Single-Piece Mail Intl	420,034	747,228	525,097	222,131	177.897	125.013	52.884	142.3%
Inbound Single-Piece Mail Intl	417,029	156,089	257,896	(101,807)	37.429	61.841	(24.412)	60.5%
Standard Mail								
High Density & Saturation Letters	5,598,913	739,763	320,542	419,221	13.213	5.725	7.488	230.8%
High Density & Saturation Flats & Parcels	13,584,059	2,171,756	844,509	1,327,247	15.988	6.217	9.771	257.2%
Carrier Route	12,070,176	2,743,126	1,814,452	928,674	22.726	15.033	7.694	151.2%
Letters	57,086,421	10,610,140	5,479,222	5,130,917	18.586	9.598	8.988	193.6%
Flats	10,010,857	3,673,412	3,891,246	(217,834)	36.694	38.870	(2.176)	94.4%
Not Flat-Machinables and Parcels	733,729	648,096	813,430	(165,334)	88.329	110.862	(22.533)	79.7%
Periodicals								
Within County	830,887	90,614	94,344	(3,730)	10.906	11.355	(0.449)	96.0%
Outside County	7,774,339	2,204,242	2,637,966	(433,724)	28.353	33.932	(5.579)	83.6%
Package Services								
Single-Piece Parcel Post	89,536	720,004	784,025	(64,021)	804.147	875.650	(71.503)	91.8%
Inbound Surface Parcel Post (at UPU Rates)	604	12,435	8,504	3,931	2,058.247	1,407.576	650.671	146.2%
Bound Printed Matter Flats	289,623	262,141	157,570	104,571	90.511	54.405	36.106	166.4%

Table III-2

Fiscal Year 2008 Volume, Revenue, Cost and Cost Coverage by Class Current Classification (Products)—Continued

	Volume (000)	Revenue ($ 000)	Attributable Cost ($ 000)	Contribution to Institutional Cost ($ 000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
Bound Printed Matter Parcels	308,561	430,148	399,192	30,956	139.405	129.372	10.032	107.8%
Media and Library Mail	158,505	420,767	478,782	(58,015)	265.460	302.061	(36.602)	87.9%
U.S. Postal Service Mail	823,685							
Free Mail	71,975		51,973	(51,973)		72.210		
Total Market Dominant Mail	**201,128,003**	**62,905,964**	**36,825,595**	**26,080,369**	**31.277**	**18.310**	**12.967**	**170.8%**
MARKET DOMINANT SERVICES								
Ancillary Services								
Certified Mail	268,917	717,822	602,622	115,200	266.931	224.092	42.838	119.1%
COD	1,155	8,136	6,835	1,301	704.361	591.750	112.611	119.0%
Insurance	51,595	144,582	143,865	716	280.223	278.835	1.388	100.5%
Registered Mail	3,861	56,883	57,744	(860)	1,473.211	1,495.489	(22.279)	98.5%
Stamped Envelopes		23,421	10,046	13,375				233.1%
Stamped Cards	49,375	987	1,364	(377)	2.000	2.763	(0.763)	72.4%
Other Ancillary Services	1,208,210	734,472	533,670	200,802				137.6%
Money Orders	149,125	223,336	152,789	70,548	149.765	102.457	47.308	146.2%
Post Office Box Service	15,068	896,656	640,346	256,310	5,950.739	4,249.715	1,701.024	140.0%
International Services	2,053	26,652	62,728	(36,076)				42.5%
Other Income		708,521		708,521				
Total Mail and Services	**202,702,926**	**74,829,138**	**45,637,420**	**29,191,718**	**36.916**	**22.514**	**14.401**	**164.0%**
Institutional Costs			32,136,447					
Appropriations: Revenue Forgone		103,148						
Investment Income		35,934						
Total Revenues		**74,968,220**						
Total Costs			**77,773,867**					
Net Income (Loss)		**(2,805,647)**						

the source documents, most importantly the audited Revenue, Pieces and Weight (RPW) data system, which is used to produce the CRA, nor are they included in the revenues recognized in the Postal Service Chart of Accounts. The same treatment holds for "imputed" expenses. Such expenses are not recognized in the Cost Segments and Components report that develops costs by product. As a result the total revenues and expenses shown in the CRA do not comport with the same items reported in the audited financial statements published in the Postal Service Annual Report or the Postal Service FY 2008 Form 10-K filing. *The Commission feels very strongly that the revenue and expense numbers in the CRA must tie directly to their source documents, namely the RPW and the Cost Segments and Components report. The revenues and expenses by product reported in the CRA also should not total more than the what was reported by the published audited financial reports. The Commission fully expects that the FY 2009 CRA will not include the "imputed" revenues and expenses that are included in the ICRA.*

Several Market Dominant products do not cover their attributable costs. In First-Class Mail, one product was noncompensatory in FY 2008, Inbound Single-piece First-Class Mail International covered 61 percent of its attributable cost in FY 2008, resulting in a negative contribution of $102 million.

Periodicals Within County had a cost coverage of 96 percent, a considerable improvement over FY 2007 when its cost coverage was only 85.8 percent. Increased volume and revenue per piece contributed to the improvement in Within County, in addition to a slight decrease in the cost per piece. Periodicals Outside County also showed a slight improvement in cost coverage, increasing to 83.6 percent from FY 2007's cost coverage of 82.9 percent. Periodicals as a class did not cover attributable costs in FY 2008 with negative contribution to institutional costs of $438 million.

Two products in the Standard Mail class did not cover costs. Flats had a negative contribution of $218 million, producing a cost coverage of 94 percent. Not Flat-Machinables and Parcels had a cost coverage of 80 percent, which represents a $165 million loss in contribution to institutional cost.

Just as last year, Package Services had positive cost coverage but the only products within the class to show a positive coverage were Bound Printed Matter Flats (166.4 percent), Bound Printed Matter Parcels (107.8 percent) and Inbound Surface Parcel Post at UPU Rates (146.2 percent). The cost coverage for Single-Piece Parcel Post declined to 91.8 percent from 98.7 percent in FY 2007 and Media and Library mail declined to 87.5 percent from 91.4 percent in FY 2007.

Other categories within specific Market Dominant products that did not cover costs in FY 2008 were Standard Regular non-profit mail (84.5 percent), Registered Mail (98.5 percent), and Stamped Cards (72.4 percent).

Inbound International First-Class mail, Inbound International Ancillary Services, Outbound International Reply Coupon Service did not cover costs. All other categories of Market Dominant products covered their attributable cost

Financial Reporting under PAEA

Pursuant to the PAEA, the Postal Service must file with the Commission annual and quarterly financial reports, and certain periodic reports, that conform to Securities and Exchange Commission (SEC) regulations. Beginning with FY 2008, the SEC reports to be filed with the Commission include Form 10-K, Form 8-K, and Form 10-Q.

Form 10-K is an annual report which contains a comprehensive summary of a company's performance, including the audited financial statements. It also includes information on cash flows, information on property owned, including facilities and vehicles, and a listing of Directors (Governors) and executive officers.

Serving a similar purpose, but filed on a more frequent basis is the Form 10-Q, which is filed within 40 days of the end of each fiscal quarter. The Form 10-Q provides quarterly financial reports and a management discussion on operations and finances. Additionally, the report requires a management assessment of the outlook for the rest of the fiscal year.

The Form 8-K is filed periodically, after announcements that materially affect the financial status of the Postal Service. This would include the quarterly financial reports presented to the Governors at their open meetings, presentations or testimony by operating managers provided to Congress, or any other updates of significant material events occurring between filings of the Form 10-K and/or Form 10-Q.

In addition to requiring the Postal Service to comply with existing SEC rules for the above financial reports, the PAEA also requires the Postal Service to include certain information on pension and post retirement health obligations in the Form 10-K filing. This includes the funding status of the pension and health benefits obligations, components of the net change in fund balances, components of the net periodic costs, and the cost methods and assumptions underlying the actuarial valuations. Additionally, the law requires reporting of the actual contributions to the funds, the payments from the funds, and estimates of the same for each of the subsequent five years. It also requires that an estimate of the effect of a one percent change in the health care cost rate for future years be provided.

The Postal Service filed the required FY 2008 Forms 10-Q in February (Quarter 1), May (Quarter 2), and August (Quarter 3), within the legally required deadlines. The Forms 10-Q have followed the requirements specified by SEC Regulations and the PAEA.

The Postal Service Forms 10-K and 10-Q conform to the structures as prescribed by the SEC. It is also comprehensively detailed in the sections of the reports that are applicable to the Postal Service, there are some sections required by SEC rules that do not apply to the Postal Service. These sections relate to securities and tax reporting. Additionally, the SEC requirements on segment reporting and reporting on financial internal controls will not be applicable to the Postal Service until the FY 2010 reports.

A comparison of the Forms 10-Q and Form 10-K filed by United Parcel Service and Federal Express shows much of the same information as is in the Postal Service reports, with exceptions regarding the shareholder information and internal controls. While the quarterly Forms 10-Q are placed on the Postal Service web site, the annual Form 10-K has not been. *The Commission recommends that the Postal Service include the Form 10-K in the annual report section of its financial information page on www.USPS.com.* Both UPS and FedEx have a significant amount of financial information placed on their Investor Relations sites, including all SEC filings, annual reports, and spreadsheets of historical financial information.

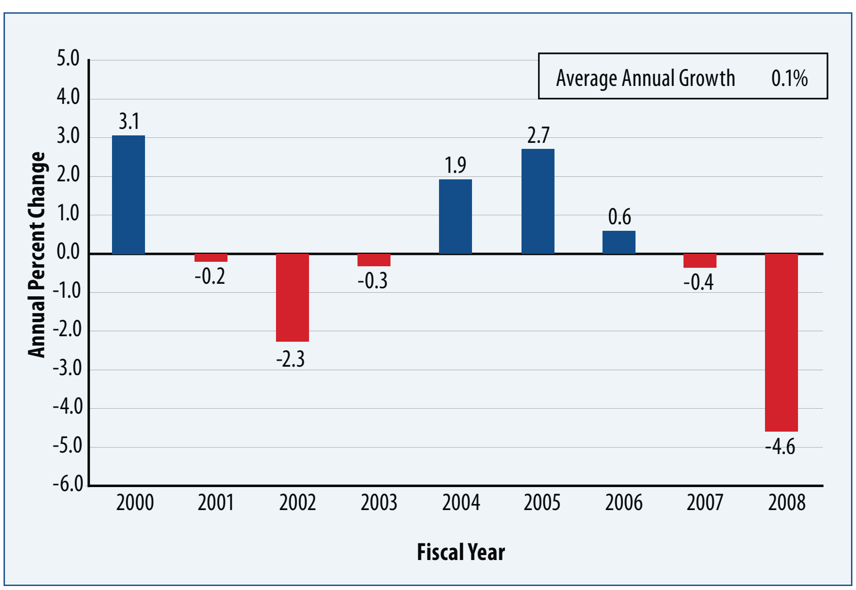
Mail Volumes

Figure III-3 depicts annual mail volume changes since FY 2000.

As seen in Figure III-3, the 4.6 percent decline in FY 2008 is the steepest for this decade and, in fact, is the largest percentage decline since the Great Depression. Over the past eight years the average growth rate was only 0.1 percent. In contrast, during the 1970s the growth rate was 2.0 percent, during the 1980s it was 4.9 percent, and in the 1990s mail volume grew an average of 2.2 percent. Total mail volume at the end of FY 2008 was at the same level as FY 2002. Volume growth by class is discussed below.

Figure III-3

Total Mail Volume Annual Growth Rates Fiscal Years 2000–2008



Source: Postal Service Revenue, Piece, and Weight (RPW) reports.

First-Class Single-piece Mail

As shown in Figure III-4, total First-Class Single-piece Mail volume continued its long decline losing 3.7 billion pieces, a 9.2 percent reduction from last year, and the largest one year decline in single-piece volumes ever. The percentage decline in FY 2008 was more than double the decline in FY 2007.

One of the major contributors to this continuing decline is the increasing use of the Internet for messaging, bill presentment and payment as well as banking. Consequently, it is unlikely that this mail volume will return as economic conditions improve. The permanent loss of First-Class single-piece is particularly troubling because revenue from this type of mail contributes substantially to the funding of the overall costs of the Postal Service.

First-Class presorted mail

Volumes for First-Class presorted mail, which in the past mitigated the volume declines in single-piece, also decreased in FY 2008, losing over 900 million pieces and declining 1.7 percent over the previous year. The decline in presort volumes is due primarily to the recession as mortgage and credit card solicitations have been curtailed dramatically. Over the last nine years the average annual growth rate for First-Class Single-Piece has been a negative 4.3 percent. The total First-Class mail growth rate has averaged a negative 1.2 percent over the same period.

International First-Class mail is now included in the total First-Class mail statistics, and has provided the only positive volume growth in FY 2008. Figure III-5 shows the annual growth rates for total First-Class Mail since FY 2000.

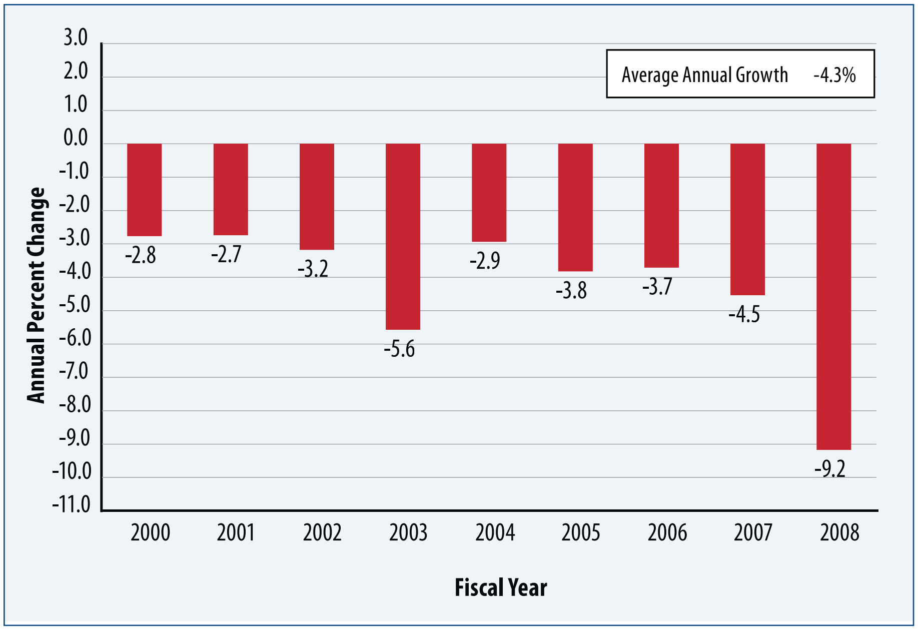
Standard Mail

Standard Mail is the largest class by volume. Total volumes for Standard Mail decreased 4.3 percent from last year, or 4.4 billion pieces. This is the first decline in Standard Mail volumes since FY 2002.[10] Over the past decade the average annual volume increase has been 1.6 percent. Without the losses in Fiscal Years 2001, 2002, and 2008 the average annual volume growth was a healthy 3.7 percent.

[10] The FY 2002 volume loss followed the 9/11 and anthrax attacks.

Figure III-4

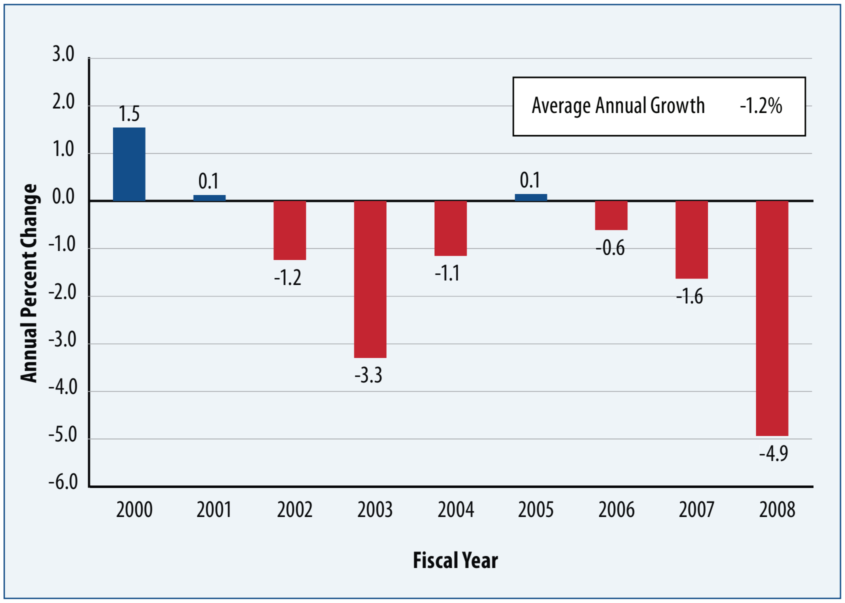
First-Class Single-Piece Volume Annual Growth Rates Fiscal Years 2000–2008



Source: Postal Service Revenue, Piece, and Weight (RPW) reports.

Figure III-5

Total First-Class Mail Volume Annual Growth Rates Fiscal Years 2000–2008



Source: Postal Service Revenue, Piece, and Weight (RPW) reports.

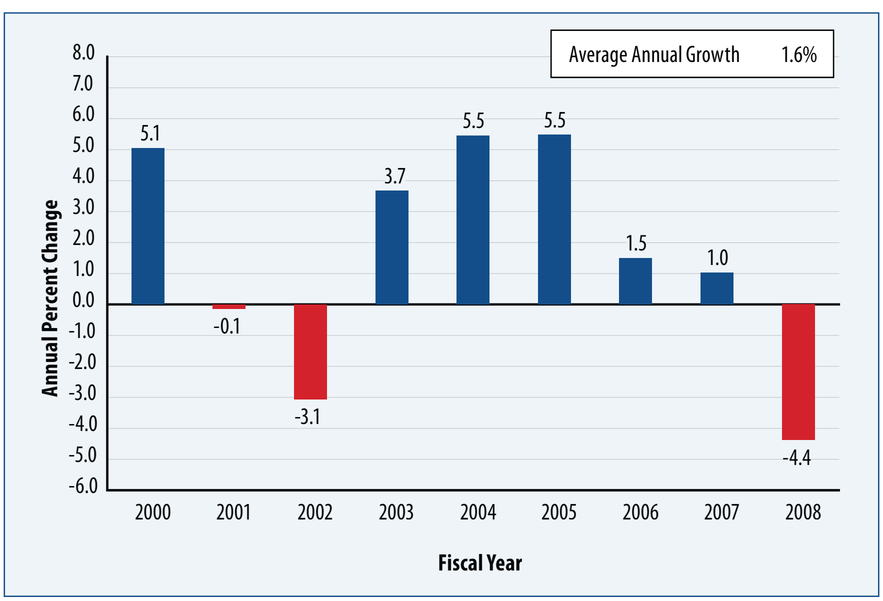
The declines in volume for FY 2008 are a result of the deteriorating economy as many businesses cut advertising budgets significantly. This volume may rebound as economic conditions improve. However, Standard Mail contributes less revenue toward funding overall costs, on a unit basis, than First-Class Mail. Thus, the Postal Service would still face challenges in funding institutional costs. Figure III-6 reflects growth rates of Standard Mail since FY 2000.

Periodicals

Periodicals volumes continued to decline in FY 2008, losing almost 191 million pieces or 2.2 percent less than last year. This is the eighth consecutive year of volume declines for Periodicals. For the decade the average annual change in volume has been a negative 2.6 percent. The decline in Periodicals is largely due to a change in reading preferences among consumers. It

Figure III-6

Standard Mail Volume Annual Growth Rates Fiscal Years 2000–2008



Source: Postal Service Revenue, Piece, and Weight (RPW) reports.

is unlikely that much of this volume will return in the future. *See* Figure III-7.

Market Dominant Package Services

Market dominant Package Services volumes declined 7.5 percent or over 68 million pieces from last year. Almost half of the volume declines were in Bound Printed Matter Flats, which declined over 31 million pieces or 9.8 percent less than last year. Bound Printed Matter Flats and Parcels are the only major products in Package Services making a positive contribution towards institutional costs, so the loss in volume is particularly troublesome. Total Single-Piece Parcel Post declined almost 11 percent from last year.[11] The following figure reflects the growth rates since FY 2000 for Package Services. *See* Figure III-8.

Competitive Products (Shipping Services)

Competitive Products, referred to as Shipping Services by the Postal Service, include Priority Mail, Express Mail, Parcel Select, Parcel Return Service, and, with the exception of First-Class International, all other International Mail. Volumes for the Competitive Products declined 3.4 percent, or more than 55 million pieces in FY 2008.

[11] Parcel Select was included in the total Package Services volumes in calculating the FY 2008 volume growth rate in order to maintain continuity with prior years.

Revenue

Total revenue for FY 2008 reflected two rate increases. A 7.6 percent average increase in rates in May 2007 affected revenues for the first half of the year. Revenues for the latter half of the year were impacted by an average 2.9 percent increase in May 2008. The loss in volume throughout the year depressed revenues significantly. Total revenues of $74.8 billion were slightly above FY 2007 revenues of $74.6 billion and below planned FY 2008 revenues of $78.2 billion.

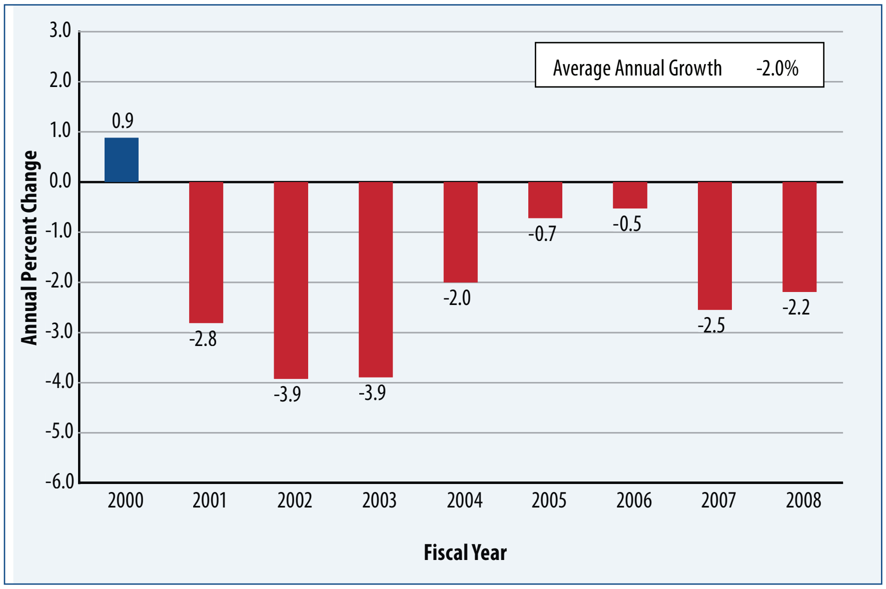
Of the total revenues, First-Class Mail provided 50 percent; Standard Mail 28 percent; Periodicals 3 percent; Package Services 2 percent; Competitive Products 11 percent and Other Services 6 percent.

Expenses

Total operating expenses include compensation and benefits, retiree health benefits, workers compensation, transportation of mail, supplies, services, Postal Service vehicle costs, maintenance of equipment and facilities, and the costs of facility rental. Interest costs for capital and operating debt are also reported as part of total expenses on the Postal Service income statement. Total operating expenses for FY 2008 were $77.7 billion, $2.4 billion or 3 percent less than the same period last year. Most of the reduction in expenses was due to the one-time inclusion of the FY 2006 escrow amount of $3.0 billion in total operating expenses in FY 2007. For

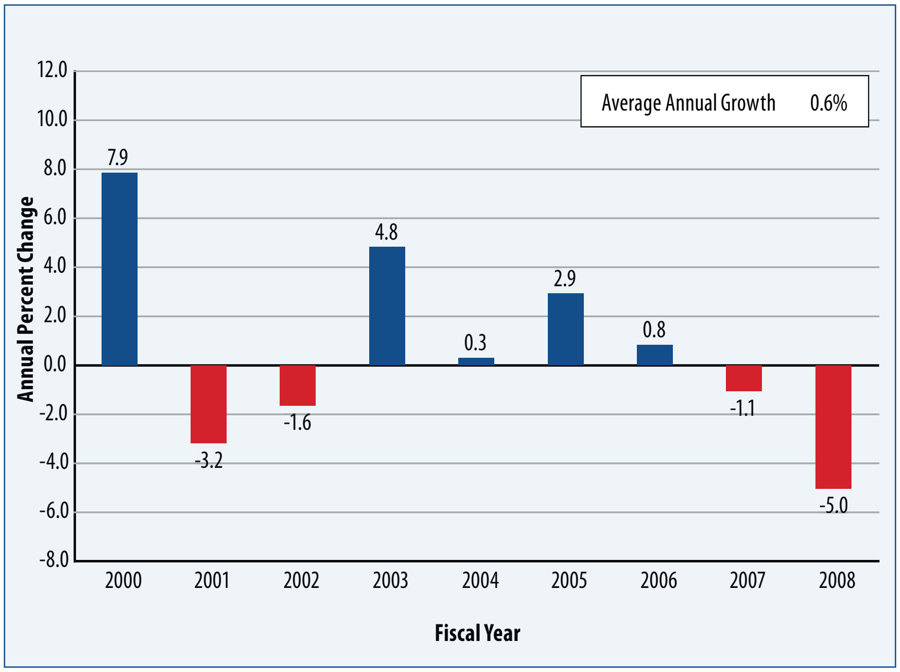
Figure III-7

Periodicals Volume Annual Growth Rates Fiscal Years 2000–2008



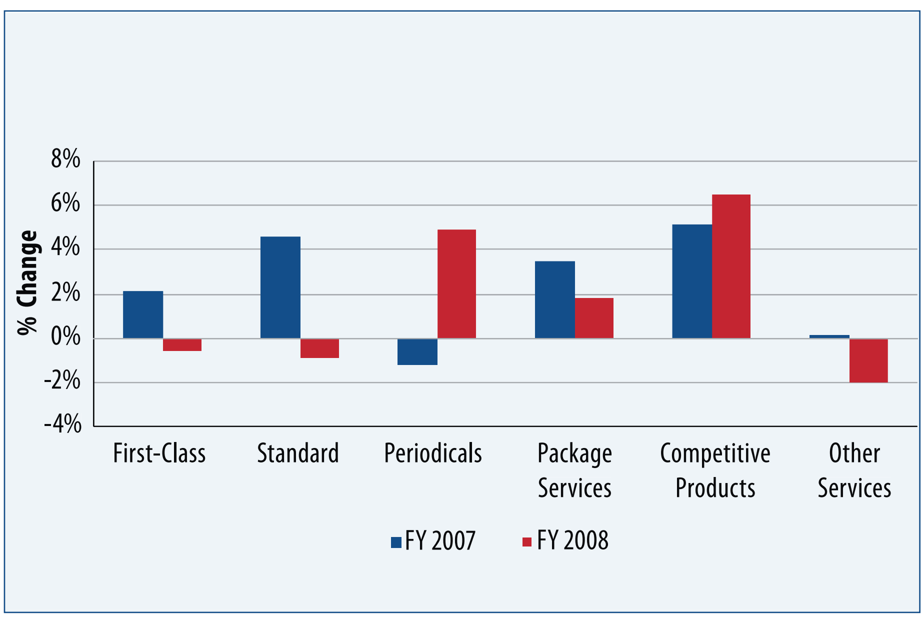
Source: Postal Service Revenue, Piece, and Weight (RPW) reports.

Figure III-8
Package Service Volume Annual Growth Rates Fiscal Years 2000–2008



Source: Postal Service Revenue, Piece, and Weight (RPW) reports.

Figure III-9
Percent Change in Revenue by Class Fiscal Years 2007–2008



Source: Postal Service Revenue, Pieces, and Weight Report, FY 2008.

comparison purposes, if this one-time charge in 2007 is not considered, total operating expenses increased 0.8 percent in FY 2008.

Compensation and Benefits

Total compensation and benefits include wages, health benefits, current employee cost of retirement benefits, bonuses, awards, relocation expenses, and uniform allowances. Also included are service-wide expenses such as workers compensation, unemployment compensation, and repricing of annual leave. Compensation and benefit expenses for FY 2008 declined $601 million or 1.1 percent from last year. The reduction was due almost exclusively to the reduction of over 50 million workhours.

The March, 2008 COLA payment averaged $469 per employee and the September 2008 COLA, due to the significant increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) to which it is pegged, averaged $1,487 per employee. These large COLAs contributed to an increase in retirement and workers compensation costs. Retirement costs were $162 million, or 2.8 percent higher than last year. Workers Compensation expense increased $357 million, or 39.4 percent over last year to reach a total expense of $1.2 billion. In addition to the large COLAs, an 8.9 percent rise in the number of medical claims and compensation claims receiving payments during FY 2008 contributed to the increase.

Retiree Health Benefits

The PAEA requires the Postal Service to publicly disclose the status of the retirement funds including the amount of obligations and the changes in net assets. The Office of Personnel Management (OPM) is required to provide the relevant data to the Postal Service for inclusion in its annual Form 10-K filing. In the FY 2008 Form 10-K the Postal Service provides a comprehensive description of the retirement plans employees participate in and the valuations of the funds as well as the changes in the obligations and net assets as provided by OPM. According to this information the retirement fund has a net surplus balance of $5.5 billion.[12]

The PAEA changed the recognition of and payment for retiree health benefits and established the Postal Service Retiree Health Benefits Fund (PSRHBF) as the funding mechanism for obligations for post-retirement health benefits. Congress also directed OPM to evaluate the Civil Service Retirement Fund balance and transfer any surplus to the PSRHBF. OPM determined that there was a $17 billion surplus in the Civil Service Retirement Fund (CSRF) and transferred that amount to the PSRHBF. Additionally, the law required the Postal Service to pay into the fund the amounts held in escrow as required by P.L. 108-18. In FY 2007 that amount was $3.0 billion.

As of the end of FY 2008 the PSRHBF had an obligation of $86.1 billion and a fund balance of $32.6 billion leaving an unfunded obligation of $53.5 billion. Table III-3 illustrates the current state of the PSRHBF.

Table III-3
Postal Service Retiree Health Benefits Fund Funded Status and Components of Net Periodic Costs Benefits as Calculated by OPM
($ in millions)

	FY 2008	FY 2007
Beginning Actuarial Liability as of October 1	80,786	74,815
Actuarial Gain	(1,136)	0
Normal Costs	3,389	3,175
Interest @ 6.25%	4,977	4,676
Subtotal Net Periodic Costs	7,230	7,851
Premium Payments	(1,934)	(1,880)
Actuarial Liability as of September 30	86,082	80,786
Fund Balance at September 30	(32,610)	(25,745)
Unfunded Obligation at September 30	53,472	55,041

Source: Postal Service FY 2008 Form 10-K at 17.

[12] The CSRS retirement fund had total assets of $196.7 billion and total obligations of $200 billion for a net unfunded amount of $3.3 billion. The FERS retirement fund had total assets of $69.9 billion and a total obligation of $61.1 billion for a net fund surplus of $8.8 billion. The actuarial liability for the total fund is estimated at $261.1 billion and a balance of $266.6 billion. The derivation of the obligations, fund balance, and the assumptions used by OPM to estimate these amounts are fully described in the Postal Service's Form 10-K filing of December 10, 2008 at pages 16-18.

The PAEA also established a schedule of payments designed to pay down the existing retiree health benefits obligation. The scheduled payments average about $5.6 billion per year. Additionally, the Postal Service is to continue to pay the current year's health benefit premiums for current retirees and their survivors until FY 2017. In FY 2008 that amount was $1.8 billion, an increase of $81 million over last year.

Under the law, OPM provides the Postal Service with information regarding the obligations, costs, and funding status of the PSRHBF each year.

Transportation Expenses

The majority of transportation costs is for air and highway. During FY 2008 total transportation costs increased 7.1 percent over last year, or $459 million. Much of this was due to the significant increase in fuel costs during the year. By July 2008 gasoline and diesel fuel prices had risen to more than $4 per gallon increasing 30 percent and 43 percent respectively.

Other Expenses

Other expenses include supplies and services, depreciation, rents, fuel and utilities, and vehicle maintenance. During FY 2008 other expenses increased $452 million, or 4.8 percent more than last year. The largest increases were for depreciation ($167 million), vehicle maintenance ($166 million), rents and utilities ($79 million), and rural carrier equipment maintenance allowance (EMA) ($50 million). The increases for vehicle maintenance, rents and utilities, and rural carrier EMA can be directly attributed to the increased cost of fuel in FY 2008. The increase in depreciation is due to the additional equipment put into service during FY 2008.

Retained Earnings

Total retained earnings of the Postal Service consist of the sum of the total net income and net loss since FY 1972. Retained earnings combined with the Capital Contributions of the U.S. Government which were transferred to the Postal Service under the Postal Reorganization Act, equal the net equity of the Postal Service. The Postal Service has had three periods where the net equity has been positive, FY 1972 – 1975, FY 1983 – 1987, and FY 2003 – 2007. As of the end of FY 2008 total net income was $17.2 billion and the sum of the total net losses was $21.9 billion. Total net equity declined from a positive $1.1 billion at the end of FY 2007 to a negative $1.7 billion at the end of FY 2008.

Liquidity and Cash Flow

Liquidity is the amount of cash available on hand and from borrowing activities. The Postal Service has a borrowing agreement with the Federal Financing Bank (FFB) for revolving credit lines of up to $4 billion. It has flexible terms which allow it to borrow either short-term or long-term with varying terms. Though the total amount that the Postal Service can borrow is limited by statute, the Postal Service has enjoyed significant flexibility in capital and operations financing through the years.[13] Other than payroll, the largest cash payments made by the Postal Service are for Workers Compensation and funding of the PSRHBF. These payments, made at the end of the year, total more than $6 billion.

Cash flows include incoming cash and outgoing cash from operations, investment activities, and financing. Postal Service operating revenues are generated in cash and outgoing cash is used for payment of payroll and other expenses.

Cash flow from operations consists of the net results from the income statement (net income or loss) and adjustments to the income statement to account for the generation of cash from various operational activities. The largest adjustments were the expensing of depreciation and amortization ($2.3 billion), reductions of net payables and accrued expenses ($324 million), and increases in deferred revenue-prepaid postage ($547 million). The Postal Service altered the methodology of estimating the deferred revenue-prepaid postage on the balance sheet because of the introduction of the Forever Stamp. Consumer behavior changed in the purchase and usage of stamps that the Postal Service said could not be measured with the old methodology.[14]

Cash was used in the purchase of almost $2 billion worth of property and equipment. Cash used for property and equipment involves major capital projects that have been approved by the Board of Governors in prior years. It may take anywhere from six months to three years before a project, approved by

[13] The total debt limit is $15 billion and the Postal Service cannot increase debt by more than $3 billion in any one year.

[14] For a complete description of the change in the deferred revenue-prepaid postage estimates see Note 2 of the FY 2008 Audited Financial Statements. Postal Service Form 10-K at 53-54.

the Board, is delivered to the Postal Service and then cash is disbursed for payment.

Another source of cash, other than operations, is borrowing by the Postal Service on either a short-term or long-term basis. During FY 2008, the Postal Service repaid $1.5 billion to the Federal Financing Bank (FFB) for payment of notes and the Postal Service's revolving short-term credit line. Additionally, the Postal Service borrowed $4.5 billion from the FFB for large end-of-year obligations. Under current law the Postal Service may incur no more than $3 billion in new debt in any given year.

The generation of cash from operations, the use of cash in capital financing, and the additional generation of cash from borrowing activities led to an increase in the amount of cash carried by the Postal Service of $533 million, increasing total cash from $899 million at the beginning of FY 2008 to $1.4 billion at the end of FY 2008. Table III-4 illustrates the Postal Service's cash balance for FY 2007 and FY 2008.

Table III-4
Postal Service Cash Flows FY 2008 and FY 2007 ($ in Millions)

	FY 2008	FY 2007
Cash Balance, October 1	$899	$997
Cash Flows:		
from Operations	(439)	(2,603)
from Investing Activities	(1,938)	500
from Financing Activities	2,910	2,005
Ending Cash Balance, September 30	$1,432	$899

Source: Postal Service FY 2008 Form 10-K at 51.

The first four months of FY 2009 has shown a continuing deterioration of volumes and revenues. Through January 2009 total revenues have declined over seven percent from the same period in FY 2008 and total year-to-date volumes have declined eleven percent. While the Postal Service has embarked on an ambitious cost reduction plan, costs have only declined one percent over the same period last year. These significant declines in revenues and the inability of the Postal Service to reduce costs fast enough could significantly increase the net loss for FY 2009 to as much as $6.5 billion. The ability to finance a net loss of this magnitude would be problematic at best, as the Postal Service is currently limited in ways in which it can raise cash fast enough to cover this estimated loss. If current conditions continue there is a very real possibility that the Postal Service will not be able to pay some of the large year-end payments for the retiree health benefits fund and workers compensation. *The Commission is concerned about the Postal Service's liquidity in the near future.*

Public Comments

Two parties, Valpak and the Public Representative, filed initial comments on the financial condition of the Postal Service. Those comments are summarized below.

Valpak used the data found in the Postal Service Form 10-K filing to note that the PSRHBF funding requirements have forced the Postal Service to borrow up to the maximum limit allowed by law and is the primary cause of the significant Postal Service deficits over the last two years. Valpak indicated that without the retirement funding requirements of the PAEA the Postal Service would have had a net income of $610 million and that net income was less than 10 percent of the total required funding of the PSRHBF. Valpak Initial Comments at 9. According to Valpak, the Postal Service is not in a long-run financial "equilibrium" because of the necessity of borrowing the maximum allowed by law in order to make the payments to the fund. Valpak contends that if the Postal Service must borrow the maximum each year, the statutory limit on total borrowing will be reached well before retiree health benefits are funded. It asserts that the Postal Service needs to focus on increasing its profitability and should act in a more business-like fashion by targeting this year's CPI-U capped rate changes on the classes that did not cover costs in FY 2008. *id.* at 11.

The Commission notes that Valpak's initial analysis using the data from Form 10-K is incorrect as Valpak misstated the financial results for FY 2007. Included in the total operating expenses of $77.2 billion was the first payment of $5.4 billion to the PSRHBF required by the PAEA. In order to be comparable to FY 2008, $5.4 billion should be deducted from the operating expenses and added to the Funding of PSRHBF line. The correct representation is presented in the following table.

As Table III-5 shows, the two year operating income is more than $6 billion and the percent of net operating income to PSRHBF expense is 43 percent, not less than 10 percent. This correction does not refute Valpak's argument that the Postal Service will have to focus on product profitability and reduce costs in order to maintain financial viability.

Table III-5
Val-Pak Initial Comments Table at 9 as Corrected by PRC
($ in Millions)

	FY 2007	FY 2008
Operating Revenue (Incl. Investment Income)	74,972.8	74,932.0
Less: Operating Expenses	71,756.8	72,138.0
Operating Profit (Deficit)	3,216.0	2,794.0
Funding of PSRHBF	8,358.4	5,600.0
Total Profit (Deficit)	(5,142.4)	(2,806.0)
Total two-year cost of PSRHBF		**13,958.0**
Two year net operating incomes		**6,010.0**
Percent of net operating income to PSRHBF expense		**43.1%**

While Valpak focused on PSRHBF expenses, unprofitable products, and the effect on Postal Service finances, the Public Representative focused on the inability of the Postal Service to control unit variable costs and contends that no amount of volume increase will alleviate the deleterious effect on Postal Service finances of unit variable costs increasing faster than unit revenues. Public Representative Initial Comments at 4.

The Public Representative also identifies several areas where efficiencies can be gained that he believes the Postal Service should explore. These include aligning rate discounts with costs avoided, switching city carriers to a rural carrier pay system, and selling most of the Postal Service's retail outlets and post offices, and contracting out the window service functions. *Id.* at 6-7. He notes that these cost reduction initiatives should be taken to keep the increase in unit costs below the rate of inflation. *Id.* at 7.

The Public Representative has developed models to "roll forward" unit costs using recent increases in unit variable costs, declines in volumes, and inflation adjusted unit revenues, presumably mimicking the CPI-U cap. He noted that with a CPI-U cap, holding the rate of increase in unit variable costs down is the most important step in ensuring the financial viability of the Postal Service. *Id.* at 8-10. There were several replies to the Public Representative's comments. The National Association of Postmasters of the U.S. (NAPUS) argued that the Public Representative's proposal to sell post offices is counter to current public policy and requirements of the PAEA. In fact, NAPUS characterizes the proposal as an effort to privatize the Postal Service. NAPUS Reply Comments at 1-2.

The Greeting Card Association (GCA) noted that the Public Representative's idea of compliance is strictly the recovery of attributable costs, but should instead focus on the Postal Service's ability to recover all costs. Even if attributable costs were static over time, declining volumes would not enable the Postal Service to even recover institutional costs and is a "…key element of compliance with the rate standards of the statute". GCA Reply Comments at 2-3.

American Business Media (ABM) claimed that the PAEA provides the Postal Service with the incentives to reduce costs. According to ABM the Public Representative's attempt at forecasting Postal Service finances into the future based on three years of "unrepresentative data" are of little use. ABM Reply Comments at 9.

The Magazine Publishers of America (MPA) noted that the financial trends of the past three years are not representative of the overall performance of the Postal Service because they were significantly affected by the dramatic decline in volumes. It claimed that the Postal Service's inability to reduce labor costs fast enough has resulted in increased costs due to "underemployed capacity", but that it will be short term and not a reasonable proxy for future costs. MPA Reply Comments at 4-5. Valpak noted that if the Postal Service were to use its pricing flexibility appropriately then average unit costs for each product should decline. It characterized the Public Representative's "straight line" approach as more of a wake-up call rather than an accurate portrayal of the future. Valpak Reply Comments at 15-16.

Valassis Direct Mail (Valassis) disputed the Public Representative's assertion that volume growth is unimportant in relation to the Postal Service financial viability. It contended that the Postal Service should be relieved of the responsibility for paying for non-current, or legacy costs, such as the funding of the PSRHBF and that the Postal Service should negotiate changes with the unions to achieve greater labor cost savings. Valassis Reply Comments at 3. According to Valassis, if not for the burden of the legacy costs imposed on the Postal Service by the Congress, the Postal Service would have covered current system costs and even earned profits. In fact, the Postal Service has done an admirable job in containing current costs despite pressures from wage and COLA increases for labor. Valassis provides two scenarios of three-year income statements to prove their point. The first three year comparison shows total expenses with only the current cost of retiree health benefits premiums, revealing that the Postal Service would have reported profits ranging from $1.2 billion to $3.2 billion if not for the imposition of the funding of future retiree health benefits costs. The second scenario shows the Postal Service funding only the normal cost of current and future retiree health benefits. This scenario shows that the Postal Service would have shown a small net loss for FY 2006 ($181 million) but would have been profitable in FY 2007 and FY 2008, with over $1 billion in gains. *Id.* at 3-4. Valassis agrees with the Public Representative that meaningful cost reductions cannot be realized without a substantial restructuring of operations, network facilities, and union contract terms, but cautioned that these are long-term projects which are limited by legal constraints. *Id.* at 6.

The Postal Service readily agreed that their current financial condition has been seriously degraded because of the significant volume declines over the past year. These volume declines are the result of the changes in the economy and the changes in the First-Class Mail market over the past few years. The Postal Service is acting aggressively to cut costs which include eliminating $5.9 billion over the next two years and cutting over 100 million workhours in FY 2009. But, it notes, if volume declines continue to accelerate the aggressive actions now being undertaken may not be enough to keep revenues above costs for some products.

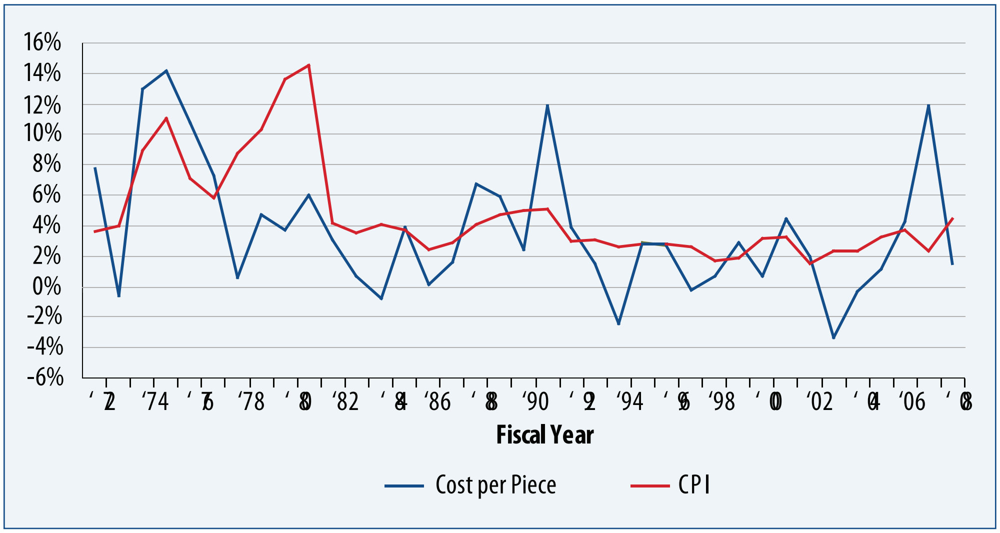
The Postal Service found the logic of the Public Representative's comments confusing. For example, the Postal Service posited that if volume declines are causing the financial problems, increases in volumes will help solve, not exacerbate, the problem. It also noted that reducing volume variable costs would not solve the Postal Service's financial problems alone; institutional cost containment is just as important. Postal Service Reply Comments at 10-13. The Postal Service pointed out volume variable costs, while based on actual costs, represent an economic view of how costs should vary with volume. However, these costs may not automatically vary with volume. Additionally, management of volume variable costs is the result of management of various cost drivers and there are constraints which can delay the recognition of the need to reduce costs which become more pronounced during periods of large, rapid declines in volumes. *Id.* at 14. Simply stating that the Postal Service must better manage unit volume variable costs oversimplifies the complexities facing postal management during this economic downturn. *Id.* at 15.

The Commission agrees that the Public Representative's analysis may not be comprehensive but notes that the Public Representative recognizes this criticism and offers his analysis as an illustration of the "direction of change and the inevitability of the end result." Public Representative Initial Comments at 8. The Public Representative's scenarios for future financial results of the Postal Service use constant and simplistic assumptions and are therefore not a true "roll forward." The assumptions do not take into account the types of cost reductions the Postal Service may take to work toward financial viability nor does it take into account the fact that rate increases would not be constant over time or the effect on volumes that rate increases cause. The limitations of the Public Representative's analysis, however, are in part necessitated by the data available. For example, the Postal Service does not currently provide a breakdown of planned cost reductions by product nor does it provide the volume forecasting model used to determine price effects on volume.

The scenarios the Public Representative presents assume a constant economic environment. The past four years have shown a great change in total Postal Service costs due to legislative actions and changes in attributable cost methodologies.

To achieve a more complete view of Postal costs the Commission broadened the analysis to include all costs and extended it over three decades. In general,

Figure III-10.
Percent Change in Total Unit Costs and Percent Changes in CPI–U



Source: Postal Service Annual Reports FY 1972-2008 and Bureau of Labor and Statistics.

the Postal Service has kept total unit costs in line with inflation over the years. Figure III-10 contrasts the rate of increase in total unit costs with the rate of increase in CPI-U.

The figure shows that unit cost changes have generally been very close to or below the increase in CPI-U. Over the last two years there has been a significant change in costs due to legislative mandate, namely the funding of retiree health benefits. By using only the last three years of data, the Public Representative has skewed the rate of change in costs more toward the highest increases of the last two years. It should be noted however that the CPI-U has leveled off in recent months and is forecast to remain steady or decrease over FY 2009. This, coupled with declining volumes and increasing retirement costs, could make it difficult for the Postal Service to continue the trend of keeping unit costs at or below inflation.

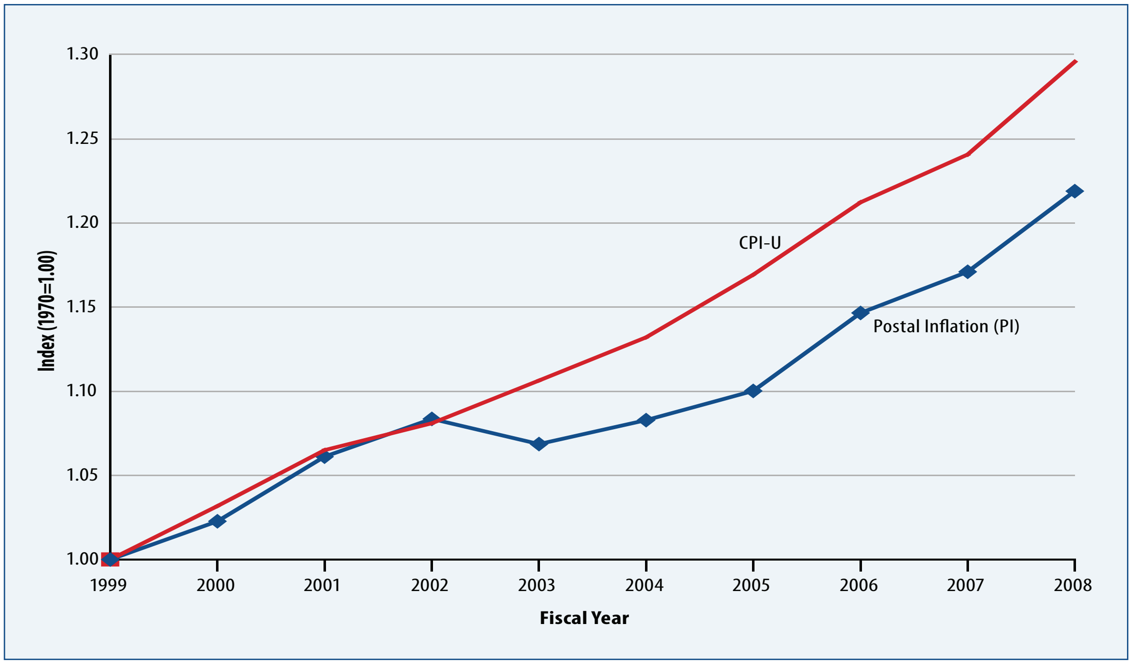
The Public Representative's analysis used the Postal Service's costing methodology, which differed from the Commission's in FY 2005 and FY 2006. The Commission replicated the Public Representative's analysis using unit costs that reflect Commission costing methods for all years, which produced little change. To isolate operating costs from those costs that are statutorily required, the Commission further altered the analysis to exclude the mandated PSRHBF payments. Table III-6 shows a 3.4 average percentage change in

Table III-6
Postal Service Aggregate Operating Statisitics for FY 2005 through FY 2008
(without pre-fund future retiree health benefits)

Category	2005	2006	Percent change	2007	Percent change	2008	Percent change	Average percent change
Volume (millions)	211,743	213,138	0.7	212,234	-0.4	202,203	-4.7	-1.5
Expenses (millions)	68,281	71,681	5.0	71,757	0.1	72,138	0.5	1.9
Workhours (millions)	1,463	1,459	-0.3	1,423	-2.5	1,373	-3.5	-2.1
Expenses/Workhours	46.7	49.1	5.3	50.4	2.6	52.5	4.2	4.0
Pieces/Workhours	144.7	146.1	0.9	149.1	2.1	147.3	-1.3	0.6
Expenses/Pieces	0.322	0.336	4.3	0.338	0.5	0.357	5.5	3.4

Source: Postal Service Annual Reports, FY 1972-2008 and Bureau of Labor and Statistics.

Figure III-11
U.S. Postal Service Postal Inflation (PI) vs. CPI–U
(PI=Cost of Resources Used divided by Workload)



Source: Postal Service Annual Tables, FY 2008 TFP.

system-wide unit costs since FY 2005. Comparing these results to the Public Representative's analysis which included the PSRHBF payments suggests that these payments contribute greatly to the Postal Service's inability to keep costs below the current CPI-U cap.

Figure III-11 further illustrates this concept through a comparison of Postal Inflation (PI) and CPI-U. Postal Inflation measures the operating efficiency of the Postal Service, a multi-product firm. It is similar to the measure of the change in the cost per piece when pieces are adjusted for differences in their workload content and for the change in delivery network. Technically, it is calculated by dividing the cost of all resources used by the Postal Service in a year by the annual workload. In other words, it is the cost to the Postal Service for producing a standard unit of output. When PI rises faster than CPI-U, capping Postal rates at CPI-U is expected to produce a Postal deficit. On the other hand, when PI growth stays below CPI-U capping Postal rates at CPI-U is expected to generate Postal surpluses. Finally, when PI and CPI-U grow at the same rate, capping Postal rates at CPI-U will likely allow the Postal Service to break even. Over the past nine years PI has remained at or below the level of CPI-U. Since 2003, in particular, the Postal Service has done an admirable job of managing operating costs. The cumulative increase in PI for FY 2008 was almost six percentage points below CPI-U.

Competitive Products Accounting Rules and Assumed Income Tax Calculation

On December 18, 2008, the Commission issued Order No. 151, which established the competitive products accounting rules and the method of calculation of the assumed Federal Income Tax as required by 39 U.S.C. 2011. Beginning with Fiscal Year 2008, the Postal Service was required to separately account for the revenues, expenses, assets, and liabilities of the competitive products segment and also submit an income tax calculation to the Commission. The rules specify the transfer of the tax calculated for competitive products from the Competitive Products Fund to the Market Dominant Fund by January 15th of each Fiscal Year. The PAEA requires an assumed income tax to be calculated on competitive products net income to provide a level playing field for competitors and to ensure no cross subsidization of competitive products by market dominant products. The rules promulgated by the Commission in Order No. 151 ensure the achievement of these goals in a timely and cost efficient manner by basing the calculation of the assumed income tax of competitive products on net income adjusted for tax purposes. The rules also include report templates for the income statement, the financial status of the competitive products, and the competitive products property and equipment assets. Additionally, the Commission required the development of a report on the allocated assets and liabilities of the competitive products segment. For calculation of the assumed Federal income tax there is a first year extension of six months to July 15, 2009 to compute the assumed tax and for the transference of the tax to the Postal Service Fund. Additionally, the initial filing of the allocation of assets and liabilities is not required until 90 days after the end of FY 2010.

On January 15, 2009 the Postal Service filed the Competitive Products Income Statement, the Competitive Products Financial Status Report, and under seal, the Identified Property and Equipment Assets Report. The Income Statement showed a net income before tax of $60.4 million in FY 2008 compared to a net income before tax of $49.1 million in FY 2007. The Postal Service calculated an assumed Federal income tax of $21.1 million but noted that the estimated tax is based on a straight corporate tax rate of 35 percent and that the actual calculation of the tax will be completed by July 15, 2009 as stipulated in the rules.

The Commission's version of the Competitive Products Income Statement, as shown in Table III-7, is based on book revenue rather than imputed revenue and therefore differs from the Postal Service's filing. *The Commission finds that the Competitive Products contributed the appropriate share to institutional costs, paid an assumed Federal income tax, and generated an after tax income of approximately $9 million.*

Table III-7
Proposed Competitive Products Income Statement ($ in 000s)

	FY 2008	FY 2007	$ Change	Percent Change
Revenue				
(1) Mail and Services Revenues	8,381,705	7,908,902	472,803	6.0%
(2) Investment Income	0	0	0	N/A
(3) Total Competitive Products Revenue	8,381,705	7,908,902	472,803	6.0%
Expenses				
(4) Volume Variable Costs	6,566,072	6,098,110	467,962	7.7%
(5) Product Specific Costs	33,743	24,922	8,821	35.4%
(6) Total Competitive Products Attributable Cost	6,599,814	6,123,032	476,782	7.8%
(7) Net Income Before Institutional Cost Contribution	1,781,891	1,785,870	(3,979)	
(8) Required Institutional Cost Contribution	1,767,505	1,736,744	30,761	1.8%
(9) Net Income (Loss) Before Tax	14,386	49,126	(34,740)	
(10) Assumed Federal Income Tax*	5,035	0	5,035	N/A
(11) Net Income (Loss) After Tax	9,351	49,126	(39,775)	

(1): Total revenue from Competitive Products Volumes and Ancillary Services (PRC-ACR2008-LR1)

(2): Income provided from investment of surplus Competitive Products revenues

(3): Sum total of revenues from Competitive Products volumes, services and investments

(4): Total Competitive Products volume variable costs as shown in the FY08 CRA report (PRC-ACR2008-LR1)

(5): Total Competitive Products product specific costs as shown in the FY08 CRA report (PRC-ACR2008-LR1)

(6): Sum total of Competitive Products costs (sum of lines 4-5)

(7): Difference between Competitive Products total revenues and attributable costs (line 3 less line 6)

(8): Minimum amount of Institutional Cost contribution required under 39 CFR 3015.7 (PRC-ACR2008-LR1)

(9): Line 7 less line 8

(10): Total assumed Federal Income Tax as calculated under 39 CFR 3060.40 (line 9 times 35 percent)

(11): Line 9 less line 10

* Note: 2008 Assumed Federal Income Tax is estimated based on a 35 percent corporate tax rate, the actual calculation will be completed by July 15, 2009. In 2007, there was no requirement for an assumed Federal Income Tax.

CHAPTER IV — POSTAL SERVICE STRATEGIC GOALS

Summary of Findings: Key Points

Primary concerns for Postal Service strategic goals are:

- Postal Service should produce reports which adhere more closely to the requirements of 39 U.S.C. sections 2803 and 2804;
- Customer satisfaction has improved but differs for commercial and small business/residential mailers;
- Postal Service has reduced workhours by 50 million

Pursuant to 39 U.S.C. 3653(d) the Commission is required to evaluate annually whether the Postal Service has met goals established under sections 2803 and 2804. section 3653(d) also states that the Commission "may provide recommendations to the Postal Service related to the protection or promotion of public policy objectives set out in this title."

Section 2803 requires the Postal Service to include an "annual performance plan covering each program activity set forth in the Postal Service budget," in its comprehensive statement. Section 2803(a) requires the performance plan to establish goals for each program activity, express such goals in an objective and quantifiable manner, describe the resources needed to meet the goals, establish performance indicators to measure the relevant outputs from each program activity, provide a basis for comparing program results with actual goals, and describe the means used to validate measured values. Section 2803(b), however, allows the Postal Service to express performance goals for a particular program activity in an alternative form if it is not feasible to express performance goals in an objective and quantifiable manner. Section 2803(b) and (c) set out that an alternative form must describe a "minimally effective program" and a "successful program," but may aggregate or consolidate program activities.

Section 2804 requires the Postal Service to prepare a report on program performance for each fiscal year to include in its comprehensive statement. Section 2804(b) requires that the program performance report include a statement of the performance indicators, along with the actual performance achieved compared to the performance goals. However section 2804(b) also requires that if the Postal Service specifies performance goals in an alternative form, a description of what constitutes a "minimally effective program" and a "successful program," the program results must be provided and described in relation to those two descriptions.

The performance plans and the program performance reports required under sections 2803 and 2804, respectively, are components of the Comprehensive Statement submitted annually by the Postal Service to Congress (along with its budget) pursuant to section 2401(e). Among other things, the Comprehensive Statement must address: [P]ostal operations, generally, including data on the speed and reliability of service provided for the various classes of mail and types of mail service, mail volume, productivity, trends in postal operations, and analysis of the impact of internal and external factors upon the Postal Service.

The Comprehensive Statement does not appear to contain specific performance goals defining the level of performance to be achieved by various program activities. Under section 2803, the Postal Service may, in lieu of expressing goal in a quantifiable form, use an alternative form providing descriptive statements of a minimally effective program and a successful program or "state why it is infeasible or impractical to express a performance goal in any form for the program activity." 39 U.S.C. 2803(b) . It is not clear which, if either, of these alternatives is used in the Comprehensive Statement.

The Compliance Statement contains the Postal Service's performance report for FY 2008 and its plan for FY 2009, which the Postal Service indicates is required by GPRA. *See* Comprehensive Statement at 5 and 53. That report does not appear to address the requirements of section 2803 in any detailed way. Thus, for example, performance goals are neither quantified nor expressed in an alternative form when the Postal Service determines that a performance goal cannot be feasibly be quantified. Instead, the Postal Service evaluates overall performance using the following criteria: service quality, financial viability, and workplace-related matters, i.e., safety and employee satisfaction. *Id.* at 53.

This is not to suggest that the Comprehensive Statement does not discuss, at least generally, various goals. *See*, e.g., *Id.* at 30 (staffing), 47 (supplier relationships), 49 (sustainability), 50 (energy), and 55 (service-related goals). However, since these goals do not appear to be quantified in any fashion, the task of assessing whether the Postal Service has met goals established under section 2803 and 2804 is problematic. *Future Comprehensive Statements should adhere more closely to the requirements of sections 2803 and 2804.* For purposes of this annual evaluation under section 3653(d), the Commission will evaluate the Postal Service's overall performance as discussed in Chapter 5 of its Comprehensive Statement. As noted above, that entails principally a review of service quality and financial viability. In addition, because the Comprehensive Statement addresses the issue of facilities, that topic is discussed in this Chapter as well.

Service Quality

The Postal Service's discussion of service quality focuses on First-Class Mail on-time performance. *Id.* at 53. In addition, it mentions that new service performance measurement standards will be implemented in FY 2009. Since these issues fall under section 3653(b)(2) and are appropriately addressed as part of the ACD, they are discussed in Chapter V, supra. As part of its ACR, the Postal Service reported on various measures of customer satisfaction. Each is addressed below.

Customer Surveys

Customer satisfaction surveys are performed by the Gallup Organization on behalf of the Postal Service and measure customers' perceptions of the quality of their mail delivery, the service they received at post offices and other Postal Outlets. *Id.* During 2008, measures of residential and business customer satisfaction with mailing services were developed and implemented through the customer satisfaction measurement survey process.

In FY 2008, the Postal Service relied on three surveys when it evaluated customer satisfaction with its mailing services. One survey evaluated small business satisfaction on a quarterly basis. Small businesses with 1 to 19 employees and residential customers were provided questionnaires. National and Premier Accounts also known as Commercial accounts—those with 500 or more employees' were surveyed as well. Both residential customers and businesses were required to base their responses on actual experience. All the surveys consisted of questions addressing client satisfaction with the following market dominant products: First-Class Mail; Periodicals; Standard Mail; Single-Piece Parcel Post; Media Mail; Bound Printed Matter; Library Mail; and, First-Class Mail International.

The Commercial survey included questions on the market dominant and commercial products as well as clients' experiences with postal employees and business solutions. It also had questions about: when mail was delivered to the business; the accuracy of the mail delivered – was the mail delivered to the appropriate address; the condition of the mail; and how the Postal Service rated in comparison to its competitors. USPS-FY-08-38. These questions were not included in the residential or small business surveys the Postal Service provided to the Commission. It appears that the Postal Service seeks more information from its commercial mailer surveys on mail services than it does its small business and residential clients. It is unfortunate that the Postal Service fails to gather more information from its small business and residential clients. The Postal Service is missing an opportunity to understand how the general public views the products and services the Postal Service provides in relation to its competitors. *The Commission recommends that the Postal Service adjust its surveys in order to gather more information from small businesses and residential customers.*

The results of the surveys are shown in Table IV-1. ACR (FY 2008) at 15.

The customer satisfaction surveys show that the Postal Service is achieving a combined customer satisfaction measurement of good, very good and

Table IV-1
Customer Satisfaction with Mailing Services FY 2008

Mailing Services	Residential & Small Businesses Rated	National & Premier Accounts Rated	FY 08 Combined Average Ratings
First-Class Mail	91.7%	96.4%	94.1%
Standard Mail	79.3%	92.0%	85.7%
Periodicals	89.4%	88.7%	89.1%
Single-Piece Parcel Post	90.3%	93.9%	92.1%
Medial Mail	92.3%	93.7%	93.0%
Bound Printed Matter	91.8%	91.8%	91.8%
Single-Piece, First-Class Mail International	85.9%	94.4%	90.2%
Library Mail	92.7%	96.0%	94.4%

Source: Response of United States Postal Service to Commission Information Request No. 1, question 12. *See* also, ACR2008 at 15.

Table IV-2
Commercial Survey Results[1]

Product Type	Percent Excellent	Percent Very Good	Percent Good	Percent EX/VG/G
First-Class Mail	30.6	41.7	24.0	96.4
Standard Mail	21.6	38.5	31.9	92.0
Periodicals	15.8	33.9	39.0	88.7
SP Parcel Post	20.8	37.5	35.6	93.9
Media Mail	19.8	34.9	39.1	93.7
Bound Printed Matter	18.0	33.2	40.6	91.8
Single-Piece, First-Class Mail International	18.8	38.3	37.2	94.4
Library Mail	23.8	37.1	35.1	96.0

Source: Response of the United States Postal Service to Questions 1, 6-13 of CIR No. 1, January 21, 2009, Question 12. Note: The number of surveys distributed was 39,369. The number of responses received was 13,363

excellent of 90 percent or better for First-Class, Single-piece Parcel Post, Media Mail, Bound Printed Matter and Library Mail. In general, it appears that National and Premier Accounts have higher customer satisfaction ratings with postal products and services than do residential and small business clients. For residential and small businesses, a customer satisfaction rating of good, very good and excellent for Standard Mail was 79.3 percent. *The Postal Service should investigate why satisfaction differs in these categories.*

Table IV-3
Residential and Small Business Distribution of Survey Results

Product Type	Percent Excellent	Percent Very Good	Percent Good	Percent EX/VG	Percent EX/VG/G
First-Class Mail	19.9	39.9	31.9	59.8	91.7
Standard Mail	10.8	26.8	41.7	37.6	79.3
Periodicals	13.1	34.8	41.5	47.9	89.4
SP Parcel Post	15.2	36.8	38.3	52.0	90.3
Media Mail	17.9	36.2	38.2	54.1	92.3
Bound Printed Matter	11.0	30.0	50.8	41.0	91.8
Single-Piece First-Class Mail Int'l	16.6	32.1	37.2	48.7	85.9
Library Mail	11.9	36.0	44.8	47.9	92.7

Source: Response of the United States Postal Service to Questions 1, 6-13 of CIR No. 1, January 21, 2009, Question 12. Note: The number of surveys distributed was 3,000. The number of responses received was 1,995. The Postal Service does not include a separate Small Business Distribution of Survey Results.

National and Premier accounts gave Standard Mail a 92 percent rating of good, very good and excellent. The good, very good and excellent score for Periodical Mail was 89.4 percent for residential and small businesses while National and Premier Accounts provided an 88.7 percent score. For residential and small business clients of single-piece International Mail, the Postal Service received a combined good, very good and excellent score of 85.9 percent. National and Premier Accounts gave single-piece International Mail a rating of 94.4 percent. *The Postal Service needs to understand why its smaller clients' score is lower than the National and Premier accounts so that improvements may be made.* The combined residential and small business ratings and the national and premier account rating for Single-piece First-class International was 90.2 percent.

In response to CIR No. 1, question 12, the Postal provided the following distributions for Commercial and Residential and Small Business surveys.

The Postal Service is requested to provide the Commission with an explanation/analysis of the differences between the Residential and Small Business survey results and those for National and Premier Accounts. Since the information for FY 2007 excluded residential customers there is not a one-to-one comparison with the FY 2008 data. Under the PAEA, the Commission recognizes that evaluating customer satisfaction for both residential, small businesses and commercial accounts is a new activity. Initial results are positive.

Ancillary Services

Total market dominant and ancillary service revenues for FY 2008 are $ 65.8 billion. Special Services represents approximately 4 percent of those revenues. The Postal Service does not evaluate the Special Services products in its customer satisfaction surveys. This is an opportunity lost in determining whether or not the Postal Service may grow those products' revenues. While Special Services revenues are low in comparison to some classes of mail, the Postal Service is relying on one Special Services, Delivery Confirmation, to evaluate service performance for parcel shaped mail. *The Commission expects the Postal Service will continue its efforts to improve customer satisfaction and improve the customer satisfaction surveys to include information on retail service experiences and Special Services.*

Survey Methodology. Commercial surveys were distributed to 39,369 companies. the Postal Service received 13,363 responses for a response rate of approximately 34 percent. *Id.* Three thousand residential and small business surveys were distributed and 1,995 responses were received for a response rate of approximately 67 percent. *Id.* Except for Bound Printed Matter, the data indicate that residential and small businesses are less satisfied with Postal Service Mailing services than are commercial customers.

The Postal Service did provide a copy of each questionnaire as requested in the FY 2007 ACD. *In addition to the information filed, the Commission requests that the Postal Service provide information on the number of surveys sent out to each group of respondents as well as the number of survey responses received. Information on Customer Satisfaction scores must be separately provided by each of the following: (1) residential, (2) small businesses and (3) commercial accounts by mailing service and by the individual scores of excellent, very good and good. A separate composite score of excellent, very good and good should be provided for each of the following: Residential, Small Businesses and Commercial accounts. A format similar to that used in the Response of the United States Postal Service to Commission Information Request No. 1, question 12 is acceptable, with the exception that small businesses and residential customers be reported separately. Finally, the Commission requests that the Postal Service provide the targets it strives to achieve with regard to its customer satisfaction survey results.*

Mystery Shopper Program

The Postal Service conducts a retail office survey known as the Mystery Shopper Program. The program is similar to those used by other retailers to identify potential areas for improvement of the retail customers' experience. The survey is conducted by an independent contractor at approximately 8,800 offices with POS terminals. The survey questions relate to market dominant and competitive products and change over time to reflect changing business needs. Results of the survey are used to identify areas needing additional training and possible coaching.[1] Actual results of the survey were submitted to the Commission as part of the non-public annex of materials. The Mystery Shopper Program provides information on wait time in line at the Postal Service's retail Facilities. The Commission views this information as an indicator of overall customer service and will monitor the results.

Customer Outreach

In the FY 2008 Comprehensive Statement, the Postal Service discusses how it interacts with its customers

[1] Response of the United States Postal Service to Question 14 of Commission Information Request No. 1, January 23, 2009.

Table IV-4
Postal Service Delivery Points

Post Office, Stations & Branches	FY 2008	FY 2007	Change from FY 07	FY 2006
Post Offices	27,232	27,276	(44)	27,318
Classified Stations, Branches and Carrier Annexes	5,509	5,419	90	5,557
Contract Postal Units	3,148	3,131	17	3,014
Community Post Offices	834	895	(61)	937
Total Post Offices	36,723	36,721	2	36,826
Residential Delivery Points				
City Delivery	79,848,415	79,470,894	377,521	78,999,153
Rural	37,684,158	37,022,488	661,670	36,068,838
P.O. Box	15,639,031	15,635,480	3,551	15,615,744
Highway Contract	2,516,783	2,473,323	43,460	2,345,255
Total Residential Delivery	135,688,387	134,602,185	1,086,202	132,978,990
Business Delivery Points				
City Delivery	7,436,965	7,411,582	25,383	7,343,020
Rural	1,407,942	1,360,478	47,464	1,297,022
P.O. Box	4,587,454	4,548,973	38,481	4,490,102
Highway Contract	71,538	69,304	2,234	65,062
Total Business Delivery	13,503,899	13,390,337	113,562	13,195,206
Total Delivery Points	149,192,286	147,992,522	1,199,764	146,174,196

Source: Annual Report 2008 of the Postal Service at 65.

to ensure that their needs are met. The Postal Service groups its customers into four major categories: large-volume business mailers; business partners and service providers; small and medium-size business mailers; and households. The Postal Service conducts several customer outreach programs including: industry events such as the National Postal Forum; customer feedback via online channels such as www.usps.com; major mailing associations and organizations that work with the Postal Service to enhance the value of the mail via the Mailers' Technical Advisory Committee (MTAC); local businesses are kept updated on the latest postal products through the Postal Customer Councils. Other points of contact include employee-based outreach programs like Business Connect, Customer Connect and Rural Reach which keeps customers informed about new postal products and services that can help them grow their business. In addition, the Postal Service has improved customer support programs during 2008, by strengthening Business Service Network teams , integrating and improving access to customer data and expanding customer support through the Customer Call Centers. In 2008, the Postal Service introduced the Customer Data Mart, which is an integrated customer database designed to help achieve the goals of improved customer service and revenue growth. The Postal Service provides corporate customers with Postal Service access through a network of toll free telephone numbers that handle queries on ZIP Codes, prices, passports and post office hours and locations. *Id.*, at 11.

Customer Access

As seen in Table IV-4 overall the number of post offices has remained stable since FY 2007. Contract

Postal Units—postal retail services offered in non-postal facilities—have increased, as have branches. The number of traditional post offices and Community post offices have decreased.

Total delivery points increased slightly in FY 2008 (less than 1 percent). A majority of that increase has been in rural delivery.

The Commission requests the disclosure in future Postal Service reports of the total number of collection boxes in the United States. The PAEA specifically includes the review of the collection function in mail service. The first factor in section 3622 discusses the collection, mode of transportation and priority of delivery. Section 403(b) requires the maintainance of an efficient system of collection. Collection boxes are an important part of collection of single-piece First-Class mail. The Commission's Universal Service Obligation report affirms the importance of collection as an essential part of postal service. *A year by year reporting of collection boxes will provide a helpful and important benchmark for the quality of collection service.*

Post Office Suspensions

In March 1998, the Postal Service instituted a moratorium on management-initiated post office closings or consolidations. The moratorium was instituted to draw attention to a backlog of post office operations that were suspended and to provide a more rigorous process for timely evaluation of post offices whose operations were suspended. In February 2000,the Postal Service, with assistance from the postmaster organizations, finalized a consensus for a process to address the backlog of suspensions to either re-open or formally close the offices. The moratorium was lifted in April 2002. Table IV-5 provides a summation of Emergency Suspension as of August 22, 2008.

The Commission recognizes that the Postal Service is attempting to finalize post office Suspensions, which in many cases have been pending for many years. *The Commission expects that those communities impacted by a suspension and/or closing are allowed to voice their opinions and concerns and that the Postal Service will be responsive to those needs. In future Annual Compliance Reports the Commission requests that the Postal Service provide updates on the disposition of any emergency suspensions as well as post office closings and provide data similar to that provided by Mr. Potter, Postmaster General and CEO, in a letter to Chairman Blair, dated September 22, 2008.*

Table IV-5
Summary of Emergency Suspension of Post Offices

Area	Suspensions
Capital Metro	19
Eastern	62
Great Lakes	21
New York Metro	1
Northeast	4
Pacific	1
Southeast	28
Southwest	14
Western	36
Total Suspensions	**186**

Source: September 22, 2008 letter.

Generate Revenue

FY 2008 presented a difficult economic environment in which to increase revenue. Volume was significantly impacted by the decline of the financial services industry, one of the Postal Service's largest commercial customer segments. Also, Online options for billing customers, making payments and conducting business and personal communications continue to erode mail volumes. The Postal Service points out that the largest share of mail is advertising, which is considered a discretionary expense by many companies. Consequently, it is one of the expenses that are curtailed during economic downturns. Vision 2013 at 2.

According to the Postal Service's Comprehensive Plan for FY 2007, planned revenue for FY 2008 was $78.2 billion. Actual revenue of $74.9 billion was $3.3 billion (4.1 percent) below plan. This contrasts markedly with the four preceding years where the Postal Service substantially met or exceeded its revenue projections.

Generating Revenue Through Pricing

The Postal Service has limited options for generating revenue other than through postage rates. By statute it cannot enter into new businesses unrelated to mail delivery. Consequently, to generate revenue the Postal Service must concentrate on setting rates that send the proper price signals to mailers and increase contribution for the Postal Service. Properly set prices serve the function of promoting allocative efficiency and at the same time maximize the Postal Service's net revenues.

Setting prices for products in a multi-product firm is a complex process. That task is made more difficult when that firm is a government owned monopoly with universal service mandates and statutorily defined obligations. Section 3622(b) of the PAEA specifies that certain objectives should be considered when setting rates including:

(1) Maximizing incentives to reduce costs and increase efficiency.

(2) Creating predictability and stability in rates.

(3) Allowing the Postal Service pricing flexibility.

(4) Assuring adequate revenues; including retained earnings, to maintain financial stability.

(5) Establishing and maintaining a just and reasonable schedule for rates and classifications.

Balancing these objectives takes thoughtful consideration of various ratemaking principles and techniques. From a strictly volume maximizing point of view, higher rates should be charged for the products least likely to leave the system such as products that have a low elasticity of demand. Lower rates should be set for products more likely to leave the system, i.e., products with high elasticity of demand. This strategy can also be used to maximize profits as long as each product contributes roughly equal amounts, on a unit basis, towards overhead costs. When products contribute unequal unit amounts to overhead costs a balance must be struck between losing volume and increasing contribution.

This is particularly true for products that are grouped together under one price cap. Exhibits 1-3 illustrate these points for two hypothetical products that have different demand elasticities. Exhibit 1 illustrates the impact of giving a larger percentage rate increase to the more elastic product, Product (X), when each product initially makes an equal unit contribution.

Exhibit 1. Equal Contribution & Unequal Elasticity

Products	X	Y	
Elasticity	-2	-1	
Rate	2	3	
Unit Cost	1.5	2.5	
Unit Contribution	0.5	0.5	
Volume	1,000	1,000	2,000
Total Contribution	$500	$500	$1,000
Price Change	0.3	0.1	
Rate	2.6	3.3	
Unit Cost	1.5	2.5	
Unit Contribution	1.1	0.8	
Volume	400	900	1,300
Total Contribution	$440	$720	$1,160
Percent Increase in Contribution			**16%**

Exhibit 2. Equal Contribution & Unequal Elasticity

Products	X	Y	
Elasticity	-2	-1	
Rate	2	3	
Unit Cost	1.5	2.5	
Unit Contribution	0.5	0.5	
Volume	1,000	1,000	2,000
Total Contribution	$500	$500	$1,000
Price Change	0.1	0.3	
Rate	2.2	3.9	
Unit Cost	1.5	2.5	
Unit Contribution	0.7	1.4	
Volume	800	700	1,500
Total Contribution	$560	$980	$1,540
Percent Increase in Contribution			**54%**

Exhibit 3. Unequal Contribution & Unequal Elasticity

Products	X	Y	
Elasticity	-2	-1	
Rate	2	3	
Unit Cost	1.5	0.5	
Unit Contribution	0.5	2.5	
Volume	1,000	1,000	2,000
Total Contribution	$500	$2,500	$3,000
Price Change	0.1	0.3	
Rate	2.2	3.9	
Unit Cost	1.5	0.5	
Unit Contribution	0.7	3.4	
Volume	800	700	1,500
Total Contribution	$560	$2,380	$2,940
Percent Increase in Contribution			**-2%**

The result of the rate increase as shown is a 16 percent increase in total contribution from $1,000 to $1,160. Volume falls, however, which could indicate a potential societal welfare loss. In Exhibit 2, the larger percent rate increase is given to the product which is less elastic, Product (Y). The result in this exhibit shows that both revenues and volumes are higher than in Exhibit 1. This result is an improvement over Exhibit 1 for both the firm and for society as a whole.

However, when the initial unit contribution is different for the two products, differential pricing that reflects demand elasticities results in lower overall contribution. Exhibit 3 illustrates this. Exhibit 3 shows a decrease in both volume—from 2,000 units to 1,500 units—and in overall contribution—from $3,000 to $2,940. While these are simplistic examples, the basic concept holds true for the Postal Service. Pricing in this manner requires detailed information on the cost and demand characteristics of the various products offered by the firm.

Public Comments

A variety of comments were received on this issue. Most of the comments submitted in this docket comment on particular rates that are regarded as economically inefficient.[2] Most of the comments submitted in this docket comment on particular rates that are regarded as economically inefficient. The Public Representative filed extensive comments concerning pricing and allocative and productive efficiency noting that "at the product level, rates that align product cost coverages most closely with the relative demand for products maximize postal profits over the long term. This long-term outcome also has the beneficial effect of maximizing social welfare." PR Reply Comments at 3. The Public Representative then illustrates how the Postal Service could identify a set of profit maximizing rates, assuming there is adequate information on elasticity of demand, finally concluding that 'It should be required to justify any deviations from the set of profit maximizing rates by demonstrating that the deviation serves a statutory objective that is a higher priority' (PR Reply Comments at 3). Section 3622(b), however, states that the objectives are to be applied in conjunction with one another, implying that they all carry equal weight. Four of the five objectives listed above could be construed as being in conflict with "profit maximizing."

Efficient rates send pricing signals that promote production by the most efficient producer, whether it is the Postal Service or the mailers. Efficient rates within a class also serve to maintain parity in unit cost contribution. The Efficient Component Pricing Rule (ECP) requires that rate differences equal cost differences. When rate differences exceed cost differences, the Postal Service is essentially paying mailers to perform work Postal Service employees can do less expensively. This lowers overall Postal Service profits. When rate differences are below cost differences the Postal Service is passing on to mailers less of the cost savings than it realizes. Therefore, the Postal Service gains contribution to the extent that

[2] Comments of Pitney Bowes Inc., January 30,2009, at 2-3; Initial Comments of American Postal Workers Union, AFL-CIO, January 30,2009 at 2-4; Comments of Association for Postal Commerce in Response to Order No. 161 and 167, January 30, 2009; Comments of Parcel Shippers Association on United States Postal Service FY 2008 Annual Compliance Report, January 30,2009,at 3-4; Comments (Stamps.com), January 30,2009, at 2; and Comments of Valpak Direct marketing Systems, Inc. and Valpak Dealers' Association, Inc. Initial Comments on the United States Postal Service FY 2008 Annual Compliance Report, January 30,2009, at 40-43, 46-53. *See* also Reply Comments of National Postal Policy Council, February 13, 2009, at 4-5; and Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Reply Comments on the United States Postal Service FY 2008 Annual Compliance Report, February 13, 2009, at 5-6.

volume is not negatively impacted by the size of the mailer discount.

In Docket No R-2006, the Commission decided that for mailers who might have control over decisions as to mail characteristics such as shape, the ECP concept goes beyond worksharing. The Commission in its decision noted that the virtue of ECP or an ECP approach beyond worksharing is that it continues to promote productive efficiency. Just as ECP should produce the least cost mail by incentivizing a mailer or third party to workshare if it can perform mail processing or transportation more cheaply then the Postal Service, so too it should provide appropriate incentives to minimize costs in the case of shape and other mail characteristics. Docket No. R2006-1, Opinion and Recommended Decision, at 87.

The Public Representative notes that "under normal circumstances, the PAEA assumes that worksharing discounts should depart from the ECP standard to the extent that doing so increases system profits and thereby increases allocative efficiency." The Public Representative presents two examples where discounts above 100 percent of avoided cost would lead to contribution increases for the Postal Service. PR Reply Comments at13-16. However, the Public Representative also cautions that "non-ECP pricing should be considered a viable option and selectively applied when data on the elasticity of demand are available, sufficient confidence is placed in such data and large enough increases in profit can be sustained". PR Reply Comments at 12.

The Commission notes that the Postal Service must conform to the worksharing requirements of 39 U.S.C. § 3622(e) that limit the circumstances under which passthroughs in excess of 100 percent may occur. The Postal Service appears to have incorporated notions of price elasticities, increasing contribution, and efficiency in some of its pricing decisions while deviating considerably from these principles in other cases. One of the pricing objectives is flexibility, however, the Commission is concerned that some of the Postal Service's pricing decisions may exacerbate the Postal Service's financial problems. These areas include the decision to apply low rate increases to categories of mail that contribute little or nothing to institutional costs and the numerous instances of discounts that exceed cost differences. Specific pricing issues are discussed in Chapter VI.

Increase Efficiency

Total Factor Productivity. In its FY 2007 Comprehensive Statement the Postal Service states that improving efficiency has long been a priority and that it continues as a goal for FY 2008. The Postal Service uses a multifactor productivity measurement known as Total Factor Productivity (TFP) as one means of measuring postal efficiency by measuring the change between outputs (workload) and inputs (resources used). The outputs include weighted mail volume and other miscellaneous output in addition to the increase in the delivery network. Inputs are labor, transportation, capital usage, and other materials. The Postal Service stresses that due to lag factors such as efficiencies gained through capital investments, TFP is best judged over a long period of time. As such, the Postal Service frequently references cumulative TFP gains.

In Chapter V of the Postal Service's Comprehensive Statement of Postal Operations, it notes that

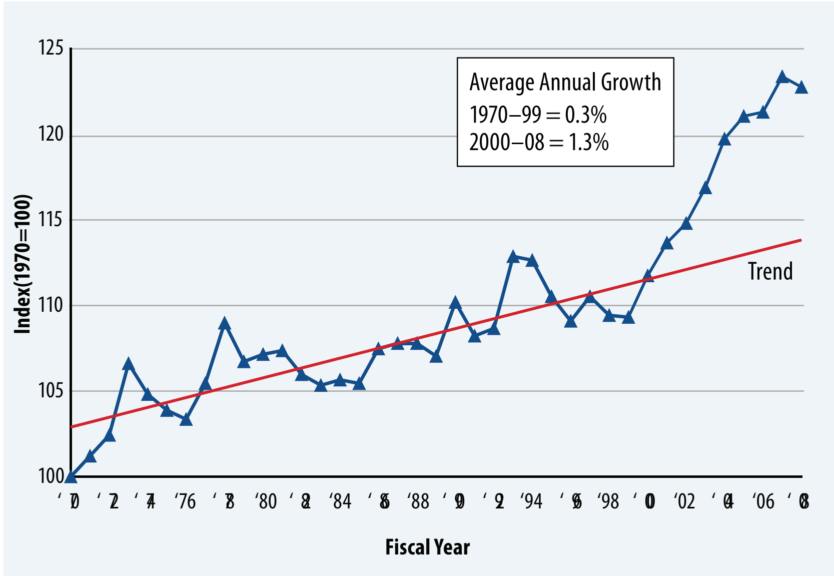
TFP measures productivity while distinguishing controllable factors from those, such as the price of fuel or the volume of mail, that are largely externally driven. *Id.* at 54.

For the eight years prior to FY 2008, TFP had been improving. However, in FY 2008, TFP declined 0.5 percent, which is a relatively small amount. In the 2008 Comprehensive Statement on Postal Operations, the Postal Service stated that despite a 50 million workhour reduction TFP declined primarily due to large volume declines that occurred rapidly and to the inability of the Postal Service to adjust resources quickly enough so as to maintain a positive TFP. Figure IV-1 shows the growth of TFP since 1970.

For FY 2009, the Postal Service plans very aggressive cost reduction strategies. It plans to double the 50 million workhour savings experienced in FY 2008 to 100 million – the equivalent of 50,000 full-time employees. The Postal Service believes it will achieve the workhour savings due to the automation investments in Intelligent Mail® and the Flats Sequencing System (FSS), and process improvements (Lean Six Sigma and value-stream mapping) which could enhance productivity.

The Postal Service claims that automation has been the most important factor in service and productivity gains and the Postal Service has pledged to continue to invest in advanced systems that will reduce manual handling, improve consistency, and standardize

Figure IV-1.
U.S. Postal Service Total Factor Productivity (TFP)
1970–2008



Source: Postal Service Annual Tables, FY 2008 TFP

processes. The Postal Service believes that the FSS will improve service consistency because it will allow deliveries to begin earlier in the day, reduce routes and vehicles, and eliminate facility space currently dedicated to carrier sorting. Vision 2013 at 3.

A December 23, 2008 audit report by the Office of Inspector General, Postal Service, indicated that the FSS machine performance is not meeting two key performance metrics—throughput and acceptance rates. Report No. DA-AR-09-001. The Postal Service average acceptance rate results, at the Dulles Processing & Distribution Center for October 2008 was 89.1 percent. However, the contractually required acceptance rate was 95 percent. Thus, the 6 percentage point difference is problematic. In addition to the FSS not meeting the contract requirements for acceptance rate, the machines do not meet the required throughput rate of 16,500 pieces per hour. Also, volume reductions in the daily sort plans may make it difficult to achieve the required throughput. As of December 17, 2008, the Postal Service was analyzing flats volume and the potential impact on the FSS program. During the February 2009 Board of Governors meeting, there was mention that the FSS throughput rate continues to be an issue.

Workhours

The Postal Service strives to match workload with resource usage. With volumes declining during the year the use of workhours in mail processing, retail services, city carriers, maintenance, and other functions were reduced by over 50 million with overtime workhours providing almost 80 percent of the reductions. Workhours were reduced in all functions except for rural carriers. Since FY 2000 workhours have been reduced each year except for one, FY 2005.

Table IV-6 shows that in the past nine years, the Postal Service was able to reduce workhours by 268 million and save about $9.8 billion in labor costs. That was an average savings of more than $1 billion per year, a remarkable achievement for an organization that is labor intensive.

Table IV-6.
U.S. Postal Service Change in Workhours and Labor Compensation

Time Period	Workhours Change (Millions)	Compensation Change ($ Millions)
1970-1979	(76.5)	(554.1)
1980-1989	287.4	4,971.1
1990-1999	148.7	3,733.0
2000-2008	(268.0)	(9,811.9)
2008	(49.6)	(2,023.8)

Source: Postal Service Annual Tables, FY 2008 TFP.

Table IV-7
U.S. Postal Service Savings in Workhours and Compensation in the Past Nine Years FY 2000–FY 2008

	Workhours Reduction (Millions)	Compensation Savings ($ Millions)
Supervisors	13.5	575.1
Clerks & Mail Handlers	227.5	7,987.3
Carriers & Vehicle Drivers	21.0	1,035.1
Other Employees	6.1	214.3
Total	268.0	9,811.9

Source: Postal Service Annual Tables, FY 2008 TFP.

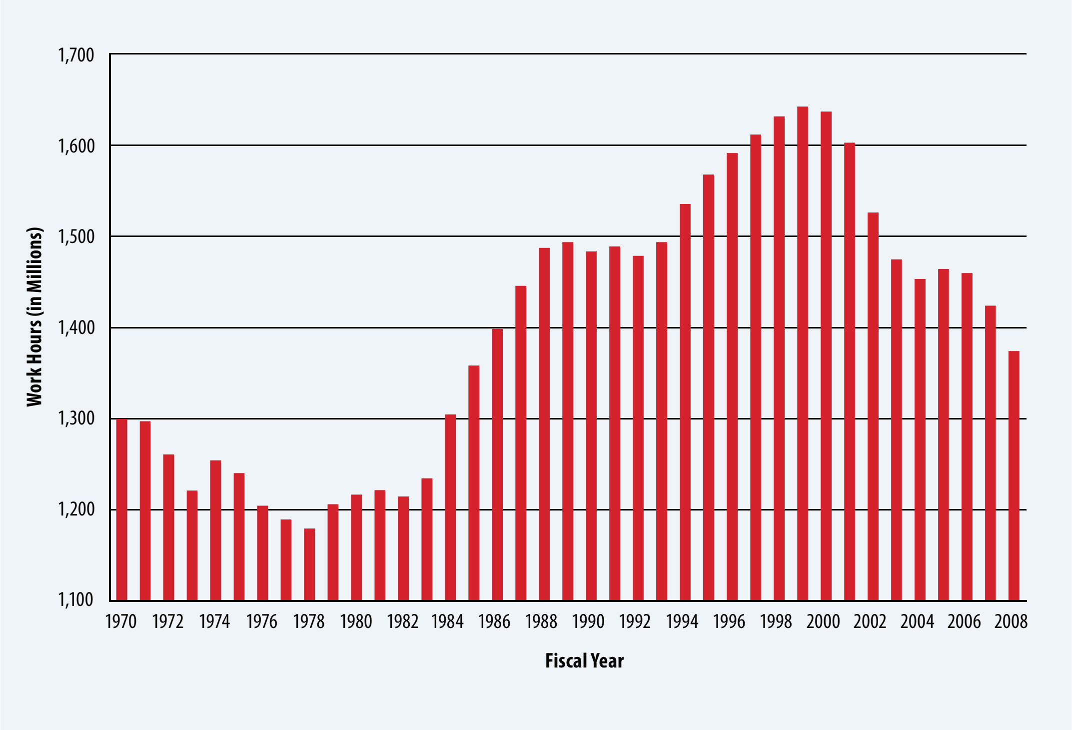
The cut in workhours helped TFP growth. Over the same period the TFP cumulative growth was 11.4 percent. In contrast, it took the Postal Service 30 years (1970-1999) to gain 9.2 percent cumulative growth in TFP.

Table IV-7 shows that clerks and mail handlers saw the greatest reduction in workhours of 228 million hours or 85 percent of total workhours reduced.

Figure IV-2 illustrates the number of workhours in each fiscal year since 1970. Peaking in 1999, the Postal Service began various cost-cutting measures to decrease its workhours. Some of the reasons offered by the Postal Service for the cost savings:

- Use of resources to smooth the changing workload resulting from volume fluctuations and the mail makeup
- Capital investment in processing and handling equipment, and
- Changing and streamlining processes as an industry from creation to delivery of mail, eliminating waste and redundancy

Figure IV-2.
U.S. Postal Service Workhours FY 1970–FY 2008



Source: Postal Service Annual Tables, FY 2008 TFP.

Customer-focused Culture[3]

The Postal Service uses six questions from its Voice of the Employee (VOE) survey to track employees' attitudes. The survey is managed by an independent third party and each employee is given the opportunity to respond. Over 60 percent of postal employees responded. The survey measures employees' perceptions of recognition, accountability, harassment and discrimination, organizational communications and being treated with dignity and respect. For FY 2008, the actual survey index score was 63.7 which is up 0.2 points from the FY 2007 score of 63.5; plan was 63.6 indicating that the Postal Service improved its performance by more than by 0.1 points. The FY 2009 plan is to be 0.1 points better than FY 2008's actual. Formal Equal Employment Opportunity (EEO) complaints for FY 2007 were 0.8 per 100 employees and remained the same for FY 2008.

[3] In the FY 2008 Comprehensive Statement the Postal Service refers to this goal as Improve Safety and Employee Satisfaction. pg. 54.

CHAPTER V - SERVICE STANDARD PERFORMANCE

The primary findings for Service Standard Performance are:

- On-time percentage for single-piece First-Class Mail has increased;
- While the on-time percentage has increased for Package Services it is still only 64 percent;
- The Commission has some concerns regarding the adoption rate of IMb.

39 U.S.C. § 3652(a)(2)(B) requires the Postal Service to provide information on the quality of service for each market dominant product, including the speed of delivery and reliability, and the degree of customer satisfaction.

In its ACR filing, the Postal Service provided limited FY 2008 delivery service performance data for First-Class Single-piece letters/postcards, Inbound and Outbound Single-piece First-Class Mail International, and Package Services.

Postal Service Measurement Systems

Speed of Delivery

The existing systems for measuring the delivery performance of market dominant products are: (1) the External First-Class Measurement System (EXFC) for single-piece First-Class Mail; (2) the International Mail Measurement System (IMMS) for Inbound and Outbound Single-piece First-Class Mail International; and (3) the Delivery Confirmation service for Package Services.[1] In May 2009, the Postal Service will open enrollment for the full-service Intelligent Mail barcode (IMb) for First-Class Mail, Standard Mail, Package Services and Periodical Mail. The IMb performance measurement system is expected to provide qualified mailers the ability to track the progress of each mail piece from acceptance to delivery and will be used in reporting service performance scores.

External First-Class Measurement System

EXFC measures delivery performance from the collection box to mailbox. The system is managed by an independent contractor, IBM Global Business Services, and uses test mailpieces sent to a nationwide panel of receivers.[2] "The number of pieces entered from each postal district is proportionate to the corresponding origin-destination volumes by service standard."[3] Currently, EXFC tests a sample of 463 3-digit ZIP Code pairs based upon geographic area and volume density.[4] In FY 2008, the Postal Service expanded EXFC to encompass nearly all 3-digit pairs.[5] In FY 2009, the EXFC service measurement will expand to 891 3-digit ZIP Code pairs.[6]

As noted in Table V-1, in FY 2008, the Postal Service's on-time performance for single-piece First-Class overnight delivery areas was 96.5 percent. 2-day and 3-day on-time delivery performances were 94.1 and 91.7 percent, respectively. ACR2008, at 13.

As stated in the Annual Compliance Determination (ACD) for 2007, the Commission found that future annual compliance reports should provide annual performance results without exclusionary periods, such as the heavier than usual holiday mailing periods. ACD2007 at 54. For 2008, the Postal Service performance comparison data followed the Commission's request and was based on data without exclusionary periods. The Postal Service's EXFC FY 08

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[1] Retail Package Services composite performance as measured by Delivery Confirmation includes single-piece Parcel Post, Bound Printed Matter, Media and Library Mail.

[2] The ZIP Code areas are selected on the basis of geographic and volume density.

[3] Postal Service's Comprehensive Statement on Postal Operations 2008, at 17.

[4] The areas represent 90 percent of originating First-Class Mail volume and 80 percent of destinating First-Class Mail volume. ACR2008, at 12.

[5] *Id*.

[6] Postal Service ACR2008, at 14.

Table V-1
First-Class Single-Piece Delivery Performance

EXFC Measurement Plan	FY 07 Actual	FY 08 Plan	FY 08 Actual	Variance from FY 07	Variance from Plan
Overnight	95.6%	96.0%	96.5%	0.9 pts	0.5 pts
2-day	92.4%	92.8%	94.1%	1.7 pts	1.3 pts
3-day	89.6%	90.5%	91.7%	2.1 pts	1.2 pts

Source: United States Postal Service Comprehensive Statement on Postal Operations 2008, at 53.
ACR2008, at 13.
ACD2007 at 53.

overnight, 2-day and 3-day performance exceeded the FY 2008 plan.[7] The improvement in service performance is commendable.

The Postal Service credits the improvement in service performance to key processing and transportation initiatives that tracked mail using a full 24-hour period known as the "24-hour-clock." The process identified "pieces-at-risk" and gave field managers the necessary tools and reports "to focus on specific processes and timeframes to improve the quality of distribution and improve mail flow through processing facilities and into delivery units." *Id.* at 14.

International Mail Measurement System (IMMS)

The International Mail Measurement System (IMMS) provides an independent (third party) measure of the domestic leg of the transit time for Inbound and Outbound Single-piece First-Class Mail International. ACR 2008 at 12. Outbound Single-piece First-Class Mail International is measured from the collection box to the designated U.S. International Mail processing center. Areas measured conform to the areas tested in EXFC. The transit time measured for Inbound Single-piece First-Class Mail International begins when the mailpiece arrives at the international processing center and ends when the mailpiece is delivered. On-time performance is measured using the same set of service standards as domestic First-Class Mail because the focus is on the domestic leg of transit. *Id.* at 13. For FY 2008, the combined IMMS single-piece First-Class international on-time service performance for letters was 93.4 percent which is an improvement of 2.0 percentage points over FY 2007 performance. The improvement in the combined IMMS International service performance score is admirable. Table V-2 illustrates this.

Table V-2
Single-piece First-Class Mail International

IMMS	FY 08	FY 07	Change
Single-Piece	93.4%	91.4%	2.0 pts

Source: ACR2008 at 13.
ACD2007 at 54.

UNEX Measurement System

A separate measurement system, UNEX, is used to calculate terminal dues revenue to the Postal Service. UNEX is an end-to-end diagnostic quality of service monitoring system that measures Postal Operators' performance for International Mail delivery. It is based on test letters using RFID technology traveling anonymously along International Mail streams. Mail to and from 39 countries are currently measured using UNEX. However, only the inbound scores are used to calculate terminal dues. (http://www.ipc.be) *See* also, Response of the Postal Service to Commission Information Request 2, question 2.

The Commission noted that there were significant differences in the performance scores reported by the UNEX and IMMS measurement systems. Since the calculation of terminal dues revenue is based upon the inbound scores and the UNEX score was substantially lower than the IMMS score, the Commission was concerned that inbound performance may be much

[6] In 2007, testing was suspended in three-digit ZIP Code areas 700 and 701 as a result of the impact of Hurricane Katrina. In 2008, testing continued to be suspended in ZIP Code areas 700 and 701 for quarters one and two. ACR2008 at 13.

lower than outbound. The Commission requested that the Postal Service provide both the inbound and outbound IMMS performance scores for comparison purposes.

In response to the Commission's second information request CIR No. 2, question 2, the Postal Service provided the IMMS inbound and outbound service performance separately. For Inbound Single-piece First-Class Mail International, overnight service was 94.6 percent; 2-day service was on-time 90.3 percent; and, 3-day service 89.1 percent. For Outbound Single-piece First-Class Mail International, overnight service performance was 96.3 percent; 2-day was 96.1 percent and 92.1 percent. *See* Table V-3. The difference between the inbound and outbound IMMS scores is not considered significant.

Table V-3
Single-piece First-Class Mail International (Inbound and Outbound)

Single-Piece	Overnight	2-day	3-day
Inbound	94.6%	90.3%	89.1%
Outbound	96.3%	96.1%	92.1%

Source: CIR No. 2, question 2.

The Commission notes the difference between IMMS and UNEX measurements. A possible explanation could be that the systems measure performance from different starting points. UNEX measurement begins at the time mail clears customs while IMMS measurement begins when the mailpieces are first scanned by the Postal Service. This could indicate that mail sits on the dock after it clears customs but before it receives its first scan. *The Postal Service should investigate mail handling practices at the point of entry to ensure mail is being moved quickly and efficiently after customs, particulary since terminal dues revenues are based on the UNEX performance.*

Delivery Confirmation

Delivery Confirmation is used to measure on-time delivery performance for retail package services. When retail clerks receive parcels with the Ancillary Delivery Confirmation Service, they scan the Delivery Confirmation barcode at a point-of-service terminal or with an Intelligent Mail handheld scanning device to "start-the-clock." At the delivery point or attempted delivery, the barcode is scanned again to "stop-the-clock."

For FY 2008, the on-time Package Services performance was 63.9 percent. ACR at 13. This is a 6.2 percentage point improvement over the FY 2007 ACD on-time score of 57.7 percent. ACD 2007 at 54. While the Postal Service has made progress in improving Package Services performance, a great deal of improvement is needed. *See* Table V-4.

Table V-4
Package Services

Delivery Confirmation	Actual FY 2008	Actual FY 2007	Variance
Package Services	63.9%	57.7%	6.2 pts

Source: FY 2008 ACR at 13.
FY 2007 ACD at 54.

As Valpak mentioned in its Initial Comments, the Delivery Confirmation scans presumably reflect successful scans—a mail piece gets both an initial and a final scan. Valpak Initial Comments at 62-63. The Postal Service provides no information on the number of total packages receiving an initial scan nor did the Postal Service provide the total number of packages getting a final scan. For example, if the Postal Service fails to get a start and an end scan on a delivery confirmation mail piece, the mail piece data is not included when the performance score is calculated. Limiting data evaluation to only those mail pieces with both a successful start and end scan can bias results. The failure to understand the magnitude of the missing records would hinder the evaluation of whether or not a Delivery Confirmation scan is the appropriate service performance measurement tool for Package Services.

Noticeably absent from the IMMS and Delivery Confirmation performance tables are the Postal Service's performance targets. As noted by Valpak in its Initial Comments on the United States Postal Service FY 2008 Annual Compliance Report, January 30, 2009, the specific performance targets were to be specified by June 19, 2008. Valpak observes that while actual performance scores are available for both FY 2008 and FY 2007, and improvements are noted, one cannot tell how the scores relate positively or negatively to the Postal Service's targets. A comparison of actual performance to the targeted performance would allow the Commission to see if the Postal Service is meeting its service performance targets as well as understanding whether the Postal Service plans on improving service performance or letting performance slip to possibly save money. The Commission noted, in its Report on Universal Postal Service and the Postal Monopoly at 198, that "[g]iven the brief interval of time between the enactment of the PAEA and the present, the modern service standards have not been fully implemented. More time is required to determine if the service standards promulgated under section 3691 are adequate to meet the needs of the Nation."

In February 2009, the Postal Service posted its FY 2009 targets on its Rapid Information Bulletin Board System Postal Service's Rapid Information Bulletin Board System (RIBBS) webpage. The link to that site is: http://ribbs.usps.gov/targets/documents/tech_guides/Targets.pdf. The targets are available for First-Class Mail, Standard Mail, Periodicals, Package Services and Special Services. The Postal Service continues to work on developing more complete service performance measurement systems, i.e., Intelligent Mail barcode (IMb). *The Commission will address the reporting requirements for service performance in a separate rulemaking during 2009.*

Implementation Of Intelligent Mail Barcode

The PAEA mandates that external measurement systems be used for measuring service performance unless alternate systems are approved by the Commission. Postal Service maintains that reliable external measurement of all real mail products, rather than test mail, would be very expensive and difficult to implement, thus they have proposed an internal measurement system for presort First-Class Mail, Standard Mail letters, and Standard Mail flats that relies on internal Intelligent Mail barcode (IMb) scans in conjunction with delivery information via external third-party reporters. An internal measurement system is also being developed for Periodicals mail. The Commission approved the proposed methods for the internal measurement of service performance of various market dominant products in Order No. 140.

PostCom and Valpak have suggested that the Commission use additional methods to evaluate operational performance targets and the implementation status of the proposed hybrid service performance measurement system which depends on the implementation and adoption of the IMb. The Commission agrees that information on service performance targets and the IMb implementation/adoption status is vital for mailers to have a reasonable expectation for service performance.

The Postal Service is actively engaged in extensive work with many industry leaders as well as the Mailers Technical Advisory Committee (MTAC) regarding IMb implementation and the development of internal measurement systems using IMb. Progress reports and pilot data results are shared with Industry leaders and the Commission on a regular basis. Mailers and other interested parties will have access to performance targets, updates, and progress reports on the (RIBBS) website.

These efforts may result in a smoother implementation of and higher adoption rate for full service IMb. Nonetheless the Commission is concerned about the level of mailer participation and its effect on the accuracy of the performance measurements. These concerns are detailed in order No. 140 at 13-15.

Tail-of-the-mail

In the FY 2007 ACD the Commission suggested that the Postal Service provide days-to-delivery data on tail-of-the-mail, in its subsequent filings, reflecting the days-to-delivery until 99 percent delivery was achieved. The Postal Service did not provide this data for the 2008 ACR. However, for FY 2009 quarter one, the Postal Service began posting on its website quarterly on-time service performance and tail-of-the-mail data for market dominant products. FY 2009 quarter one on-time and tail-of-the-mail data is available for First-Class Single-piece Mail by district for overnight, 2-day, and 3-day to five-day delivery. For First-Class Presort, on-time and the tail-of-the-mail performance is reported by region. The combined Inbound and Outbound Single-piece First-Class Mail International on-time and tail-of-the-mail performance is reported by region. On-time performance for Standard Mail is reported by destination entry and by end-to-end. Standard Mail performance is reported by region. Periodical on-time performance and tail-of-the-mail is reported by region. Package Service's on-time performance and tail-of-the-mail is available by district. The FY 2009 quarter one service performance scores are available at: http://www.usps.com/serviceperformance/.

CHAPTER VI — MARKET DOMINANT PRODUCTS

Introduction

This chapter presents the Commission's analysis of the financial results and rate design for each market dominant class, for market dominant negotiated service agreements (NSAs), and for market dominant international products. The financial analysis focuses on cost coverage and pricing issues, including whether the class and its products generate adequate revenue to cover attributable costs.

Each class section also contains a discussion of rate design issues. Methodological issues affecting the development of estimates of worksharing related cost avoidances are addressed, the resulting cost avoidances are compared with the corresponding discounts, and the discounts and other rate relationships are analyzed.

In the decades before enactment of PAEA the Commission endorsed the principles of efficient component pricing (ECP) when reviewing and designing workshare rate discounts. This rate design method fostered economic efficiency by tying discounts to the costs the Postal Service expected to avoid as a result of mailer worksharing. Consistent application of ECP principles provided needed predictability and stability. While the basic tenets of this method were generally adhered to, the Commission, the Postal Service, and mailers came to recognize through experience that certain circumstances justified variation from rates that strict application of the principle might initially indicate. These principles and exceptions were applied by the Postal Service to build the strongest and most successful postal market in the world.

Both the basic principles of ECP, and the acknowledged exceptions, were carried forward in the workshare discount provision of PAEA, section 3622(e). In reviewing workshare rates, the Commission has initially examined the extent that discounts conform to or vary from ECP rates. The fact that the discussion generally first focuses on the economic efficiency of rates should not be viewed as implying that the Commission is unaware of, or unconcerned with, the many other statutory rate policies set forth in the objectives and factors sections of the PAEA. *See* 39 U.S.C. § 3622(b) and (c). Good ratemaking involves balancing multiple considerations.

By practice, Commission rate review has started with the cost based ratemaking factors, and applied other policies to explain variations from cost-based rates. The Postal Service has followed that convention in it's Notices of Rate Adjustments. That practice is carried forward in this discussion. Where the Postal Service rates vary from ECP, the Commission looks to the Postal Service to provide some explanation of the variation, whether it came about to further a particular statutory policy, or whether it was simply the unintended consequence of unexpected variation in the market or in operations. The PAEA directs the Commission to engage in after-the-fact review of whether rates successfully achieved multiple rate policies. Such review provides beneficial transparency and should, over time, enable the Postal Service to improve its ability to design rates to achieve these multiple objectives.

Since the publication of the FY 2007 ACD, the Postal Service petitioned the Commission to consider 13 distinct methodological changes. *See,* e.g., RM2008-2. Those which affect cost attribution and the development of group-specific costs are discussed in Appendix B. Several of the changes relate to intra-class cost measurement, including worksharing cost avoidance. Each of these is briefly discussed in the relevant class section below.

In this year's ACR, the Postal Service introduced several additional changes in methodology. *See* PRC Order No. 169 (January 12, 2009). Most are specific to a class and are discussed in the sections below. One of the changes affected both First-Class Mail and Standard Mail. The Postal Service incorporates the results of a letter density study that, for the first time, develops separate densities for First-Class Mail and Standard Mail. It also includes re-feed percentages for some operations that previously did not have them. The use of this study has relatively minor effects on the results of letter worksharing cost avoidance for First-Class and Standard and no commenter opposes its adoption. The Commission adopts the results of the new density study.

In its review of the Postal Service's ACR documentation, the Commission discovered that the First-Class and Standard Mail letter cost model inputs for the optical character reader (OCR) piggyback factor and remote encoding center (REC) productivity were taken from different sources than the previous year. In response to questions from the Commission, the Postal Service acknowledged that these changes were inadvertent. Response to CIR No. 3, Questions 2 and 3 (February 13, 2009). The Commission's analysis uses the corrected input sources.

The Commission also notes that the productivity for the 3-pass delivery point sequence (DPS) operation in the letter cost models is not updated for 2008. In response to a Commission inquiry, the Postal Service states that it only has 12 monthly observations in MODS for the operations, and that the already small role for the equipment appears to be diminishing. It observes that the available data for 2008 imply a productivity in excess of the maximum machine throughput and concludes that "the remaining volumes and workhours were no longer being consistently recorded[.]" It therefore asserts that the FY 2007 data are the best available. Response to CIR No. 3, Question 4. The Commission understands that this operation plays a small role in mail processing and its productivity has a similarly small effect on the model outputs. *If the 3-pass DPS equipment is to remain in use for the foreseeable future, a remedy should be found so that the analysis is based on reliable-up-to date information*.

To enable a clear focus on the central purpose of this report, the types of methodological changes identified in Order No. 169 should be considered in separate proceedings and not in the annual compliance review. Ideally, methodology changes would be proposed with sufficient time before the Postal Service files its ACR so as to allow for a Commission ruling prior to the ACR filing. This will allow the Commission and interested persons to spend the limited time available for this report to focus on compliance issues, instead of evaluating and debating methodologies.

The rates for market dominant mail are discussed in detail in the following sections. For each class, a financial analysis is presented, methodological issue raised by commenters are addressed, and the findings and evaluation of the applicable statutory provisions are explained. Where an inconsistency with the statute is identified, relevant events since the conclusion of the fiscal year (e.g., rate adjustments in Docket No. R2009-2) are considered and the appropriate remedial action, if any, is described.

First-Class Mail

Introduction

The class consists of six products: Single-piece Letters and Cards, Presort Letters and Cards, Flats, Parcels, Outbound Single-piece First-Class Mail International, and Inbound Single-piece First-Class Mail International. First-Class Mail had a volume of 91.7 billion pieces in FY 2008 and made a contribution of $19.1 billion. First-Class Mail accounts for 45 percent of total volume and 65 percent of total contribution. Contribution-wise this is the most important class of mail.

The most controversial issue for First-Class is the development of workshare discounts. The established methodology uses the difference between bulk metered mail (BMM) workshare cost and automation mixed AADC letters. That difference is then subtracted from the price for the First-Class one-ounce letter to calculate the rate for a one-ounce automation mixed AADC letters. As discussed below, the Postal Service contends that the Automation mixed AADC presort letter discount is not a worksharing discount and therefore is not subject to the workshare provision of the PAEA. Ultimately, the Commission has chosen to resolve this issue through a rulemaking procedure (Docket No. RM2009-3).

The primary concerns for First-Class in FY 2008 are:

- Revenues did not cover the attributable cost of presort parcels producing a cost coverage of 88 percent;
- The cost coverage for Parcels was 104 percent;

- Using the established workshare methodology, the year end discount for Automation mixed AADC presort letters exceeded the avoided worksharing cost avoidance.

- *The Postal Service should develop benchmarks and cost avoidance estimates for the least-workshared categories of Flats and Parcels, and the current proxies (flats bundle costs) for presort parcel cost avoidance calculations should be replaced with parcel-specific costs*

Financial Analysis

Table VI-1 presents selected First-Class Mail financial data. First-Class Mail rates recovered 200.4 percent of attributable costs in FY 2008. The Postal Service has reconfigured its data systems to enable the reporting of financial results by product for the first time. A comparison of unit cost data with the subclass-level data from last year shows that Letters, Flats and Parcels unit costs increased by 0.4 percent and Cards decreased by 1.2 percent in FY 2008. These increases are 4 percentage points and 5.6 percentage points below the 4.4 percent increase in CPI-U for the Fiscal Year.[1]

Single-piece Letters and Cards, Presort Letters and Cards, and Flats each recover their attributable costs and make reasonable contributions to institutional costs.

Parcels have a cost coverage of 104 percent, and presort parcels fail to recover attributable costs with a cost coverage of 88 percent.[2] The Postal Service should strive for cost reductions and future rate adjustments to ensure consistency with 39 U.S.C. § 3622 (c)(2) and other sections.[3] The discussion of International First-Class Mail appears in the section on International Mail.

Several commenters address the relative contributions to institutional costs of Single-piece and Presort Letters and Cards, and whether the markups of these products comply with the objectives and factors in § 3622(b) and (c). Pitney Bowes asserts that because Presort Letters and Cards contributes 4.9 cents more per piece to institutional costs than Single-piece Letters and Cards, it should receive a rate increase less than the rate of inflation. Pitney Bowes at 1-2. NPPC urges the Commission to refrain from increasing the markup on Presort Letters and Cards and reducing the markup on Single-piece letters and Cards. NPPC Reply at 4-5. APWU disagrees, arguing that the Commission and the Congress have determined that efficient component pricing within the class overrides consideration of the relative cost coverages of the products. APWU Reply at 1-2.

The arguments of the commenters do not convince the Commission that remedial action is neccessary.

Worksharing and Rate Design: Methodology Issues

As discussed in the introduction to this chapter, the Commission uses the class-specific densities and ISS refeeds from the new density study as well as the corrected REC productivity and OCR piggyback factor references in the letter cost avoidance model. The flats cost avoidance estimates incorporate the modifications to the rate mapping of bundles proposed by the Postal Service and adopted by the Commission in Docket No. RM2008-2, Proposal 8.

MMA objects to the continued use of the delivery costs of non-automation machinable mixed AADC (NAMMA) as the proxy for the bulk metered mail (BMM) benchmark. It advocates a change in methodology, suggesting a change in the proxy and a reconciliation of modeled DPS percentages and sampled carrier cost system (CCS) DPS percentages. MMA at 15-19. MMA also presents an analysis of the recent changes in the results of the cost models, which have been largely driven by changes in input data, and identifies several which it considers anomalous. It notes that some of these changes significantly impact the resulting cost avoidance estimates and suggests that they should be explained by the Postal Service and subjected to the type of vetting that the Commission would require for nonperfunctory changes to input data and analytical methods. MMA at 1-14.

The Postal Service responds that NAMMA is the established and correct proxy for the delivery costs of BMM. It points out that it does not collect DPS percentages by rate category, and argues that MMA's delivery cost calculations are unrealistic. Postal Service Reply at 6. Addressing MMA's criticism of its updating of input data, the Postal Service states that its basic obligation is to follow the established methodology. It

[1] The 4.4 percent increase in CPI-U for FY 2008 is calculated using the same method that determines the amount of the rate cap under § 3010.21.
[2] Each of these types of mail received a below-average rate increase as a result of Docket No. R2009-2.
[3] The desirability of rates that recover attributable costs and make reasonable contributions to institutional costs is also supported by §§ 101(d), 3622(b)(1), and 3622(b)(5).

Table VI-1
First-Class Mail
Fiscal Year 2008 Volume, Revenue, Cost, Contribution, and Cost Coverage by Product

	Volume (000)	Total Revenue ($ 000)	Attributable Cost ($ 000)	Contribution to Institutional Cost ($ 000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
First-Class Mail:								
Single-Piece Letters	33,509,710	14,433,529	8,444,087	5,989,442	43.073	25.199	17.874	170.9%
Single-Piece Cards	1,845,860	505,426	446,544	58,882	27.382	24.192	3.190	113.2%
Total Single-Piece Letters and Cards	35,355,570	14,938,955	8,890,630	6,048,325	42.253	25.146	17.107	168.0%
Presort Letters	48,379,874	16,412,484	5,442,818	10,969,666	33.924	11.250	22.674	301.5%
Presort Cards	3,555,997	738,532	282,322	456,210	20.769	7.939	12.829	261.6%
Total Presort Letters and Cards	51,935,871	17,151,016	5,725,140	11,425,875	33.023	11.023	22.000	299.6%
Single-Piece Flats	2,607,157	3,443,742	2,118,063	1,325,679	132.088	81.240	50.848	162.6%
Presort Flats	772,584	620,085	453,184	166,902	80.261	58.658	21.603	136.8%
Total Flats	3,379,740	4,063,827	2,571,247	1,492,580	120.241	76.078	44.163	158.0%
Single-Piece Parcels	595,014	1,106,314	1,061,737	44,577	185.931	178.439	7.492	104.2%
Presort Parcels	10,507	15,892	18,091	(2,199)	151.245	172.174	(20.929)	87.8%
Total Parcels	605,522	1,122,205	1,079,828	42,378	185.329	178.330	6.999	103.9%
Total Domestic First-Class Mail	**91,276,703**	**37,276,003**	**18,266,845**	**19,009,158**	**40.838**	**20.013**	**20.826**	**204.1%**
Total International First-Class Mail	420,034	903,317	782,993	120,324	215.058	186.412	28.646	115.4%
Total First-Class Mail	**91,696,737**	**38,179,320**	**19,049,838**	**19,129,482**	**41.637**	**20.775**	**20.862**	**200.4%**

Source: PRC-ACR2008-LR1.

argues that using FY 2008 input data, because it is the most recent available data, is part of the established methodology. Postal Service Reply at 3.

The Postal Service also addresses MMA's concerns about the relationship between the mail processing costs of automation and non-automation mixed AADC letters. It explains that each type of mail enters a different operation for its first sort, and the densities of the operations are different because of different mixes of local and nonlocal destinations for the mail types. While nearly half of non-automation mixed AADC letters are sorted to the 5-digit level in the first operation, less than 10 percent of automation mixed AADC letters are sorted to the 5-digit level in the first operation. Therefore on average, automation mixed AADC letters go through more subsequent operations before being finalized and these additional operations result in additional costs. Postal Service Reply at 3-6.

Pitney Bowes suggests a change in methodology that would develop separate mail processing CRA adjustment factors for incoming secondary operations and for all other (non-incoming secondary) operations. It contends that this modification would produce more accurate estimates of avoided cost, and that these more accurate estimates would justify a larger discount for automation 5-digit presort letters. It also argues in favor of an adjustment to estimated avoidable costs to account for increases in labor costs which, if implemented, would result in larger estimates of avoided cost and justify larger worksharing discounts. Pitney Bowes at 2-5.

The Postal Service replies that a showing of different results from using more disaggregated CRA adjustment factors is not the same as a showing of improved results. It stresses the importance of an awareness of the limitations of MODS data and potential distortions that can result from using the data at finer operational levels. Postal Service Reply at 7-8. APWU disputes Pitney Bowes' assertions about future increases in labor costs, stating that the anomalous labor cost increases during 2008 were the result of a combination of a cost-of-living increase and an upgrade in salary level, neither of which will be repeated in Fiscal Year 2009. It further argues that efficiency gains and cost reduction programs should lead to a reduction in avoided costs. APWU Reply at 2-3.

As in the Fiscal Year 2007 ACR, the Postal Service takes the position that discounts between rates in different products are not worksharing discounts as defined under § 3622(e)(1) ("rate discounts provided to mailers for the presorting, prebarcoding, handling, or transportation of mail, as further defined by the Postal Regulatory Commission under subsection (a)"). *The Postal Service's position is that the use of the phrase "with respect to each market dominant product" in the Postal Service reporting requirements of § 3652(b) effectively limits the Commission's application of the worksharing regulation aspects of the system of modern rate regulation in § 3622(e).* FY 2008 ACR at 50-51. The Postal Service maintains that it does not dispute the correctness of the methodology for calculating avoided costs, but seeks a change in the application of the results based on a legal interpretation that the results are not relevant to determining compliance with § 3622(e). Docket No. R2009-2, Response to CHIR No. 1 at 3 (February 20, 2009).

APWU opposes the proposed change and expresses concern that the Postal Service appears to be deliberately ignoring instruction from the Commission. It urges the Commission to stop "the Postal Service's attempts to depart from the law incrementally." APWU at 3. For discounts that exceed avoided costs as measured using the established methodology, it seeks either appropriate legal justification or a firm commitment to bring discounts into line with avoided costs. *Id.* at 3-4.

The Public Representative's comments in this docket focus on very broad issues relating to the long-term financial health of the Postal Service, but its comments in Docket No. R2009-2 address more specific issues, including this one. The Public Representative disagrees with the Postal Service's legal interpretations, noting that "the Commission has consistently treated these services of presort and single-piece First-Class Mail for purposes of worksharing as inter-related and has not ruled otherwise. The Postal Service's justification for its approach is not new and is without foundation." Docket No. R2009-2, PR at 10. The Public Representative points out that the word "product" does not appear in the section which defines and sets limitations on worksharing discounts (§ 3622(e)) and concludes that the Commission should reject the proposed change and require the Postal Service to file a request to address the issue separately. *Id.* at 10-11.

NPPC disagrees with APWU's assertion that the Postal Service's position contradicts that of the Commission. In support of this understanding, it refers to the Commission's finding of the Postal Service's Docket No. R2008-1 discounts in compliance with § 3622(e), and an interpretation that the Commission declined to resolve in the FY 2007 ACD. The Public Representative further asserts that the demand elasticities of single-piece letters and presort letters and the relative cost coverages lead to the conclusion that the Postal Service could improve its financial position by reducing presort rates and using the additional cap room to further increase single-piece rates. NPPC Reply at 1-5.

Pitney Bowes asserts that based on the analogy between subclasses and products, the Postal Service's proposed approach is consistent with Commission precedent. The Public Representative agrees with the Postal Service's legal interpretations, and supports the proposed change in worksharing discount analysis. Pitney Bowes Reply at 4-5. However in its review of the models that calculate cost avoidances using the proposed change in methodology, Pitney Bowes opposes the incorporation of two additional unapproved changes in methodology. Pitney Bowes at 7-9.

NAA submits comments addressing a related issue that are relevant to the changes proposed in First-Class. It asserts that Congress can be presumed to have understood the Commission's historical treatment of presort discounts. It concludes that if Congress intended to disrupt such historical treatment, it would have explicitly done so. NAA Reply at 6-8.

NAA also argues that § 3622(e) assigns authority for refinements of the definition of worksharing discounts to the Commission. It notes that § 3652(e) authorizes the Commission to prescribe the content and form of the Postal Service's ACR under § 3652. Because it is the province of the Commission to determine the methodologies under which compliance is to be determined, the Postal Service cannot lawfully redefine a worksharing discount. *Id.* at 8-10.

As the Commission noted in last year's ACD, the annual compliance review process is not the appropriate forum to consider the adoption of alternative methodologies. This is especially true for changes which are controversial and have potentially significant impacts on the facts underlying a determination of compliance or noncompliance.

The routine updating of input data that is produced from data collection systems and methodologies that are unchanged from accepted practice is not among the types of changes for which the Commission would require review in separate proceedings. Changes in the results of cost avoidance estimates are not sufficient cause to reject the use of more recent input data. To do so would elevate the goal of obtaining results that are consistent with preconceived expectations above the more important goal of using methodologies that have been properly vetted and designed to maximize the accuracy and applicability of the results.

Last year, the Commission rejected the idea of adjusting estimated cost avoidances for inflation, concluding that "[i]t has not been demonstrated that a simple inflating of the cost avoidances would accurately approximate the combination of changes that affect actual cost avoidances from one year to the next." 2007 ACD at 59. *The Commission is not convinced that its previous conclusion is invalid.*

In the FY 2007 ACD, the Commission did not accept that it was appropriate to restrict the analysis of worksharing discounts to intra-product rates, partly because of the difference between subclasses under PRA and products under PAEA. The Commission further stated that it would not change that determination until full consideration of the advantages and disadvantages of the proposed methodological change in a proper forum. The Postal Service opted to not request such a proceeding prior to filing this year's compliance report, and in its ACR and comments reasserted its previous argument for an exception to the definition of worksharing.

The issue is clearly a complex and controversial one, and a change from the accepted methodology or definition would effectively overturn an accepted economic assumption underlying the Commission's evaluation of worksharing discounts. This would have a substantial impact on the factual basis for determining compliance or noncompliance. Lacking a compelling argument that the current accepted methodology and definition are fatally flawed as to require immediate remedy, this type of change is not proper to introduce or adopt in the context of an annual compliance determination.[4]

Therefore the Commission finds the current methodology, whereby the automation mixed AADC presort letter rate and the non-automation presort letter rate each reflect a worksharing discount from the single-piece letter rate and BMM is the benchmark for determining the worksharing-related costs avoided by the Postal Service, is retained. The Commission evaluates compliance with the limitations of § 3622(e) using the accepted approach, notwithstanding product separations between rates and benchmarks.

For the same reason, MMA's proposals to change the delivery cost proxy for BMM and to adjust the modeled DPS percentages, as well as the Pitney Bowes proposal to use separate CRA adjustment factors for incoming secondary and non-incoming secondary operations are not accepted. Those seeking methodological changes may petition the Commission to initiate a rulemaking proceeding to consider their proposals. Such petitions may take a similar form to those filed by the Postal Service last year (e.g., Docket No. RM2008-2) and need not await the implementation of final rules on periodic data reporting.[5]

[4] In Docket No. RM2008-4, the Commission has issued proposed rules which, under the authority of § 3652(e), prescribe the form and content of the Postal Service's ACR to the Commission. When final rules are adopted they will help inform the issue of the specific form and content of the Postal Service's reporting requirements under § 3652(b) and procedures to alter the prescribed content. Docket No. RM2009-3 will also address the application of 3622(e) to the automation mixed AADC presort letter discount.

[5] Proposals to change workshare discounts should be submitted in Docket No. RM2009-3.

Rate Design Issues

Pitney Bowes asserts that the increase in avoided costs for automation 5-digit presort letters from 2.2 cents in FY 2007 to 2.4 cents in FY 2008 justifies a corresponding increase in the discount. It also states that the Postal Service's estimate of the additional cost of non-automation presort letters, as compared to automation presort letters, should be addressed in rate design by increasing the rate difference between single-piece letters and non-automation presort letters. Lastly, it argues for a "meaningful" discount to encourage full-service Intelligent Mail barcode (IMb) participation, justified by the high contribution of Presort Letters and Cards and the need for data on service performance that widespread adoption of the program would generate. Pitney Bowes at 2-7.

The Commission finds that the cost avoidance of automation 5-digit letters could justify a larger discount, but discounts that are less than avoided costs do not violate the restrictions of § 3622(e). Pitney Bowes has not made an adequate showing to support a determination that the discount violates 39 U.S.C 3622 (e). The Postal Service's method of calculating worksharing cost differences between automation mixed AADC letters and non-automation presort letters is not the accepted methodology for evaluating the non-automation presort rate or its conformity with the requirements of § 3622(e). The accepted methodology uses BMM as the benchmark for the non-automation presort letter discount. *Therefore, the Commission finds no rate adjustment is necessitated by the results of the calculations.* The IMb program was not operational (beyond pilot testing) in the fiscal year covered by this report, so there is no issue with respect to IMb at this time.

Stamps.com proposes a new discount for single-piece mail mailers who use CASS certified software to generate mail meeting the requirements for Basic IMb service and which has cleansed addresses. It asserts that such a discount would help to achieve compliance with §§ 3622(b)(1) (reduce costs and increase efficiency), 3622 (b)(7) (enhance mail security), 3622 (b)(8) (just and reasonable rates), 3622 (c)(5) (degree of mail preparation), and 3622 (c)(13) (promoting intelligent mail). Stamps.com at 2-3.

The Public Representative supports the proposal on the grounds that it has the potential to slow the exodus of profitable single-piece mail from the system and as a means to address the bias of the Mail Classification Schedule in favor of large mailers. In addition, it asserts that a discount could lead to greater participation in IMb, and thus make service performance data more representative. PR Reply at 17. Pitney Bowes also supports the concept of de-averaging rates to reflect cost differences and thus promote efficient mailing practices. Pitney Bowes Reply at 1-3.

Due to the limited scope of the compliance review and the lack of a fully formed proposal, Stamps.com's proposal is not ripe for consideration in this docket. The recently initiated rulemaking (Docket No. RM2009-3) provides an opportunity for Stamps.com to make a more fully-formed proposal. In the rulemaking, the potential merits cited by the commenters can be explored, as well as how the development of distinct rates for user-printed indicia single-piece mail might help to alleviate some of the difficulties in rate design that arise from the current whole-cent rounding constraint.

Results

Tables VI-2 and VI-3 present each First-Class Mail worksharing discount, its associated cost avoidance, and the discount as a percentage of the avoided cost (passthrough).

Currently, there are five worksharing discounts greater than the costs avoided by the Postal Service as a result of the workshare activity: the automation mixed AADC and 3-digit presort discounts for letters, the automation ADC and 3-digit presort discount for flats, and the automation 3-digit presort discount for cards. The Commission recently initiated Docket No. RM2009-3 to consider proposals to modify the established methodology for estimating presort letter cost avoidances and workshare discounts.

When the next rate adjustment is filed, the discounts must be aligned with cost avoidances reflecting the established methodology and any applicable empirical changes in model inputs.

The Postal Service asserted in the recently completed rate adjustment case, Docket No. R2009-2, that to reduce the excess discount embodied in its planned rates would disrupt its and mailers' operational preparation for implementing the rate change and therefore impede the efficient operation of the Postal Service. It claimed the discount was therefore justified under § 3622(e)(2)(D). Docket No. R2009-2 Response to CHIR No. 1 (February 20, 2009). The effectiveness of the modern system of rate regulation could be

Table VI-2
First-Class Mail
Letters, Flats, and Parcels Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	FY 2008 Year-End Discount (cents)	FY 2008 Unit Cost Avoidance (cents)	FY 2008 Passthrough
First-Class Mail Automation Letters			
Barcoding & Presorting			
Automation mixed AADC Letters (Bulk Metered Mail (BMM) Letters)	5.1	4.5	112.2%
Automation AADC Letters (Automation mixed AADC Letters)	1.8	2.2	83.5%
Automation 3-digit Letters (Automation AADC Letters)	0.5	0.3	166.0%
Automation 5-digit Letters (Automation 3-digit Letters)	2.2	2.4	90.4%
First-Class Mail Automation Flats			
Barcoding & Presorting			
Automation ADC Flats (Automation Mixed ADC Flats)	13.2	8.4	157.5%
Automation 3-digit Flats (Automation ADC Flats)	9.1	6.1	150.0%
Automation 5-digit Flats (Automation 3-digit Flats)	11.5	16.2	70.9%
First-Class Mail Presorted/Business Parcels			
Barcoding & Presorting			
Presort 3-digit Parcels (Presort ADC Parcels)	6.0	48.0	12.5%
Presort 5-digit Parcels (Presort 3-digit Parcels)	14.7	22.1	66.6%
First-Class Mail Non-automation Letters			
Presorting			
Non-automation Presort Letters (Bulk Metered Mail (BMM) Letters)	2.6	5.8	44.9%
Qualified Business Reply Mail			
Barcoding			
QBRM[1] (Handwritten Reply Mail)	2.3	2.3	101.4%

Source: PRC-ACR2008-LR3

Notes: Where discounts are equal to unit avoided costs, the calculated passthroughs may deviate from 100 percent because passthrough percentages are based on unrounded unit avoidable costs.

[1] The QBRM cost avoidance presented here is estimated using the Postal Service methodology. The Commission found in R2006-1 that this underestimated avoided costs, but that the alternative on the record overestimated avoided costs.

Table VI-3
First-Class Mail
Cards Workshare Discounts and Benchmarks

	FY 2008		
Type of Worksharing (Benchmark)	**Year-End Discount (cents)**	**Unit Cost Avoidance (cents)**	**Passthrough**
First-Class Mail Automation Cards			
Barcoding & Presorting			
Automation mixed AADC Cards (Non-automation Presort Cards)	1.9	2.9	65.6%
Automation AADC Cards (Automation mixed AADC Cards)	1.0	1.2	84.2%
Automation 3-digit Cards (Automation AADC Cards)	0.3	0.2	187.4%
Automation 5-digit Cards (Automation 3-digit Cards)	1.1	1.3	84.0%
Qualified Business Reply Mail Barcoding			
QBRM[1] (Handwritten Reply Cards)	2.3	2.3	101.4%

Source: PRC-ACR2008-LR3

Notes: Where discounts are equal to unit avoided costs, the calculated passthroughs may deviate from 100 percent because passthrough percentages are based on unrounded unit avoidable costs.

[1] The QBRM cost avoidance presented here is estimated using the Postal Service methodology. The Commission found in R2006-1 that this underestimated avoided costs, but that the alternative on the record overestimated avoided costs.

significantly diminished if the Postal Service were to regularly announce rate adjustments that include discounts in excess of avoided costs and then justify them by claiming any modification to the announced rates would be so disruptive to implementation as to impede the efficient operation of the Postal Service. *The Postal Service should notify the Commission far enough in advance of its planned implementation date to allow for smooth application of the modern system of rate regulation.*

In Docket No. R2009-2, the Postal Service reduced the discounts for automation 3-digit letters, automation 3-digit flats, and automation 3-digit cards to equal the corresponding avoided costs, effectively resolving the issue.

The discount for automation ADC flats was also reduced in the recent rate adjustment, but it remains in excess of avoided costs. However, the Postal Service claimed that further reduction in the discount at this time would result in excessive rate shock, and that it would phase out the excess discount over time. § 3622(e)(2)(B). *With the expectation that the Postal Service will phase out the excess discount in future rate adjustments, no further action is necessary at this time.*

While the PAEA does not impose a minimum passthrough of avoided costs for worksharing discounts, parts of the law (including § 3622(b)(1) on incentives to increase efficiency and § 3622(c)(5) on reflecting the degree of mail preparation) do provide a rationale for promoting efficient mailing choices by mailers, which 100 percent passthroughs of avoided costs does help to achieve.

In Docket No. R2009-2, the Postal Service increased the discounts for automation AADC letters, automation 5-digit flats, and automation 5-digit cards to equal the corresponding avoided costs. The discounts for automation 5-digit letters, non-automation presort letters, and automation AADC cards were left unchanged despite being less than avoided costs. The discount for automation mixed AADC cards was reduced to a level further below avoided costs. *The Postal Service should use future rate adjustments to move the passthroughs for these discounts closer to 100 percent to promote economic efficiency unless competing objectives and factors compel otherwise, in which case the Postal Service should provide an explanation consistent with* 39 U.S.C. § *3010.14(b)(5).*

The Commission stated in the Fiscal Year 2007 ACD that it anticipated that the Postal Service would collect actual cost data for business parcels and move discounts towards 100 percent of avoided costs. While understanding that volumes for this service are low and the rate design is relatively new, the Postal Service should ultimately develop cost avoidances that are specific to presort parcels and replace the flats bundle proxy costs currently used. A better understanding of costs would also assist in developing rates that ensure that this type of mail contributes to institutional costs in the future.

Finally, with Flats and Parcels each designated as products and with the recent establishment of distinct single-piece rates for letters, flats and parcels, it is appropriate to develop benchmarks and estimates of avoided costs for the least-workshared categories of presort flats and parcels. These issues could be addressed either in Docket No. RM2009-9 or in a subsequent rulemaking.

Periodicals

Introduction

The Periodicals class includes publications such as magazines, newspapers, journals, and newsletters. Eligibility criteria include a minimum amount of nonadvertising (or editorial) content[6]. This requirement distinguishes Periodicals from the other classes and is the basis for according this class special consideration due to its educational, scientific, cultural, and informational (ECSI) value.

Periodicals is comprised of two products: Within County and Outside County. This division parallels the structure of the class before enactment of the PAEA. Within County is typically used by smaller-circulation weekly newspapers for distribution within the county of publication. Pricing mainly reflects the number of pieces in a mailing, presort level, and total weight. The Outside County product consists of publications with a wide variety of circulation sizes, distribution patterns, and frequencies. There are three Outside County categories: Regular (including Science of Agriculture publications), non-profit, and Classroom. Pricing is based not only on number of pieces and weight, but also on other elements, such as bundles, type of container, entry point, machinability and automation.

The profiles of the two Periodicals products differ significantly in terms of volume and revenue. In Fiscal Year 2008, approximately 831 million publications were mailed at Within County prices, generating approximately $93 million in revenue. In contrast, during the same year, 7.8 billion Outside County publications were mailed, generating approximately $2.2 billion in revenues.

The Primary FIndings for Periodicals in FY 2008 are:

- The attributable costs of Periodicals, as a class, exceeded revenue by a little more than $400 million in Fiscal Year 2008, equating to cost coverage of 84 percent;
- The PAEA addresses cost coverage in terms of the class as a whole, so 84 percent is a composite figure. However, Within County, at about 96 percent cost coverage, is quite close to meeting the attributable cost floor requirement in section 3622(c)(2) of title 39, and accounted for approximately 1 percent of the extent to which class revenues were less than attributable costs. *Thus, the focus of most efforts to improve cost coverage necessarily must be on Outside County;*
- *These efforts should be directed mainly at cost control and improved pricing signals so that meaningful progress toward compliance with section 3622(c)(2) can be made;*
- Under the PAEA, the presence of ECSI value provides a justification for worksharing discounts that exceed 100 percent. The Postal Service, in the interest of transparency, nevertheless provides certain data and information about Periodicals worksharing. This shows that in the past year, no Within County discounts exceeded avoided costs and only eight Outside County discounts did so. This is an improvement, for both product

[6] *See* Domestic Mail Manual, 707.4.0, Basic Eligibility Standards, 707.6.0, Qualification Categories. 707.4.13, Advertising Standards.

classes, over last year's results. *The Commission appreciates the Postal Service's inclusion of this information;*

- The Commission makes several revisions to revenues, attributable costs, and unit attributable costs for categories used to calculate unit avoided costs for Periodicals based on Postal Service responses to information requests[7];
- The Commission accepts two of three changes in the Postal Service's underlying methodology for Periodicals. One of the accepted changes affects determination of unit mail processing costs of Within County Non-automation pieces. The other involves using Mail Characteristics data to directly measure the percent of Mixed Area Distribution Center (MADC) sacks sent to certain destinations[8]; and
- *The Commission does not accept the Postal Service's new method for calculating the probability flats have of receiving a mechanized incoming sort.*

Methodology

Pre-filing modifications. In Docket No. RM2009-1, which was established in anticipation of this proceeding, the Commission considered and accepted 13 Postal Service-proposed changes to its flats cost models generally and to the Periodicals' cost model in particular. However, it identified five areas where data collection and cost reduction should be further examined. The areas pertain to the feasibility of collecting periodical-specific data in future field studies estimating Periodicals cost parameters (Modification 2); investigating methods of reducing sack sorting costs (Modification 6); verifying the correlation of bundle and piece sorting mechanization probabilities (Modification 8); examining the feasibility of measuring weight-related cost pools (Modification 9); and examining the anomalies created by assuming the Managed Mail Program is 100 percent mechanized (Modification 10)[9]. The Commission recommends that these topics be examined by the Joint Periodicals Task Force, which has been formed pursuant to section 708 of the PAEA.

Additional modifications. In addition to the 13 modifications proposed and accepted by the Commission in Docket No. RM2009-1, the Postal Service included two other modifications in its ACR filing. The first change involves directly estimating the percent of Mixed Area Distribution Center (MADC) sacks which are sent only to destinations to which First-Class mail travels by surface transportation by obtaining this percentage directly from the Mail Characteristics Study.[10] The Commission agrees with the Postal Service that using a data source, rather than an estimate, is a more reliable method of obtaining this percentage, and therefore accepts this change.[11]

The second change involves the Postal Service's use of the new, directly calculated, percentage of flats that receive an incoming secondary sort to derive a new figure for the percentage of flats receiving a mechanized incoming sort. It does this by reversing the previously accepted formula that calculated the percentage of flats receiving a mechanized incoming secondary sort. Based on this new methodology, the Postal Service estimates the probability a flat receives a mechanized incoming secondary sort to be 98.82 percent.[12]

The Commission does not include this modification in its ACD for Fiscal Year 2008. Once the Commission approved the Postal Service's proposal to directly estimate the probability of flats receiving a mechanized incoming secondary sort, the formula that had been used to make this calculation in ACR2007 was superseded and therefore no longer recognized as an approved methodology or formula.[13] Consequently, the Commission does not believe it is appropriate to rely on the earlier formula to determine the incoming mechanization rates for Periodical flats. It also notes that continued use of this formula could easily produce the illogical result that more than 100 percent of

[7] *See* Postal Service Response to CIR No.1, question 11; United States Postal Service Response to CIR No. 2, questions 7, 9-12; United States Postal Service Response to CIR No. 3, questions 2-3,5,6; United States Postal Service Response to CIR No. 4, question 6; United States Postal Service Response to CIR No. 5, questions 1, 5, 9, and 10; and Preface to PRC-ACR2008-LR7.

[8] These sacks, based on a labeling practice, are referred to as L201 sacks.

[9] *See* Docket No. RM 2009-1, Order No. 170.

[10] Responses of the United States Postal Service to CIR No.1, Question 1.

[11] Docket No. ACR2008, USPS-FY08-11, Preface.doc.

[12] The new formula calculates the percent of flats receiving a mechanized incoming sort as being equal to the percent of flats receiving a mechanized incoming secondary sort divided by the percent of plants capable of performing a mechanized incoming secondary sort.

[13] The formula may be found at: Docket No. ACR2007, USPS-FY07-11 Rev.1.18.08, File: Per OC Flats 07ACRv121807.xls, Sheet: Coverage Factors, Cell: D74.

Table VI-4
Periodicals
Fiscal Year 2008 Volume, Revenue, Cost, Contribution, and Cost Coverage by Product

	Volume (000)	Total Revenue ($000)	Attributable Cost ($000)	Contribution to Institutional Cost ($000)	Rev/ Pc. (¢)	Cost/ Pc. (¢)	Contribution to Institutional Cost (¢)	Cost Coverage (percent)
Periodicals								
Within County	830,887	90,614	94,344	(3,730)	10.91	11.35	(0.45)	96.05%
Outside County	7,774,3397	2,204,2427	2,637,966	(433,724)	28.35	33.93	(5.58)	83.56%
Total Periodicals	8,605,227	2,294,857	2,732,310	(437,453)	26.67	31.75	(5.08)	83.99%

Source: PRC-ACR2008-LR5, Coverage Table.xls, Sheet: ACR08 Coverage

Note: Figures may not add due to rounding.

flats will receive a mechanized incoming sort.[14] The Commission retains the previously accepted value of 85 percent for the probability of a flat receiving an incoming mechanized sort, and adjusts the probability of a flat receiving a manual incoming secondary sort to be equal to 1 minus the newly determined probability of a flat receiving a mechanized incoming secondary sort.

Financial Analysis

Tables VI-4 and VI-5 contain pertinent financial data for Within County Periodicals, Outside County Periodicals, and the Periodicals class as a whole. Other tables appear in accompanying workpapers. Table VI-4 shows that for each Periodicals product and or the class as a whole, attributable costs exceeded revenues.[15]

Table VI-5 compares Periodicals cost coverage for this year (using Commission revisions and methodology) to last year. Within County Periodicals cost coverage has improved by approximately 10 percentage points, making its revenues nearly equal to its attributable costs. Outside County Periodical's cost coverage increased by .65 percent. Cost coverage for the entire class improved by nearly 1 percent.

Table VI-5
Periodicals Cost Coverage Fiscal Year 2008 Compared To Fiscal Year 2007

Periodicals	Cost Coverage 2008 (percent)	Cost Coverage 2007 (percent)	Percentage Change (percent)
Within County	96.05%	85.82%	10.23%
Outside County	83.56%	82.91%	0.65%
Total Periodicals	83.99%	83.01%	0.98%

Source: PRC-LR5, Coverage Table.xls, Sheet: Comparison 08 07

Worksharing: Presorting and Prebarcoding

Section 3622(e)(2) generally requires the Commission to ensure that worksharing discounts do not exceed the cost that the Postal Service avoids as a result of the workshare activity (avoided costs). However, the PAEA identifies several exceptions to this general proscription. One, codified in section 3622(e)(2)(C), is relevant to Periodicals, as it authorizes the Commission to allow worksharing discounts that exceed avoided costs if the discount is provided in connection with subclasses of mail consisting exclusively of mail matter with ECSI value.

Notwithstanding this justification, the Postal Service presents worksharing discounts for Within County and Outside County Periodicals in the interest of transparency in its Annual Compliance Report for Fiscal Year 2008.[16] The Commission addresses them here in the same spirit. In general, after adjustments to the Postal Service's filing based on revisions and methodology decisions, 8 out of 18 Outside County presort passthroughs exceeded 100 percent in Fiscal

[14] This would occur if the percent of flats that received a mechanized incoming secondary sort increased by only 1.5 percentage points.

[15] Table VI-4 reflects revisions to the Postal Service's filing based on Postal Service response to information requests identified in footnote 7.

[16] Docket No. ACR2008, United States Postal Service FY 2008 Annual Compliance Report at 55.

Year 2008. Last year, 10 of out the 18 passthroughs were over 100 percent. Postal Service FY 2008 ACR at 55. Thus, the past fiscal year showed a slight improvement for the Outside County product.

Within County worksharing discounts historically have been below avoided costs, and the Postal Service's filing shows that this pattern continued in the past fiscal year, as no Within County rate category received a discount greater than avoided costs. The Commission presents additional analysis of Periodicals passthrough data in accompanying workpapers.

Worksharing: Bundles and Containers

Review of the Postal Service's filing shows that the price-cost ratios for bundle, sack, and pallets passthroughs are significantly below 100 percent. This was also the case in last year's ACD. Data supporting the conclusion about this year's data appear in accompanying workpapers.

Views of Commenters

Valpak makes three main points in the course of extensive remarks about Periodicals issues. One relates to 39 U.S.C. § 3622(c)(2), which requires each class of mail to bear the direct and indirect costs that can reasonably to be attributed to it. Valpak Comments at 14. Valpak observes that Periodicals revenues were less than its attributable costs in Fiscal Year 2008, and says it does not expect this to change after implementation of Docket No. R2009-2 rates, given the size of the increase (19 percent) needed to accomplish that goal. *Id.* at 19. It maintains that only three actions (or combinations thereof) will bring Periodical revenues to a point where they are greater than attributable costs: incentives to establish an efficient rate structure; cost reductions; and price increases above the price cap. *Id.* at 21.

Valpak's second point is that including allied piece costs in the measurement of worksharing cost avoidances would help achieve a more efficient price structure, but would cause large rate increases for certain publications. *Id.* at 21. It maintains that "if the Commission determines the CPI-U price cap is not to be violated…disproportionate rate increases on copies of publications that do not come close to paying the costs which they impose on the Postal Service present the most efficacious way to increase coverage." *Id.* at 24.

Valpak's third point is that if Periodical revenues continue to fall short of attributable costs, the Postal Service will not only be in violation of section 3622(c)(2), but also of section 3622(b)(5), which identifies "the assurance of financial stability" as one of the statutory objectives the new system of regulation is to achieve. *Id.* at 24.

The Public Representative's main concern is with the long-term financial viability of the Postal Service. It expects the Postal Service's financial condition to continue to worsen, based in large part on its finding that unit costs are increasing, even as volume declines. Public Representative Comments (Table 1) at 9. It expects this trend to continue, and so argues that the Postal Service's primary focus should be on cost reduction. *Id.* at 10. The Public Representative's general concern with increasing unit costs focuses specifically on Periodicals, and it asserts that Periodicals are not in compliance with section 39 U.S.C. § 3622(c)(2). It further states that because the amount by which Periodicals fall short of making a contribution is such a large share of its revenue (19 percent), the failure to comply with 39 U.S.C. § 3622(c)(2) will only worsen unless its unit costs begin to decline. *Id.* at 11.

Time Warner (TW) supports including allied labor costs in the measurement of avoided costs. TW Comments, Stralberg Appendix, at 2. It also presents data showing that despite a decline in flats volume, which should have freed up mechanized sorting capacity for Periodicals that had been manually sorted, manual sorting of Periodicals has not diminished. TW Reply Comments at 10. It asserts that little progress controlling manual sorting costs occurs because the Postal Service sends Periodicals that arrive at a processing plant too late to be processed mechanically to offices where they are manually sorted, to meet "service reasons." *Id.* at 11. As part of a possible solution to what it sees as excessive manual sorting, Time Warner proposes that the Postal Service and mailers agree that in these situations, service requirements be reduced by one day to allow mechanized sorting to be utilized. *Id.* at 12. However, it notes that the problem is complex, needs in-depth exploration, and suggests that it be more fully addressed in the joint Commission/Postal Service study being conducted pursuant to section 708 of the PAEA. *Id.* at 12.

In joint comments, Magazine Publishers of American and Alliance of non-profit Mailers (MPA-ANM) also support including allied costs in the calculation of worksharing cost avoidances, but assert that education is an equally important method to "send signals" to periodical mailers to save costs. MPA-ANM Reply

Comments at 3-4. Moreover, they caution that their support of including allied costs in cost avoidance calculations should not be interpreted as support for Valpak's proposal to increase rates on publications which disproportionately impose costs on the Postal Service. *Id.* at 3. MPA-ANM also notes the Public Representative's expectation of increasing unit costs assumes that volume growth will continue to decline and that the Postal Service will be unable to reduce its overcapacity of labor in response. It argues that the current overcapacity of labor is a short-term problem, and that the Postal Service is addressing it by significantly reducing workhours and taking other aggressive cost-cutting measures. *Id.* at 5. The Postal Service makes similar arguments in response to the Public Representative's observations. Postal Service Reply Comments at 14.

The Nation and the Magazines of Politics, Policy, and Current Events Coalition (MPPACE) also opposes Valpak's suggestion that prices on higher-cost publications be increased, on grounds that this would contradict the goal of having Periodicals disseminate essential information.[17] The Nation and MMPACE Comments at 1. The Nation and MMPACE further state that "rates should continue to reflect, to some extent, average costs to ensure the maintenance of a vital free press that includes small and independent publishers …." The Nation and MPPACE Reply Comments at 1.

American Business Media (ABM) opposes Valpak's suggestion that targeted price increases would improve cost coverage, contending that this approach ignores Congress's desire to "…maintain a broad and diverse Periodical mailstream." ABM Reply Comments at 3. It makes two other main points. One is that poor cost attribution methods are responsible for Periodical revenues falling short of attributable costs. *Id.* at 8. The other is that the aggressive cost-cutting measures the Postal Service is implementing will improve the Periodicals cost/revenue relationship. *Id.* at 9.

Proposed worksharing modifications. Several commenters propose including allied piece costs as part of the calculation of avoided costs. Their rationale is that allied piece costs are costs that can be avoided when mailers perform deeper presorting and dropshipping.[18] These commenters conclude that discounts based upon avoided costs including both direct and allied piece costs would provide mailers greater incentive to achieve additional cost savings.[19] This proposal was also raised in the previous ACR proceeding by TW and MPA-ANM.[20] The Commission notes that at that time, direct unit piece costs had unexpectedly declined, and unit allied piece costs had increased.[21] This year, the reverse is true.[22]

It appears that if allied piece costs were included in the calculation of avoided costs, the rate structure would provide better signals to mailers. *The Commission believes this issue should be fully explored by the joint Periodicals Task Force. It also anticipates the possibility of exploring it in a separate proceeding.*

Cost coverage. Results for the past fiscal year clearly show that Periodicals remain, in the Postal Service's words, "a challenged class" in terms of cost coverage. The need to bring Periodicals revenues into closer alignment with attributable costs is not simply a matter of achieving technical compliance with PAEA requirements for this class, but also of fostering broader assurances of systemwide financial stability and fairness to other mailers.

Both of these considerations highlight the imperative need to reduce the extent to which Periodicals are exposed to manual sorting operations, to control other costs, to improve cost modeling, to align the pricing structure more closely with cost incurrence, and to employ pricing objectives that also send clear signals to mailers. Toward these ends, *the Commission anticipates exploring the feasibility and impact of including allied piece costs in worksharing cost. It supports and encourages the Joint Task Force effort to improve the data used in the Periodicals cost model, to search for practices that will improve operational efficiency handling and transporting Periodicals, and to consider whether the discount or rate structure can help the Postal Service and its customers to become more efficient users of the mail. It also strongly encourages the Postal Service and Periodicals mailers to consider administrative solutions to processing decisions*

[17] Congress incorporated this goal into section 3622(b)(11) of PAEA, namely to take into account the educational, cultural, scientific, and informational (ECSI) value to the recipient of mail matter.
[18] Valpak Comments at 22, TW Comments at 2, and MPA-ANM Reply Comments at 3-4.

[19] Valpak Comments at 22.
[20] ACD FY 2008, at 80.
[21] *Id.* at 80.
[22] File: Periodical Tables PRC_ACR08.xlsx, Sheet:Table VII-C-3, in Library Reference 5 shows that between Fiscal Year 2007 and Fiscal Year 2008, direct unit piece costs have increased an average of 6.80 cents, compared to an average decrease in allied piece costs of 1.52 cents.

that currently elevate service decisions over cost considerations.

Standard Mail

Introduction

The Standard Mail class has six products: Letters; Flats; Not Flat Machinables (NFMs) and Parcels; Carrier Route Letters, Flats and Parcels; High Density and Saturation Letters; and High Density and Saturation Flats and Parcels. Standard Mail had a volume of 99.1 billion pieces in FY 2008 and made a contribution of $7.4 billion. Standard Mail accounts for 49 percent of total volume and 25 percent of total contribution.

Analysis of FY 2008 data for Standard Mail indicates:

- Revenues did not cover the attributable cost of Standard Mail Flats by $218 million producing a cost coverage of 94 percent;
- Revenues did not cover the attributable cost of Standard Mail NFMs and Parcels by $165 million producing a cost coverage of 80 percent;
- No workshare discount appears to conflict with §3622(e);
- Per-piece revenue from Standard non-profit pieces was 60.7 percent of Standard commercial per-piece revenues;
- Postal Service should improve DAL costing and volume measurement;
- Carrier Route, High Density and Saturation Letters, and High Density and Saturation Flats and Parcels unit mail processing and unit delivery cost are anomalous and the Postal Service should improve the costing;
- The methodology for calculating the pre-barcoding cost avoidance for letters should be improved; and
- More reliable cost data for calculating the cost avoidance associated with presort discounts for Parcels should be developed.

Financial Analysis

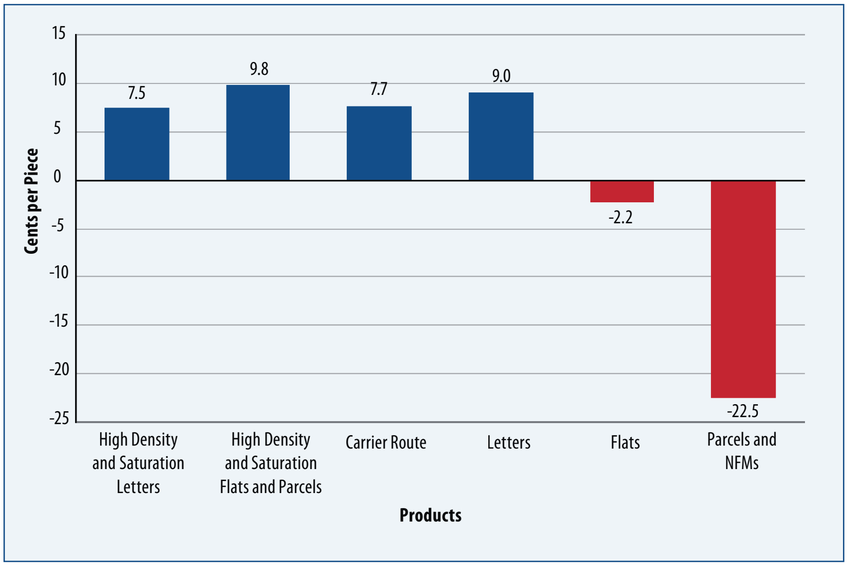
Standard Mail's cost coverage, as a class, for FY 2008 was 156 percent. As Table VI-6 shows, total revenue from Standard Mail for FY 2008 was $20.6 billion, which covered its attributable cost of $13.2 billion and contributed $7.4 billion to institutional cost.

Table VI-6
Standard Mail
Fiscal Year 2008 Volume, Revenue, Cost, Contribution, and Cost Coverage by Product

	Volume (000)	Revenue ($000)	Attributable Costs ($000)	Contribution to Institutional Costs ($000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Costs/Pc. (Cents)	Cost Coverage
Standard Mail:								
High Density & Saturation Letters	5,598,913	739,763	320,542	419,221	13.213	5.725	7.488	230.8%
High Density & Saturation Flats & Parcels	13,584,059	2,171,756	844,509	1,327,247	15.988	6.217	9.771	257.2%
Carrier Route	12,070,176	2,743,126	1,814,452	928,674	22.726	15.033	7.694	151.2%
Letters	57,086,421	10,610,140	5,479,222	5,130,917	18.586	9.598	8.988	193.6%
Flats	10,010,857	3,673,412	3,891,246	(217,834)	36.694	38.870	(2.176)	94.4%
Not Flat-Machinables and Parcels	733,729	648,096	813,430	(165,334)	88.329	110.862	(22.533)	79.7%
Total Standard Mail	**99,084,155**	**20,586,292**	**13,163,401**	**7,422,891**	**20.777**	**13.285**	**7.492**	**156.4%**

Source: PRC-LR-ACR08-1

Figure VI-1
Unit Contribution of Standard Mail Products



Standard Mail volume decreased by 4.3 percent or 4.4 billion pieces from FY 2007 to FY 2008. The economic downturn is primarily responsible for this drop in volume which follows five consecutive years of increases and represents the largest decrease since reorganization in 1970.

As shown in Table VI-6, the Postal Service provides financial data aligned with the new product designations for FY 2008, which allows the Commission to analyze the pricing relationships in the Standard Mail class. Figure VI-1 shows the unit contribution for each of the six products.

Standard Mail Letter rates recovered 194 percent of their attributable costs in FY 2008. On a unit basis, Letters contributed 9.0 cents per piece to the institutional cost of the Postal Service. Standard Mail Flats and Parcels and Not Flat Machinables (NFMs) did not generate enough revenue to cover their attributable costs, and did not contribute to the institutional cost of the Postal Service.

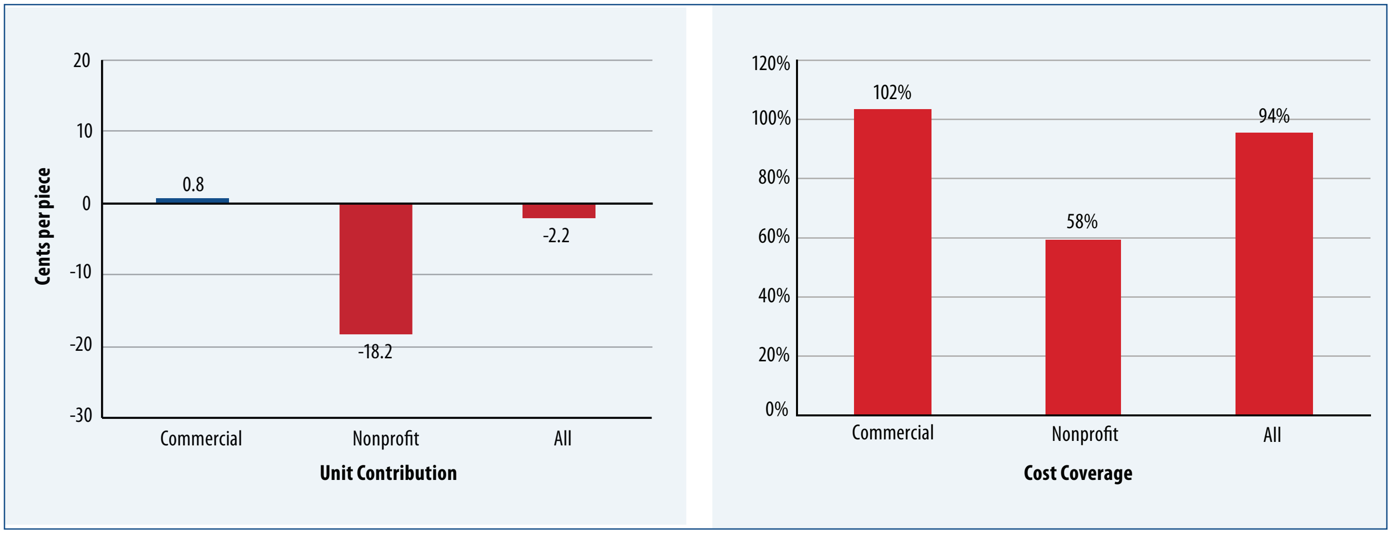
Cost coverage for Flats was 94 percent, with a loss of 2.2 cents per piece. Based on a study submitted by the Postal Service, which estimates the attributable cost for non-profit letters and flats, the Commission was able to determine that cost coverage of Commercial Flats and non-profit Flats. *See* PRC-ACR2008-LR1. As Figure V1-2 illustrates, Commercial Flats only just covered cost with 102 percent cost coverage, while non-profit Flats significantly failed to cover cost (58 percent), resulting in a cost coverage below 100 percent for the product as a whole. Statutory requirements link the rates for commercial flats to the rates for non-profit flats. As a result, an increase for one dictates a corresponding increase for the other.

ACMA comments that while Standard Mail flats' average revenue is less than average attributable cost, this shortfall can be attributed to three factors: previously this information was not broken out in this form (so a historical increase cannot be measured), volume degradation from the R2006-1 rate increase has led to a higher fixed cost calculation, and there exists a lack of infrastructure and automation investment to reduce costs for flats. ACMA Comments at 7.

Valpak also comments in reply to ACMA that there is no equitable or efficiency rationale for other mailers to cover flat costs, because for efficiency, marginal costs associated with flats should be covered by flats' revenues. Valpak Reply Comments at 3. Valpak also counters ACMA's argument that flat costs have not been broken out in this manner before, and comments that separate cost and coverage data for flats have been available for some time. *Id.* at 4. Finally, Valpak reasons that it is possible that the elasticity for Standard Regular Mail is weighted towards letters since the volume of letters is much greater than that of flats. *Id.* at 4-5. However, as far as elasticity for Standard Regular Mail applies to flats, "the indication is (under any notion of economic efficiency) that the cost coverage for flats should be close to the cost coverage for letters." *Id.* at 5.

Valpak expresses concerns about ACMA's comments that catalogs might drive retail sales at

Figure VI-2
Comparison of Standard Mail Flats Commercial and Non-profit



	Volume (000)	**Total Revenue ($ 000)**	**Attributable Cost ($ 000)**	**Contribution to Institutional Cost ($ 000)**
Commercial Flats	8,441,165	3,282,160	3,214,265	67,895
Non-profit Flats	1,569,692	391,252	676,723	(285,470)
Total Commercial and Non-profit	10,010,857	3,673,412	3,890,988	(217,576)

physical locations, when a customer views a product in a catalog and ultimately purchases it at a physical store. *Id.* at 7. Given that Flats revenue does not cover cost, this could be considered a form of subsidized advertising if used to spur retail sales in physical stores. *Id.* at 8. Valpak states that catalogers should be provided with the same kinds of pricing and service alternatives as other mailers, because no basis exists for subsidizing catalogs. *Id.*

The Postal Service disagrees with Valpak's comments and states that there are no compliance issues with regards to flats. Although in its comments, the Postal Service acknowledges that it is not "sound to have a market dominant product that fails to cover its costs, particularly over the long-term," it takes the view that the policy directives in PAEA are not as explicit or restrictive as those of the PRA so the compliance concerns raised by Valpak "harkens back to the pre-PAEA regulatory structure, in which the Commission, for all practical purposes, established the prices." (Postal Service Reply 28-29).

The Commission is concerned with the $218 million loss for Standard Mail flats. As noted elsewhere in this report, the Postal Service suffered a $1.2 billion loss from products with a negative contribution during FY 2008. Of that loss, Standard Mail flats account for more than 20 percent. The revenues for Standard Mail flats in FY 2008 failed to satisfy 39 U.S.C. § 3622 (c)(2), which requires that each class of mail or type of mail service cover attributable costs and make a reasonable contribution to institutional costs. For flats to cover FY 2008 cost, the rates of flats would have needed to be increased by 6.2 percent holding all other factors constant. The lack of a sufficiently high cost coverage may be inconsistent with the policy set forth in 39 U.S.C. § 101(d),[23] which directs the Postal Service to apportion the costs of the Postal Service on a fair and equitable basis and 39 U.S.C. § 3622(b)(5), which states that rates must be set to ensure adequate revenues to maintain financial stability.

[23] 39 U.S.C. § 3622 (c)(14) requires the Commission to take into account the policies of title 39 and other factors deemed to be appropriate.

In Docket No. R2008-1, the Postal Service proposed below-average increases for flats and above average increases for letters. Further, the Postal Service placed a disproportionate share of the burden of institutional cost on letters. The unit contribution made by letters was 9 cents in FY 2008 compared with negative 2 cents per piece from flats. This is inconsistent with 39 U.S.C. § 3622(b)(5) and 39 U.S.C. §3622(c)(2.

Valpak asserts that Standard Mail flats' failure to cover costs essentially gives preferential treatment to catalogs. This treatment may be inconsistent with 39 U.S.C. § 403 (c) which provides that the Postal Service should neither unduly or unreasonably discriminate nor give undue or unreasonable preference to any user of the mail.

From a purely economic perspective, for rates to be non-discriminatory, the rates need to reflect an Efficient Component Pricing (ECP) approach or reflect equal percentage markups.[24] *See* Docket No. R2006-1, Opinion and Recommended Decision at 81-90. Departures from either of these approaches should be justified by differences in non-cost factors. For Standard Mail letters and flats, such a departure could be justified for example, by a difference in own price elasticity. However, the Postal Service has not presented empirical evidence that letters and flats have different market characteristics or other non-cost factors which would justify the disparate difference in per piece contributions and percentage markups between letters and flats.

The Postal Service should either decrease the disparity between letters and flats in future rate increases or provide the Commission with empirical evidence that the market characteristics of letters and flats or other non cost factors justify the unequal treatment.

Like Standard Flats, the rates for Parcels/NFMs did not produce sufficient revenues to cover attributable costs, losing $166 million in FY 2008. However, because NFMs are a relatively new rate category having been created in Docket No. R2006-1 and because Parcels/NFMs are costly to process, increasing rates by a large magnitude too quickly to bring them into alignment with costs might cause severe economic distortion in the relevant markets. Consideration of 39 U.S.C. § 3622(c)(3), the effect of rate increases on mailers and others, militates prudence with respect to increasing rates for NFMs.

In Docket No. R2008-1, the Postal Service increased the rates for Standard Mail parcels and NFMs by an average of 9.7 percent. This increase was well above the average increase for Standard Mail as a whole (2.838 percent). Further, in Docket No. R2009-2, the Postal Service increased rates for Parcels/NFMs by 16.2 percent, substantially above the average increase for the class of 3.781 percent. *The Postal Service should continue its "phasing-in" approach to increasing the rates for Standard Mail Parcels and NFMs to make them compensatory.*

In FY 2008 the High Density and Saturation Letters product had a cost coverage of 231 percent. It contributed $419 million to the institutional cost of the Postal Service. Both the non-profit and commercial components of the High Density and Saturation Letters product made a positive contribution to institutional cost.

Revenues for the High Density and Saturation Flats and Parcels product exceeded attributable cost by $1.3 billion which resulted in a cost coverage of 257 percent. Both the non-profit and commercial components of the High Density and Saturation Flats and Parcels product covered their attributable cost.

Valpak comments that the cost coverage for High Density/Saturation Letters and Flats are high compared with other products in Standard Mail. Valpak Comments at 50. Valpak also draws attention to the high demand elasticity of the former subclasses which can be roughly correlated with current products. *Id.* at 51. As a result of the high cost coverage and high elasticity, Valpak recommends that High Density/Saturation Letters and Flats receive relatively low percentage increases in future rate adjustments, so as not to favor other Standard Mail products at the expense of High Density/Saturation Letters and Flats. *Id.* at 52.

Valpak also comments on the implementation of the rate relation ratio (60 percent) accorded to Standard non-profit mail. Valpak calculates the non-profit ratio at the product level whereas the Postal Service calculates it at the class level. Valpak Comments at 55-58. Proceeding to examine individual products, Valpak notes that non-profit High Density/Saturation Letters, Flats and Parcels have an average revenue that is substantially less than 60 percent of

[24] The ECP approach can be characterized as "rate differences equal cost differences," which is non-discriminatory because rates differences are cost based. Similarly, equal cost coverages are non-discriminatory because the proportionate differences in rates equal the proportionate differences in cost and are therefore cost based.

their commercial counterparts. *Id.* As a result, Valpak calls for an increase in the non-profit rates for these products to increase cost coverage and reduce the burden on commercial saturation mail. *Id*.

Based on FY 2008 costs, the Carrier Route Letters, Flats, and Parcels product covered its attributable costs with cost coverage of 151 percent. The Carrier Route product contributed $917 million toward the Postal Service's institutional costs. The non-profit component of the Carrier Route product failed to cover its attributable cost, which resulted in a negative contribution of $3.5 million.

39 U.S.C. § 3626(a)(6) requires non-profit rates to be set in relation to their commercial counterparts regardless of the independent costs associated with non-profit mail. Non-profit rates were set to yield per-piece revenues that are 60 percent of commercial revenues at the class level. The Commission calculates that in FY 2008 the actual per-piece revenue from Standard non-profit pieces was 60.7 percent of Standard commercial per-piece revenues.

The law does not require actual non-profit revenues to equal exactly 60 percent of commercial revenues. It instead requires a forward-looking estimate when setting rates. Thus, *the Commission's review of non-profit revenues in the Annual Compliance Report is limited. If over the span of several compliance reports, there is a discernable pattern whereby the actual non-profit per-piece revenues are consistently too high or too low, the Commission may find that the methodology used by the Postal Service in setting rates to achieve the non-profit revenue target should be changed or improved.*

Worksharing/Rate Design

Methodology. The Commission made several changes to the Postal Service's filing which affect Standard Mail costs. As discussed in the introduction to this chapter, the Commission uses class-specific densities and ISS refeeds from the new density study as well as the corrected REC productivity and OCR piggyback factor references in the letter cost avoidance model.

In the 2008 ACR, the Postal Service aligns CRA data with the new PAEA products for the first time. The re-alignment of Standard Mail costs by product necessitates that certain calculations be performed in the CRA "B" workpapers, specifically the Detached Address Label (DAL) adjustment and the "D" Report final adjustment.

DAL Adjustment. The DAL Adjustment shifts delivery costs of letter-shaped DALs associated with Saturation Flats from the CRA product High Density and Saturation Letters to the CRA product High Density and Saturation Flats. For the purpose of matching rate category costs with CRA level costs, this calculation is moved from the Delivery Costs by Shape file "UDCInputs.xls" (USPS-FY07-19) to the CRA "B" workpapers (USPS-FY08-32/USPS-FY08-NP14) file "CS6&7.xls". The Postal Service claims that this is not intended to constitute a change in methodology. See USPS-FY08-19 Preface at 2.

Valpak filed two motions for the "Issuance of Commission Information Requests" to facilitate better understanding of the DAL adjustment as calculated in "CS6&7.xls".[25] At the technical conference Valassis also asked questions concerning the mechanics of the DAL adjustment, specifically the calculation of sequenced mail costs. The inquiries related to the DAL adjustment mechanics address the determination of the Postal Service as to what costing data will be made publicly available. *See* Reply of Valpak et al to Response of the Postal Service to Order No. 155, January 21, 2009 at 2 fn; *See* e.g. Public Representative Motion to Make Core Cost, Volume, and Revenue Materials Public, January 27, 2009. As part of Delivery Cost spreadsheets USPS-FY07-19 and PRC-ACR2007-7, the DAL adjustment calculation was provided with all sources linked. The CRA "B" Workpapers are part of the material protected by the Postal Service, as such the DAL adjustment as calculated as part of USPS-FY08-32 is hardcoded, so the commenters could not trace the data sources.

As a result of efforts by commenters and the Commission, errors in the calculation of the unit delivery costs by rate category and the DAL adjustment have been corrected. *See* Preface to PRC-ACR2008-LR7. Most of these corrections relate to cell references. In R2005-1, the Commission calculated the Saturation Flats unit cost using the costs of all Saturation Flats (Flats associated with DALs and Flats not associated with DALs). This is the established methodology. In USPS-FY08-19, the Postal Service "inadvertently

[25] Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Motion for issuance of Commission Information Request Concerning Core Costing Data on Detached Address Labels, January 13, 2009. Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Suggested Questions for Discussion at the Technical Conference of January 26, 2009, or in the Alternative, Motion for a Commission Information Request, January 21, 2008.

"[26] overlooks the cost of Unaddressed Flats in the calculation of Saturation Flats unit cost as a whole. For this reason, the Postal Service's methodology does not match the eastablished methodology. Valassis, in its Response to Postal Service Reply Comments[27] , modifies the Postal Service calculation to reflect the established methodology., which the Commission uses herein. *See* PRC-ACR2008-LR7.

Valpak expresses concern over a variety of DAL related costing issues, including the mismatch of RPW and Delivered DAL volumes, possible Mail Processing and Transportation costs, and the accuracy of the DAL related casing costs. *See* Valpak Comments at 31-39. Valpak is concerned that the "established methodology" may be underestimating the total DAL volume, the dollar amount that should be shifted from saturation letters to saturation flats, and the cost coverage of saturation letters. Id at 36. Valpak also calls for a reporting of the "passthrough" represented by the DAL rate. *Id.* at 39.

The Commission finds that no action is needed at this time, but the Postal Service should look to improve the accuracy of DAL costing and volume measurement in the future. Valpak, Valassis, and the Postal Service should consider initiating a rulemaking to explore ways to improve the accuracy of costing Carrier Route, High Density/Saturation Letters, and High Density/ Saturation Flats and Parcels. This possibility should be considered in the strategic rulemaking referred to in the introduction to this chapter.

D Report Final Adjustment. The development of CRA costs for Standard High Density and Saturation Letters and Standard High Density and Saturation Flats and Parcels incorporates a new adjustment to accurately attribute CRA costs by product. The "D" Report final adjustment accounts for High Density and Saturation Letters that, by DMM standards, fail to meet machinability and barcoding requirements and are consequently rated for postage as Flats. Although the RPW system correctly includes the volume and revenue for ineligible letters with flats, the IOCS does not have the ability to recognize these letters. Accordingly, the cost of ineligible letters is included in the cost of letters. The "D" Report final adjustment is necessary to properly align costs with volumes and revenues by product.

This adjustment was not included in the Postal Service's 13 proposed methodological changes for the 2008 ACR. *See* Request of the Postal Service for Commission Order Amending the Established Costing Methodologies August 11 2008. While the Commission rules regarding methodological changes of this type require review outside of the context of the truncated ACR docket, the significance of this adjustment in the accuracy of costs by products requires the adjustment to be implemented for FY 2008. Public comment on this issue by PostCom, Valpak, and Valassis affirmed the need for such methodological changes to undergo the process for amending the established costing methodology.

The magnitude of the adjustment is explained in the Postal Service response to Order No. 169:

> In FY08 there were 6.136 billion … letter-shaped pieces, while Standard High Density and Saturation Letters includes only 5.599 billion of these pieces (or 91.2 percent). The rest, 537 million letter-shaped pieces paid at flats rates, are part of Standard High Density and Saturation Flats and Parcels. As a result, the following adjustment was made. The volume variable costs reported for Standard High Density and Saturation Letters in the CRA were adjusted to reflect only 91.2 percent of the volume variable costs shown in the Cost Segments and Components Report for that product.
>
> Request of the Postal Service for Modification of Commission Order No. 169, (January 16, 2009).

Thus, 8.8 percent of Standard High Density and Saturation Letter costs need to be transferred to High Density and Saturation Flats. The Postal Service proposal for executing this adjustment initiated several comments and recommendations for improvement. The following table, from CIR No. 4, question two, contains the High Density and Saturation adjustment factors for Delivery and Mail Processing Costs, as filed by the Postal Service.

The Postal Service explains the difference in method in their response to CIR No. 4 question two subpart

[26] "The spreadsheet filed with the parties' proffered response correctly applies the methodology used previously, which the Postal Service intended to use this year as well." Response of the United States Postal Service to Motion of Valassis and SMC for Leave to Respond to the Postal Service's Reply Comments (February 19, 2009) at 2.

[27] Response of Valassis Direct Mail, Inc. and the Saturation Mailers Coalition to Reply Comments of the United States Postal Service, February 18, 2009

e (February 20 2009), where they further quote their reply comments:

> The primary rationale for the High-Density and Saturation adjustments was to align costs and volumes at the "product" level. The mail processing and delivery adjustments were then devised independently and, due to the limited time available from the identification of the underlying cost-volume mismatch issue to the Annual Compliance Report deadline, not reconciled for the differences at the "rate category" level. The Postal Service believes that the methods would have been harmonized given sufficient time, and reiterates from its reply to the Valassis comments that the use of separate adjustment factors for the mail processing component "may have some merit as well, but the impact is not large."
>
> Reply Comments of the United States Postal Service (Feb. 13, 2009) at 22.

Table VI-7
Percent of Volume and Cost Shifted from Letters to Flats

	Mail Processing	Delivery
High Density	8.75%	4.17%
Saturation	8.75%	10.27%

Valassis argues that separate mail processing costs by shape for High-Density and Saturation should be used instead of the average. Using the Postal Service method, this means that 4.2 percent of High-Density letter cost should be transferred to High-Density flat cost while 10.3 percent of Saturation letter cost should be transferred to Saturation flat cost. The same proportions of ineligible letter volume should then be appropriately transferred to flat volumes. Valassis Initial Brief at 9,10 January 30 2009. Valpak agrees that the adjustment factors should be aligned. Valpak Reply Comments at 10.

The Commission finds that the Delivery and Mail Processing factors should match. The cost of ineligible Letters is shifted to Flats on the proportion of volume rated as flats, and since volumes are available for High Density and Saturation ineligible Letters separately, *the Commission sees no reason to ignore rate category level data (in favor of product level data). The Commission finds that separate adjustment factors for High Density and Saturation, found in USPS-FY08-19 file "UDCInputs.xls" tab "Inputs", should be used in the calculation of ECR Mail Processing Unit costs.(See Preface to PRC-ACR2008-LR7).*

Findings. In this section, the Commission first discusses products formerly referred to as part of an enhanced carrier route (ECR) subclass. Then it turns to the other Standard Mail products.

In its initial filing, the Postal Service did not present all the required information for workshare discounts related to Carrier Route, High Density and Saturation Letters and High Density and Saturation Flats and Parcels. For this reason, the Postal Service did not analyze price differences which had previously been defined as worksharing. The Postal Service contends that the differences between the Basic, High Density and Saturation categories of the former ECR subclasses are due to address density not presorting. It argues that there is no mailer preparation that takes place when moving from lower address density to higher address density and therefore it should not be treated as worksharing. Postal Service Response to Order No. 169 at 17.

Valassis agrees with the Postal Service and reiterates that address density is not worksharing. Valassis Comments at 16-18. Additionally, Valassis comments with regard to discounts between the Carrier Route product and the High Density and Saturation Letters and High Density and Saturation Flats and Parcels products, that demand characteristics like density (and volume) define the differences between products, and therefore moving between products is not worksharing under the PAEA. *Id.*

NAA comments that the Commission should use its established methodology to calculate workshare discounts and passthroughs. NAA Reply Comments at 5-10. NAA argues that the Postal Service's claim that moving between products is not worksharing is flawed because it has historically been a worksharing discount (based on presortation), and defining worksharing for the ACR is the Commission's responsibility. *Id.*

NAA is correct that the Commission has treated Basic, High Density, and Saturation as worksharing since their inception as a result of Docket No. R90-1. The Commission notes that deeper presortation requires a certain level of density. For example, to obtain the presort discount for 3-digit letters, a mailer

Table VI-8
Workshare Discounts and Benchmarks
For Carrier Route, High Density, and Saturation by Shape

Line Number		FY 2008 Year-end Unit Cost (cents)	Discount (cents)	Pass-through
	Letter Presort Cost Differentials			
1	Carrier Route Letter	21.7		
2	High Density Letter	5.0		
3	Presort Differential (L3 = L1–L2)	16.6	4.4	26%
4	High Density Letter	5.0		
5	Saturation Letter	5.8		
6	Presort Differential (L6 = L4–L5)	-0.8	1.1	-145%
	Flat Presort Cost Differentials			
7	Carrier Route Flat	13.8		
8	High Density Flat	8.9		
9	Presort Differential (L9 = L7–L8)	5.0	4.5	90%
10	High Density Flat	8.9		
11	Saturation Flat	6.3		
12	Presort Differential (L12 = L10–L11)	2.6	1.9	74%
	Parcel Presort Cost Differentials			
13	Carrier Route Parcel	58.6		
14	High Density Parcel	227.1		
15	Presort Differential (L15 = L13–L14)	-168.5	11.4	-7%
16	High Density Parcel	227.1		
17	Saturation Parcel	59.3		
18	Presort Differential (L18 = L16–L17)	167.8	1.6	1%

Source: PRC-ACR2008-LR5

Note: Numbers may not subtract due to rounding.

must have sufficient volume going to the same 3-digit ZIP Code. Density here would be measured in terms of volume per 3-digit zip. To qualify for the 5-digit presort discount, a mailer would need sufficient volume going to one 5-digit zip, i.e., sufficient density. This concept logically extends to the Carrier Route level, High Density Level, and Saturation level. *For this reason, the Commission continues to rely on the same analytical framework for evaluating workshare discounts as it used to design rates. However, this issue will be considered further in Docket No. RM2009-3.* Table VI-8 presents the cost avoidances, discounts, and passthroughs for Standard Mail Carrier Route, High Density and Saturation.

For the former ECR categories, the Commission presents its calculation of the passthroughs for worksharing in the table above. Only two worksharing cost differentials are problematic. The cost differentials between High Density letter-Saturation letter and Basic parcel-High Density parcel are negative which means (1) that the discounts exceed avoidable costs and (2) that the costs are likely anomalous . The Postal Service contends that the costs are anomalous and should not be relied on for setting rates. *See* Postal Service response to Chairman's Information Request No. 4, Question 7(c). Because the costs are anomalous, the Commission can not determine whether the discounts are consistent with 39 U.S.C. § 3622(e). In the FY 2007 ACD, the Commission indicated that the mail processing unit costs may be causing the seemingly anomalous results with regards to cost avoidan ces and urged the Postal Service to identify the source of anomalous results. The Postal Service has not yet reported any progress towards this end. *The Commission expects that the Postal Service will produce accurate cost estimates in time for the next ACR, to allow for meaningful analysis of workshare discounts.*

Turning to the remaining products in Standard Mail, the Commission has reviewed the passthrough calculations submitted by the Postal Service and has updated the costs as discussed above. Table VI-9 shows the passthroughs based on the updated costs for Standard Mail, Letters, Flats, and NFMs/Parcels.

In FY 2008, six presort discounts and two pre-barcode discounts exceeded avoided cost for products previously grouped in the former Standard Mail Regular subclass. *For the reasons explained below, the Commission finds none of these discounts to be inconsistent wit*h 39 U.S.C. § 3*622(e).*

For Standard Mail letters, the presort discount for automation 3-digit letters compared to AADC letters and the presort discount between nonmachinable ADC letters and nonmachinable mixed AADC letters exceed avoided cost. In Docket No. R2008-1, both of these passthroughs were at or below 100 percent. However, lower avoided costs between FY 2007 and FY 2008 caused these passthroughs to exceed 100 percent, which renders the discounts inconsistent with 39 U.S.C. § 3622(e). *The Postal Service's proposed rate increase in Docket No. R2009-2 realigns the discounts with avoided cost, therefore, no further action is required.*

The prebarcoding discount for letters, a measure of the discount between non-automation mixed ADC machinable letters and automation mixed AADC letters exceeds avoided cost. In Docket No. R2008-1, the Postal Service proposed an increase to the discount. In Order No. 66, the Commission found the discount inconsistent with 39 U.S.C. § 3622(e). The Postal Service filed an amended notice to remedy the problem. Consequently, *the Commission found the revised discount consistent with 39 U.S.C. § 3622(e).* The cost avoidance calculated for FY 2008 is negative. Intuitively, a barcoded piece should be less costly to process than a nonbarcoded piece. The Postal Service should examine the methodology for calculating the avoided cost for prebarcoding letters to enable a more meaningful analysis of the passthrough.

For Standard Mail Flats, two presort discounts exceed avoided cost: the discount between automation ADC flats and mixed ADC flats, and the discount between non-automation ADC flats and non-automation mixed ADC flats. In Docket No. R2008-1, both of these passthroughs were at or below 100 percent. However, lower avoided costs between FY 2007 and FY 2008 caused these passthroughs to exceed 100 percent, which renders the discounts inconsistent with 39 U.S.C. § 3622(e). *The Postal Service's proposed rate increase in Docket No. R2009-2 realigns the discounts with avoided cost, therefore, no further action is required.*

For Standard Mail Parcels and NFMs the presort discount between BMC machinable parcels and mixed BMC machinable parcels and the presort discount between 5-digit machinable parcels and BMC machinable parcels exceed avoided cost. In both cases the passthroughs were higher when the Commission approved the discounts in Docket No. R2008-1. The decreases in the excessive passthroughs are due to higher estimated avoided costs in FY 2008 compared with FY 2007. In Docket No. R2008-1, the Commission granted the Postal Service permission to give mailers a discount in excess of avoidable costs for presorting parcels under 39 U.S.C. § 3622(e)(2)(D) because of the possibility that reduction or elimination of the discount would impede the efficient operation of the Postal Service. Because the cost avoidance information used to calculate these passthroughs is based on modeled costs, the Postal Service claims that the avoided costs "are approximations that should serve as guidelines to develop reasonable parcel prices." Notice at 32. Further, the Postal Service is concerned that because setting the discounts at 100 percent passthroughs would require reducing the discounts from their previous

Table VI-9
Standard Mail Letters, Flats, and NFMs/Parcels
Discounts and Benchmarks

Type of Worksharing (Benchmark)	FY 2008 Year-end Discount (cents)	FY 2008 Unit Cost Avoidance (cents)	FY 2008 Pass through
Standard Mail Automation Letters			
Presorting (dollars/piece)			
Automation AADC Letters (Automation mixed AADC Letters)	1.3	1.7	74.6%
Automation 3-digit Letters (Automation AADC Letters)	0.3	0.2	130.4%
Automation 5-digit Letters (Automation 3-digit Letters)	1.6	1.8	89.1%
Pre-barcoding (dollars/piece)[1]			
Automation mixed AADC Letters (Non-automation Machinable Mixed ADC Letters)	0.3	(1.0)	-31.9%
Standard Mail Non-automation Letters			
Presorting (dollars/piece)			
Non-automation AADC Machinable Letters (Non-automation mixed AADC Machinable Letters)	0.2	*See* note[1]	
Non-automation ADC Nonmachinable Letters (Non-automation Mixed ADC Nonmachinable Letters)	10.0	8.6	115.8%
Non-automation 3-digit Nonmachinable Letters (Non-automation ADC Nonmachinable Letters)	2.3	4.3	52.9%
Non-automation 5-digit Nonmachinable Letters (Non-automation 3-digit Nonmachinable Letters)	9.5	11.7	81.5%
Standard Mail Automation Flats			
Presorting (dollars/piece)			
Automation ADC Flats (Automation Mixed ADC Flats)	5.3	1.0	524.2%
Automation 3-digit Flats (Automation ADC Flats)	3.6	6.8	53.1%
Automation 5-digit Flats (Automation 3-digit Flats)	6.1	12.0	51.0%
Pre-barcoding (dollars/piece)			
Automation Mixed ADC Flats (Non-automation Mixed ADC Flats)	6.4	2.8	227.8%
Standard Mail Non-automation Flats			
Presorting (dollars/piece)			
Non-automation ADC Flats (Non-automation Mixed ADC Flats)	7.0	4.9	142.7%
Non-automation 3-digit Flats (Non-automation ADC Flats)	3.2	4.5	70.5%
Non-automation 5-digit Flats (Non-automation 3-digit Flats)	8.5	9.7	87.2%

Source and notes displayed on the following page.

Table VI-9
Standard Mail Letters, Flats, and NFMs/Parcels Discounts and Benchmarks—Continued

Type of Worksharing (Benchmark)	FY 2008 Year-end Discount (cents)	FY 2008 Unit Cost Avoidance (cents)	FY 2008 Pass through
Standard Mail Parcels			
Presorting (dollars/piece)			
BMC Machinable Parcels (Mixed BMC Machinable Parcels)	20.8	19.6	106.1%
5-digit Machinable Parcels (BMC Machinable Parcels)	39.9	37.5	106.5%
ADC Irregular Parcels (Mixed ADC Irregular Parcels)	25.0	96.5	25.9%
3-digit Irregular Parcels (ADC Irregular Parcels)	31.9	96.5	33.1%
5-digit Irregular Parcels (3-digit Irregular Parcels)	5.3	17.7	29.9%
Pre-barcoding (dollars/piece)			
Mixed BMC Machinable Barcoded Parcels (Mixed BMC Machinable Nonbarcoded Parcels)	5.0	*See* note[2]	
Mixed ADC Irregular Barcoded Parcels (Mixed ADC Irregular Nonbarcoded Parcels)	5.0	*See* note[2]	
Standard Mail NFMs			
Presorting (dollars/piece)			
BMC/ADC NFMs (Irregular Parcels) (Mixed BMC/ADC NFMs (Irregular Parcels))	31.2	96.5	32.3%
3-digit NFMs (Irregular Parcels) (BMC/ADC NFMs (Irregular Parcels))	29.1	96.5	30.2%
5-digit NFMs (Irregular Parcels) (3-digit NFMs (Irregular Parcels))	6.1	17.7	34.5%
Pre-barcoding (dollars/piece)			
Mixed ADC Barcoded NFMs (Mixed ADC Nonbarcoded NFMs)	5.0	*See* note[2]	

Source: PRC-ACR2008-LR5

Notes:

[1] The Postal Service letters mail processing cost model only estimates costs for the combined non-automation machinable AADC and mixed AADC categories.

[2] The Postal Service Standard Mail NFM/Parcel mail processing cost model does not estimate costs separately for pre-barcoded and non-barcoded pieces.

level, it may lead to fewer presorted parcels and greater movement of Standard Mail parcels to the BMCs, which the Postal Service believes is operationally inefficient.

In Docket No. R2008-1, the Commission found the discounts to be justified. As the Commission stated in that order, the "Postal Service should be given a reasonable amount of time to obtain accurate costs to measure the success of the discounts in increasing the efficiency of these processing operations." Review of Postal Service Notice of Market Dominant Price Adjustment at 39. *The Postal Service should work towards reliable cost data for these categories and make the necessary adjustments to discounts to reflect 100 percent or less of the avoided costs.*

The prebarcoding discount for flats, a measure of the discount between automation mixed ADC flats and non-automation mixed ADC flats, had a passthrough of 265.4 percent in Docket No. R2008-1. The Postal Service justified this passthrough under section §3622(e)(2)(D) of title 39. Specifically, the Postal Service explained that strong incentive to barcode flats will enhance the ability of the Postal Service to implement its Flats Sequencing System (FSS). Postal Service Response to Commission Information Request No. 1, (March 4, 2008). The Commission accepted the Postal Service's justification and the pre-barcoding discount was implemented on May 12, 2008. An increase in the avoided costs between FY 2007 and FY 2008 has reduced the passthrough from 265.4 percent in Docket No. R2008-1 to 227.8 percent in ACR 2008. For these reasons, *the Commission finds the discounts satisfy 39 U.S.C. § 3622.*

Standard Mail dropship discounts and passthroughs are shown in Table VI-10.

The DDU dropship discount which applies to Standard Mail parcels and NFMs, Carrier Route parcels, and High Density and Saturation parcels, exceeded 100 percent of avoided costs. The Postal Service justified these passthroughs under section 39 U.S.C. § 3622(e)(2)(D) of title 39, as explained in its response to CIR No. 1.

PSA comments that several parcel related passthroughs range from 16-25 percent, and for efficiency, the Postal Service should substantially increase the related discounts in the next rate change. PSA Comments at 4-5.

The Postal Service does not have a dedicated cost model for Standard Mail parcel and NFM drop-shipping, so the avoided cost estimates are based on Standard Mail as a whole. The Postal Service contends that the avoided costs per pound estimated for Standard Mail as a whole do not adequately reflect the larger costs avoided by the less dense, and more voluminous, machinable parcels when measured on a per-pound basis.

The Postal Service offers additional data in its Standard Mail analysis to estimate dropship cost avoidances by shape (letters, flats, and Non-Flat Machinables/parcels). These cost avoidances, [28] may substantiate the Postal Service's claim that the avoided costs for Parcels and NFMs are understated in the avoided costs per pound estimated for Standard Mail as a whole, but these costs have not been subjected to a full review. *The Postal Service should present its study in a separate docket to allow the Commission and the public an opportunity to examine the results.*

Package Services

Introduction

Package Service mail consists of the following five products: Single-Piece Parcel Post, Bound Printed Matter Flats, Bound Printed Matter Parcels, Library/Media Mail, and Inbound Surface Parcel Post (at UPU rates).[29] These products share common traits including: none is sealed against postal inspection; none receives preferential handling or transportation; and generally, each consists of parcels containing merchandise, although heavier catalogs and directories may also be mailed as Package Services mail. In FY 2008, 846 million pieces were mailed as Package Services mail. This accounts for 0.42 percent of total mail volume.

The primary findings for Package Services in FY 2008 are:

- Package Services had an overall cost coverage of 101 percent, contributing $17 million to institutional costs;
- Single-Piece Parcel Post revenues did not cover attributable costs by $64 million;

[28] USPS-FY08-13, the STD_DEST_ENT_TOTAL.xls workbook, Summary tab.

[29] Inbound Surface Parcel Post (at UPU rates) is discussed in the Market Dominant International Mail section.

Table VI-10
Standard Mail
Dropship Workshare Discounts and Benchmarks
FY 2008

Type of Worksharing (Benchmark)	Year-end Discount (cents)	Unit Cost Avoidance (cents)	Passthrough
Dropship (cents per piece)			
DBMC Letters (Origin Letters)	15.9	22.1	72.1%
DSCF Letters (Origin Letters)	20.3	26.7	76.1%
DBMC Flats (Origin Flats)	15.9	22.1	72.1%
DSCF Flats (Origin Flats)	20.3	26.7	76.1%
DDU Flats (Origin Flats)	24.8	31.2	79.4%
DBMC Parcels (Origin Parcels)	15.9	22.1	72.1%
DSCF Parcels (Origin Parcels)	20.9	26.7	78.4%
DDU Parcels (Origin Parcels)	33.1	31.2	105.9%

Source: PRC-ACR2008-LR5

- Media Mail and Library Mail revenues failed to cover attributable costs by $58 million;
- No workshare passthroughs were inconsistent with the 30 U.S.C. § 3622(e).

Financial Analysis

Table VI-11 shows that the Package Services class had a cost coverage of 101 percent. The revenues for Inbound Surface Parcel Post (at UPU Rates), Bound Printed Matter Flats, and Bound Printed Matter Parcels each covered their attributable costs in FY 2008. The revenues for Single-Piece Parcel Post, and Media and Library Mail did not cover their attributable costs in FY 2008.

The Public Representative argues that the current outlook for postal markets increases the risk that revenues for some mail classes will not cover their attributable costs in the future. PR at 11. He notes that Package Services only covers its attributable costs by 0.8 percent and that the class may fail to cover costs in FY 2009 . *Id* at 11. He points out that in FY 2008 Single-piece Parcel Post and Media/Library Mail were substantially below 100 percent coverage. *Id* at 20. The Public Representative states that unless steps are taken to moderate the present cost trend, Package Services will soon be non-compliant. *Id.*

Single-Piece Parcel Post. In FY 2007, Single-Piece Parcel Post was not reported separately from the Parcel Post subclass which also included Parcel Select and Parcel Return Service. For this reason, the Postal Service used a special study approach to develop attributable costs. Using this methodology the Postal Service estimated the cost coverage to be 98.7 percent in FY 2007. For FY 2008, the Postal Service re-designed the CRA model to directly produce attributable costs for Single-Piece Parcel Post.[30]

[30] Single-Piece Parcel Post cost, revenue, and volume calculations have been evolving since the passage of the PAEA. This product was formerly a part of the Parcel Post subclass. In FY 2007, the Postal Service made efforts to separate the products based on existing data. For FY 2008 the Postal Service has collected data

Table VI-11
Package Services
Fiscal Year 2008 Volume, Revenue, Cost and Cost Coverage by Product

	Volume (000)	Revenue ($ 000)	Attributable Cost ($ 000)	Contribution to Institutional Cost ($ 000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
Package Services:								
Single-Piece Parcel Post	89,536	720,004	784,025	(64,021)	804.147	875.650	(71.503)	91.8%
Inbound Surface Parcel Post (at UPU Rates)	604	12,435	8,504	3,931	2,058.247	1,407.576	650.671	146.2%
Bound Printed Matter Flats	289,623	262,141	157,570	104,571	90.511	54.405	36.106	166.4%
Bound Printed Matter Parcels	308,561	430,148	399,192	30,956	139.405	129.372	10.032	107.8%
Media and Library Mail	158,505	420,767	478,782	(58,015)	265.460	302.061	(36.602)	87.9%
Total Package Services	**846,225**	**1,845,495**	**1,828,073**	**17,422**	**218.086**	**216.027**	**2.059**	**101.0%**

Source: PRC-ACR2008-LR1.

Based on CRA data, the Postal Service estimates that the attributable costs for Single-piece Parcel Post exceeded revenue by $64 million with a cost coverage of 91.8 percent in FY 2008. The negative contribution is not consistent with 39 U.S.C. § 3622(c)(2), which requires each class or type of mail service to bear the direct and indirect costs attributable and 39 U.S.C. § 3622(b)(5) which requires the assurance of adequate revenues, including retained earnings, to maintain financial stability.

The proximate cause for the $64 million loss was a substantial increase in unit attributable cost. Despite an increase of 15 percent in unit revenues between FY 2007 and FY 2008, unit attributable costs, which also exceeded unit revenues in FY 2007, increased by 23.6 percent. This increase in unit attributable costs not only outstripped the increase in unit revenues, but was more than 5 times the increase in inflation as measured by the CPI-U at 4.4 percent. In Docket No. R2009-2 the Commission approved an average increase of 4.5 percent for this product.

Bound Printed Matter (BPM). In FY 2007, revenues, volumes and costs were not reported separately for BPM Flats and BPM Parcels, therefore only an aggregate unit cost and unit revenue analysis can be made. Unit revenues increased 6.9 percent from FY 2007 to FY 2008, while unit attributable costs decreased 1.4 percent, which is less than the increase in inflation as measured by the CPI-U at 4.4 percent. Overall volume for the combined products decreased 6.2 percent.

FY 2008 revenues for BPM Flats and BPM Parcels partly reflect rates approved by the Commission in Docket No. R2008-1. The Commission believes that an administrative change that occurred in FY 2007 resulted in a significant reduction in single-piece volumes at retail windows.[31] Because FY 2007 volumes were used as weights to calculate the percentage change in rates, this administrative change may have had an adverse impact on rate cap calculations for Package Services in Docket No. R2008-1.[32] In the future, the Postal Service is expected to provide the

separately for Single-Piece Parcel Post. The Postal Service proposed two methodological changes prior to the filing of the 2008 ACR, which aided in the disaggregation of the former Parcel Post subclass. First, the Postal Service initiated Proposal Ten, which enabled it to separate the three products in the CRA using IOCS, CCS, and TRACS data. The PRC approved this methodological change. *See* Order No. 118 at 6. Second, the Postal Service initiated Proposal 13, which split the Single-Piece Parcel Post data out of the former combined transportation and mail processing avoidable cost models. This proposal was also approved by the Commission. *See* Order No. 156 at 3.

[31] Single-piece BPM was no longer a mailing option at the retail window. PRC Order No. 89, Order Addressing Proposed Classification Change For Bound Printed Matter, July 16, 2008, at 12-14 (Order No. 89).

[32] Order No. 89, at 12-15.

Commission with the appropriate data needed to ensure price changes do not exceed the annual rate adjustment authority for any class of mail.

For FY 2008, the Postal Service modified the CRA model to separately report data for BPM Flats and Parcels which are now separate products. The revenue for BPM Flats covered its attributable costs and made a contribution of $104.6 million to institutional costs in FY 2008, resulting in a cost coverage of 166.4 percent. The revenue for Bound Printed Matter Parcels covered its attributable costs in FY 2008 and made a contribution to institutional costs of $31.0 million, resulting in a cost coverage of 107.8 percent.

Media and Library Mail. Despite above average rate increases in Docket No. R2008-1 for this product, Media and Library Mail's attributable costs exceeded its revenue producing a net loss of $58.0 million, resulting in a cost coverage of 87.9 percent. Volumes decreased 10.25 percent, unit revenues increased 15.2 percent and unit attributable costs rose 19.8 percent, which is 4 times the inflation as measured by the CPI-U at 4.4 percent. The revenues for Media and Library Mail were less than attributable costs in FY 2007. Thus, the Commission finds that the rates for Media and Library Mail appear inconsistent with 39 U.S.C. § 3622(c)(2), which requires each class or type of mail to bear the direct and indirect costs attributable and 39 U.S.C. § 3622(b)(5) which requires the assurance of adequate revenues, including retained earnings, to maintain financial stability. In Docket No. R2009-2 the Commission approved a 7.5 percent rate increase for this product.

Worksharing

There are worksharing discounts in the following Package Service Products:

- Media and Library Mail
- Bound Printed Matter Flats
- Bound Printed Matter Parcels

In the Postal Service's ACR Fiscal Year 2008 filing it modified the calculation of avoided costs for pre-barcoding. This change affected Bound Printed Matter Flats, Bound Printed Matter Parcels, and Media and Library Mail. The Postal Service explains in USPS FY08-15 that an estimate of the time required for a Primary Parcel Sorting Machine clerk to key a 5-digit ZIP Code was used to estimate barcode savings estimates. Formerly, these products used the avoided cost from the Parcel Post subclass as a proxy, which is now classified as competitive, and is under seal. The Postal Service's efforts to compute barcode savings appear to be reasonable and no party filed comments supporting or opposing the change, therefore *the Commission accepts this method of calculating barcode savings for these products.*

The Postal Service's new method of calculating barcode costs shows a savings of 3.6 cents for BPM Flats and Parcels and 3.7 cents for Media and Library Mail compared with 3 cents from the previous study. The passthrough for pre-barcoded pieces has fallen from 103.4 percent to 83.3 percent for Bound Printed Matter Flats and Parcels, and 81.8 percent for Media and Library Mail.

Tables VI-12, VI-13 and VI-14 present each Package Service worksharing discount, its associated cost avoidance, and the discount as a percentage of the avoided cost (passthrough).

Media and Library Mail. FY 2007 passthroughs that exceeded 100 percent decreased in FY 2008. Passthroughs that were below 100 percent in FY 2007 have also decreased. Media and Library Mail 5-digit passthroughs were 264 and 253 percent respectively, in FY 2007. Table VI-12 shows these passthroughs were 197 and 189 percent in FY 2008, respectively.

This decrease is a result of Docket No. R2008-1 where the Postal Service began to better align discounts with avoided costs. The Postal Service justifies these passthroughs under § 3622(e)(2)(B) as necessary to mitigate rate shock and adds that it plans to phase the discount out over time. The Postal Service also justifies these passthroughs as mail that is educational, cultural, scientific or informational under § 3622(e)(2)(C) of title 39.

Bound Printed Matter Flats. Because of an increase in unit avoidable costs and because the Postal Service decreased discounts to reflect cost savings in Docket No R2008-1, the passthroughs shown in Table VI-13 for BPM Flats have decreased since the FY 2007 ACD. Dropshipped DDU Flats are now just below 100 percent, while dropshipped DSCF, and DBMC Flats remain above 100 percent at 107.0 percent and 140.0 percent, respectively. The Postal Service justifies these passthroughs of over 100 percent under section 3622(e)(2)(B) to mitigate rate shock and adds that it plans on phasing-out the discount over time. *The Commission accepts this justification and encourages*

Table VI-12
Media/Library Mail Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	FY 2008 Year-End Discount (Cents)	Unit Cost Avoidance (Cents)	Passthrough[1]
Media Mail			
Presorting (cents/piece)			
Basic	33.0	39.1	84.5%
(Single-piece)			
5-digit	48.0	24.4	197.0%
(Basic)			
Pre-barcoding (cents/piece)			
Single-piece Barcoded	3.0	3.7	81.8%
(Single-piece Non-barcoded)			
Library Mail			
Presorting (cents/piece)			
Basic	31.0	39.1	79.3%
(Single-piece)			
5-digit	46.0	24.4	188.8%
(Basic)			
Pre-barcoding (cents/piece)			
Single-piece Barcoded	3.0	3.7	81.8%
(Single-piece Non-barcoded)			

Source: PRC-ACR2008-LR6
Notes:
[1] The calculated passthrough percentages are based on unrounded unit avoidable costs.

the Postal Service to continue to align discounts with cost savings.

The avoided costs associated with Carrier Route Parcels have decreased, causing the passthrough to increase since the FY 2007 ACR, pushing the passthrough above 100 percent. In Docket No. R2009-2, the Postal Service reduced the discounts for Carrier Route Flats to equal the corresponding avoided costs, effectively resolving the issue.

Bound Printed Matter Parcels. Because of an increase in unit avoidable costs and because the Postal Service decreased discounts to reflect cost savings in Docket No R2008-1, passthroughs for BPM Parcels have decreased since the 2007 ACD. Table VI-14 shows Dropshipped DDU, DSCF, and DBMC Flats remain above 100 percent at 103.1, 105.0 percent and 142 percent, respectively. The Postal Service justifies these passthroughs over 100 percent under section 3622(e)(2)(B) to mitigate rate shock and the discount will be phased out over time. *The Commission accepts this justification and encourages the Postal Service to continue to align discounts with cost savings.*

The avoided costs associated with Carrier Route Parcels have decreased, causing the passthrough to increase since the FY 2007 ACR pushing the passthrough above 100 percent. *In Docket No. R2009-2, the Postal Service reduced the discounts for Carrier Route Parcels to equal the corresponding avoided costs, effectively resolving the issue.*

Table VI-13
Bound and Printed Matter Flats Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	FY 2008 Year-End Discount (Cents)	FY 2008 Unit Cost Avoidance (Cents)	FY 2008 Passthrough[3]
BPM Flats			
Presorting (cents/piece)[1]			
Basic Flats	34.7		*See* Note[1]
(Single-piece Flats)			
Carrier Route Flats	10.7	9.8	109.0%
(Basic Flats)			
Presorting (cents/pound)[1]			
Basic, Carrier Route Flats			
(Single-piece Flats)			
Zones 1&2	5.4		*See* Note[1]
Zone 3	5.1		*See* Note[1]
Zone 4	5.1		*See* Note[1]
Zone 5	5.2		*See* Note[1]
Zone 6	5.3		*See* Note[1]
Zone 7	5.0		*See* Note[1]
Zone 8	5.3		*See* Note[1]
Pre-barcoding (cents/piece)[2]			
Single-piece Automatable Flats	3.0		*See* Note[2]
(Single-piece Nonautomatable Flats)			
Basic Automatable Flats	3.0		*See* Note[2]
(Basic Nonautomatable Flats)			
Carrier Route Automatable Flats	3.0		*See* Note[2]
(Carrier Route Nonautomatable Flats)			
Dropship (cents/piece)			
Basic, Carrier Route DBMC Flats	27.0	19.3	140.0%
(Basic Origin Flats)			
Basic, Carrier Route DSCF Flats	66.0	61.7	107.0%
(Basic Origin Flats)			
Basic, Carrier Route DDU Flats	74.4	79.5	93.6%
(Basic Origin Flats)			

Source: PRC-ACR2008-LR6

Notes:

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

[2] Separate estimates of pre-barcoding cost savings are not available for BPM flats. Based on the cost savings for BPM Parcels, the pre-barcoding discount for BPM flats implies a passthrough of 82.3 percent.

[3] The calculated passthrough percentages are based on unrounded unit avoidable costs.

Table VI-14
Bound Printed Matter Parcels Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	FY 2008 Year-End Discount (Cents)	Unit Cost Avoidance (Cents)	Passthrough [2]
BPM Parcels/IPPs			
Presorting (cents/piece)[1]			
Basic Parcels/IPPs	44.7	*See* Note[1]	
(Single-piece Parcels/IPPS)			
Carrier Route Parcels/IPPs	10.7	9.8	109.0%
(Single-piece Parcels/IPPS)			
Presorting (cents/pound)[1]			
Basic, Carrier Route Parcels/IPPs			
(Single-piece Parcels/IPPs)			
Zones 1&2	5.3	*See* Note[1]	
Zone 3	5.0	*See* Note[1]	
Zone 4	5.0	*See* Note[1]	
Zone 5	5.1	*See* Note[1]	
Zone 6	5.2	*See* Note[1]	
Zone 7	4.9	*See* Note[1]	
Zone 8	5.2	*See* Note[1]	
Pre-barcoding (cents/piece)			
Single-piece Barcoded Parcels/IPPs	3.0	3.6	82.3%
(Single-piece Nonbarcoded Parcels/IPPs)			
Basic Barcoded Parcels/IPPs	3.0	3.6	82.3%
(Single-piece Nonbarcoded Parcels/IPPs)			
Carrier Route Barcoded Parcels/IPPs	3.0	3.6	82.3%
(Single-piece Nonbarcoded Parcels/IPPs)			
Dropship (cents/piece)			
Basic, Carrier Route DBMC Parcels/IPPs	27.4	19.3	142.0%
(Basic Origin Parcels/IPPs)			
Basic, Carrier Route DSCF Parcels/IPPs	64.8	61.7	105.1%
(Basic Origin Parcels/IPPs)			
Basic, Carrier Route DDU Parcels/IPPs	81.9	79.5	103.1%
(Basic Origin Parcels/IPPs)			

Source: PRC-ACR2008-LR6.

Notes:

[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 passthrough percentages are based on unrounded unit avoidable costs.

Special Services

Introduction

The Special Services class consists of ten products that can be separated into three groups, Ancillary Services (treated as a product)[33]; "Stand-Alone" Services (contains six products)[34]; and International Special Services (contains three products).[35]

The principcal findings for Special Services in FY 2008 are:

- The Special Services class earned $2.8 billion in revenue and contributed more than $600 million towards institutional costs, which is third highest contribution amount for all market dominant classes;
- The revenues for Registered Mail and Stamped Cards did not cover their corresponding attributable costs; and
- In order to analyze all products within the Special Services class, the Postal Service must provide cost, revenue, and transaction data for all products, including Confirm, Address List Services, and Change-of-Address Credit Card Authentication Service.

For FY 2008, the Special Services class as a whole, including International Mail services, produced a cost coverage of 128.1 percent – a decrease of 11 percent from the 139.1 percent in FY 2007.[36]

Ancillary Services

The Ancillary Services product consists of a number of individual services that may only be used in conjunction with other mail services. The Ancillary Services product had a cost coverage of 124.3 percent and a contribution of $330 million.

Although the revenue for the product, Ancillary Services, is consistent with section 39 U.S.C. § 3622(c)(2), the revenues for three services fell short of the meeting the requirement "that each class of mail or type of mail service must cover its attributable costs and make a reasonable contribution to institutional costs," as well as the objective in section 3622(b)(5) that rates ensure adequate revenues to maintain financial stability. Revenues for Registered Mail and Stamped Cards did not cover their attributable costs, while Insurance fees collectively did not make a reasonable contribution to institutional costs. The cost coverages for the three services were 98.5 percent, 72.4 percent, and 100.5 percent, respectively.

Registered mail incurred a loss of 22 cents per transaction and had a total negative contribution of $860 thousand. Compared with the FY 2007 loss of 48 cents per transaction, Registered Mail's cost contribution is improving. *Effective May 11, 2009, the Postal Service plans to raise Registered Mail fees by 8.69 percent. This fee increase should help Registered Mail service to increase its contribution to the institutional cost of the Postal Service, provided Registered Mail's unit attributable cost increase at a lower rate.*

Stamped Cards incurred a loss of 0.76 cents per transaction and had a total negative contribution of $377 thousands. Compared with the FY 2007 positive contribution of 0.75 cents per transaction, Stamped Cards' unit attributable cost is increasing while its unit revenue remains constant. However, when combined, the cost coverage for Stamped Cards and Stamped Envelopes is 213.9 percent, which mitigates the impact of the loss from Stamped Cards. *See* Table VI-15.

Additionally, an analysis of the unit attributable costs for each ancillary service reveals that the unit attributable cost for each service increased from FY 2007 to FY 2008. Stamped Cards had the highest percentage increase in unit attributable cost, 112.3 percent, or more than 25 times the FY 2008 CPI-U. Moreover, the volume for Stamped Cards decreased

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[33] The Ancillary Services is a domestic product which contains 22 separate services: (1) Address Correction Service; (2) Applications and Mailing Permits; (3) Business Reply Mail; (4) Bulk Parcel Return Service; (5) Certified Mail; (6) Certificate of Mailing; (7) Collect on Delivery; (8) Delivery Confirmation; (9) Insurance; (10) Merchandise Return Service; (11) Parcel Airlift; (12) Registered Mail; (13) Return Mail; (14) Return Receipt for Merchandise; (15) Restricted Delivery; (16) Shipper-Paid Forwarding; (17) Signature Confirmation; (18) Special Handling; (19) Stamped Envelopes; (20) Stamped Cards; (21) Premium Stamped Stationery; and (22) Premium Stamped Cards.

[34] Stand Alone Services include six domestic products: Address List Services; Confirm Service; Caller Service and Reserve Number; Change-of-Address Credit Card Authentication; Money Order; and post office Boxes.

[35] There are three International Special Services products: International Ancillary Services (which consists of International Certificate of Mailing, International Registered Mail, International Return Receipt, and International Restricted Delivery); International Reply Coupon Service; and International Business Reply Mail Service.

[36] For a discussion of International Special Services, please refer to the International section in this chapter.

by 53.4 percent.[37] *These volume and unit cost declines, if they continue during FY 2009 indicate a problematic future for Stamped Cards that should be carefully reviewed by the Postal Service in its Annual Compliance Report for FY 2009. The Postal Service is urged to find ways to reduce the costs for Stamped Cards as well as better align the revenue with the costs in the next rate case.*

Insurance contributed 1.39 cents per transaction and had a total positive contribution of $716 thousand. Compared with the FY 2007 contribution of 48.98 cents per transaction, it is clear that Insurance's unit attributable costs are increasing at a faster rate than unit revenue. According to the January 27, 2009 *Federal Register*, the Postal Service proposed to revise its regulations governing the processing and adjudication of domestic mail insurance claims by making its online claims processing service available to customers who purchase domestic insurance through any retail channel.[38] If adopted, this proposal could help reduce the attributable costs for Insurance. Additionally, effective May 11, 2009, the Postal Service plans to raise the fee for Insurance by 3.81 percent which is close to the average increase for Special Services of 3.825 percent. *It would be important to monitor the attributable costs for Insurance prior to the FY 2009 ACR. If unit attributable costs for Insurance continue to grow at a faster rate than unit revenues, the Postal Service should develop other means to reduce unit attributable costs and/or increase revenues in the next rate case.*

The Postal Service distributes the revenue for some Ancillary Services to their host mail class as fee revenue and thus, such revenue is not included in the calculation of the cost coverage for Ancillary Services.[39] Historically, the cost, revenue, and volume for Special Handling were included with the Ancillary Services product's cost coverage. This year, however, the Postal Service distributed the costs to their host piece. In response to Order No. 169, the Postal Service stated that "reallocating the cost of Special Handling to the host piece products brings the CRA into conformance with the way the Special Handling fees have customarily been treated in the RPW." Response to Order No. 169 at 8.

"Stand-Alone" Special Services

As noted above, there are six "stand-alone" services each of which is classified as a separate product: Address List Services, Confirm Service, Caller Service and Reserve Number [40], Change-of-Address Credit Card Authentication, Money Orders, and post office Boxes. As separate products, each of the six stand-alone services should individually cover attributable costs.

Money Orders had a cost coverage of 146.2 percent and a contribution of $71 million. PO Boxes and Caller Service combined for a cost coverage of 140.04 percent and a contribution of $256 million.[41]

An analysis of the unit attributable costs for Money Orders and post office boxes (including Caller Service) reveals that the unit attributable cost for both services increased from FY 2007 to FY 2008. For Money Orders, unit attributable costs increased 12.07 percent. For post office boxes/Caller Service, unit attributable costs increased 7.81 percent. Furthermore, the volume for the two services increased by 8.46 and 1.27 percent, respectively.

The Postal Service did not isolate costs, revenues, and volumes for Confirm Service, Caller Service, Change-of-Address Credit Card Authentication, and Address List Services.[42] ACR at 8-9. This precludes the Commission from evaluating the cost coverage for the above-referenced stand-alone Special Services. *For its subsequent Annual Compliance Reports, the Postal Service must isolate costs and revenues for all stand-alone Special Services products.*

The absence of cost data is particularly troublesome, with respect to Confirm Service, because in Docket No. R2009-2, the Postal Service proposed to raise the fees for Confirm service product by 149 percent. The Commission rejected the Postal Service's request for several reasons, including the fact that without cost, revenue, or volume data, the Commission has no "reliable basis for concluding that an increase of this magnitude [963.8 percent] targeted solely at mail agents for Platinum Service will 'better' align costs with

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[37] Compare the FY 2007 unit attributable cost and total volume with the FY 2008 unit attributable cost and volume listed in Table VI-15.
[38] *See Federal Register*, Vol. 74, No. 16, January 27, 2009
[39] These services are Address Correction Services, Business Reply, Bulk Parcel Return Service Certificate of Mailing, Merchandise Return Services, Parcel Airlift, and Shipper Paid Forwarding.
[40] For Caller Service, the CRA combines the revenue, volume and, and costs with post office Boxes.
[41] The Commission suggests in future filings that the Postal Service should attempt to provide billing determinants and costs for anticipated changes in post office Box reclassifications that result in the migration of post office Boxes from one rate category to another.
[42] The revenue for Confirm, Change-of-Address Credit Card Authentication, and Address List Services are included in Library Reference PRC-ACR2008-LR1, FY Postal Service's Finances.

Table VI-15
Special Services Fiscal Year 2008 Volume, Cost, Revenue, and Cost Coverage by Product

	Units [1] (000)	Total Revenue ($ 000)	Attributable Cost ($ 000)	Contribution to Institutional Cost ($ 000)	Unit Revenue (Cents)	Unit Cost (Cents)	Contribution to Institutional Unit Cost (Cents)	Cost Coverage
MARKET DOMINANT SPECIAL SERVICES								
Domestic Special Services:								
Ancillary Services:								
Certified Mail	268,917	717,822	602,622	115,200	266.931	224.092	42.838	119.1%
COD	1,155	8,136	6,835	1,301	704.361	591.750	112.611	119.0%
Insurance	51,595	144,582	143,865	716	280.223	278.835	1.388	100.5%
Registered Mail	3,861	56,883	57,744	(860)	1,473.211	1,495.489	(22.279)	98.5%
Stamped Envelopes [2]		23,421	10,046	13,375				233.1%
Stamped Cards	49,375	987	1,364	(377)	2.000	2.763	(0.763)	72.4%
Stamped Envelopes and Cards	49,375	24,408	11,411	12,998	49.435	23.110	26.324	213.9%
Other Ancillary Services: [3]	1,208,210	734,471	533,670	200,802	60.790	44.170	16.620	137.6%
Total Ancillary Services	1,583,113	1,686,303	1,356,147	330,156	106.518	85.663	20.855	124.3%
"Stand-Alone" Special Services:								
Money Orders	149,125	223,336	152,789	70,548	149.765	102.457	47.308	146.2%
Post Office Box Service	15,068	896,656	640,346	256,310	5,950.739	4,249.715	1,701.024	140.0%
Other Special Services[4]								
Total "Stand-Alone" Special Services	164,193	1,119,993	793,135	326,857	682.121	483.052	199.070	141.2%
International Special Services[5]	2,053	26,652	62,728	(36,076)	1,298.376	3,055.835	(1,757.459)	42.5%
Total Market Dominant Services	1,749,358	2,832,948	2,212,010	620,938	161.942	126.447	35.495	128.1%

Source: PRC-ACR2008-LR1

Notes:

[1] "Units" represents the number of transactions for each service, except for Stamped Envelopes, which are individual envelopes or boxes of envelopes, and post office Boxes, which represents primarily P.O. Box Rentals.

[2] The CRA and RPW do not report volume for Stamped Envelopes.

[3] Other Ancillary Services includes those Ancillary Services for which the FY 2008 ACR did not provide service-specific costs

[4] The FY 2008 ACR did not provide costs, revenue, or transactions for Other Special Services. The Other Special Services are Address List Services, Confirm Service, and Change-of-Address Credit Authentication Service.

[5] International Special Services are discussed in the International Mail section of this chapter.

revenues."[43] In response to the Commission's Order in Docket No. R2009-2, the Postal Service withdrew this aspect of its proposal. Docket No. R2009-2, Notice of the United states Postal Service of Filing Amended Notice of Market Dominant Price Adjustment at 1.

Market Dominant International Mail Products

For market dominant (and competitive) International Mail products, the distinction between rates and fees applicable to outbound and inbound mail has important ramifications for the financial performance of International Mail. For most of FY 2008 (prior to May 12, 2008), outbound rates and fees were set by the Postal Service without prior Commission review according to the provisions of the PRA. On that date, new market dominant outbound mail rates were implemented by the Postal Service following Commission review pursuant to the provisions of the PAEA.

By contrast, rates and fees paid to the Postal Service for handling inbound International Mail are not entirely in its control. [44] In the case of letter post [45]—the largest category of inbound mail—the Postal Service receives revenues from terminal dues payments based upon rates established by international agreement through the Universal Postal Union (UPU), of which the United States is a member.[46] However, such rates are non-compensatory to the Postal Service and, pursuant to the UPU agreement, are renegotiated once every four years. The effect of non-compensatory terminal dues rates for an extended period of time has predictable, and negative, consequences on the financial performance of inbound mail, specifically, and market dominant International Mail, generally.

There is a problem with identifying the revenue for inbound International Mail. The Postal Service has two figures for each inbound product. One figure is booked revenue and the other figure is imputed revenue. Booked revenue reflects an accrual methodology which means the Postal Service books the revenue it expects to receive in a specific fiscal year. The Postal Service that prepares the cost and revenues for International Mail using imputed revenues which are conceptually easy to understand, but different from booked revenue.

The Postal Service knows the rate per piece and per kilogram that it will receive from each country and it knows, more or less because of sampling, the pieces and kilograms it receives from each country or group of countries. To calculate the imputed revenue, the Postal Service multiplies the known rates by the known piece and weight volumes. However the rates are not in dollars but in a currency unit called special drawing rights (SDR). Although, the SDR rates are known with certainty, the U.S. dollar-SDR ratio fluctuates daily. To calculate imputed revenues, the Postal Service uses the average dollar/SDR ratio for the fiscal year under study. However, payments are settled on a continuing basis and at the time of actual payment the Dollar/SDR ratio on the day of settlement is used, not the average for the year. There are also differences due to disagreements over the actual volume exchanged. These factors, among other things, apparently give rise to the difference between booked revenues and imputed revenues.

Imputed revenue exceeded booked revenue by roughly $100 million in FY 2008. If one adds the booked revenue of domestic mail and services, the booked revenue of outbound International Mail and services, and the imputed revenue for inbound International Mail and services, the sum exceeds the

[43] *See* Order No. 191, Order Reviewing Postal Service Market Dominant Price Adjustments, where the Commission found that the mail agent rate for Gold and Platinum tier Confirm Service inconsistent with applicable law. Order No. at 72.

[44] There are three types of payment generally referred to as settlement charges:

- Terminal dues are charges imposed on all inbound "letter post." The Postal Service assesses terminal dues at rates set by the Universal Postal Union (UPU) on all developing countries (DCs) and industrialized countries (ICs), except Canada, which pays terminal dues based upon rates established in a negotiated bilateral agreement, i.e., non-UPU rates.
- Imbalance charges, established by the Postal Service, are payments received for handling inbound Express.
- Inward land charges consist of payments received for handling inbound Surface and Air Parcel Post. For the Postal Service, country payments for inward land charges parallel payments of terminal dues. All countries pay inward land charges at UPU rates, except Canada, which pays such charges at non-UPU rates based on a bilateral agreement.

[45] The term "letter post" refers to mail that is not Parcel Post or Express. Thus, letter post, also referred to as LC/AO mail, basically contains mail similar to domestic First-Class Mail, Periodicals, Standard Mail, Bound Printed Matter, and Media/Library Mail, weighing up to four pounds.

[46] The Universal Postal Union (UPU) is a United Nations technical agency through which international treaties governing the exchange of International Mail, including rates, are negotiated among its 191 members. The U.S. is a member of the UPU.

booked revenue the Postal Service shows for all its operations by about $100 million. This difference is important not only because there should be only one revenue figure for the Postal Service and not only because the sum of the parts should equal the whole, but because it is important to know with certainty the revenue for each product for statutory and business reasons.

For all these reasons, the Postal Service must develop a system by which there is only one revenue figure reported in its Annual Compliance Report.

The sections below use booked revenues for inbound mail.

The primary findings for Market Dominant Mail in FY 2008 are:

- Revenues exceeded attributable costs for market dominant International Mail products as a whole, providing a contribution to institutional cost of the Postal Service by $88.2 million;
- Revenues exceeded attributable costs for outbound single-piece First-Class Mail International and outbound International Ancillary Services by $222.1 million and $6.1 million, respectively;
- Revenues for market dominant inbound single-piece First-Class Mail International revenues did not cover attributable costs by $101.8 million;
- The Postal Service must bring book revenues and imputed revenues into alignment so that there is only one revenue figure each fiscal year for International Mail and the Postal Service as a whole.

Financial Analysis

Market dominant International Mail consist of the following outbound and inbound products: Outbound Single-piece First-Class Mail International, International Ancillary Special Services; Inbound Single-piece First-Class Mail International, Surface Parcel Post (at UPU rates), International Reply Coupon Service, and International Business Reply Mail Service.[47] As a whole these market dominant products provided a net contribution to the institutional costs of the Postal Service during FY 2008 of $88.1 million on revenues of $942.4 million and costs of $854.2 million. This overall net increase, however, includes a $140.0 million loss in contribution from market dominant inbound mail.

Market dominant outbound mail products

Market dominant outbound Single-piece First-Class Mail International (FCMI) is the largest source of International Mail contribution. For FY 2008, outbound single-piece FCMI provided a net contribution to institutional costs of $222.1 million on revenues of $747.2 million and costs of $525.1 million. ACR, Table 1, at 18. The cost coverage for outbound FCMI was 142.2 percent. *Id*.

Market dominant inbound mail products

During FY 2008, as in FY 2007, inbound single-piece First-Class Mail International did not cover its attributable costs. The loss from inbound single-piece First-Class Mail International was $101.8 million on revenues of $156.1 million and attributable costs of $257.9 million. The resulting cost coverage for inbound FCMI during FY 2008 was 60.5 percent, a modest improvement over FY 2007. Inbound International Ancillary Special Services revenues also did not cover costs, caused solely by a net loss in contribution by Registered Mail of $42.1 million.

In contrast to inbound FCMI, inbound Surface Parcel Post at UPU rates generated sufficient revenues to cover its attributable costs by $3.9 million.

The net loss in contribution for inbound single-piece First-Class Mail International continues a trend identified by the Commission in its annual Reports to Congress on the revenues, volumes and costs of International Mail that began in FY 1998.[48] For a

[47] For market dominant products, certain "ancillary" Special Services are grouped into one product, while other special services are classified as separate products. International special services within the Ancillary Services product are Certificate of Mailing, Registered Mail, Return Receipt, Restricted Delivery, and Customs Clearance and Delivery Fee. These services can be purchased only in conjunction with the purchase of mail services. Other international special services products—Reply Coupon Service and Business Reply Mail Service—can be purchased on a "stand-alone" basis.

[48] Pursuant to section 3663 of the Postal Reorganization Act, the Commission issued eight annual reports, apart from IM99-1, to Congress, covering Fiscal Years 1998 through 2005. *See* Docket Nos. IM99-1, IM2000-1, IM2001-1, IM2002-2, IM2003-1, IM2004-1, IM2005-1 and IM2006-1. However, the content of these reports are not public. *See* 112 Stat. 2681-527.

number of years (including FY 2007), terminal dues revenues from foreign postal administrations, with the exception of Canada, failed to cover the attributable costs of inbound First-Class Mail International. The rates that determine the amount of revenues are set by the UPU once every four years, as noted earlier. These rates are not compensatory. Moreover, the fact that UPU terminal dues rates are insufficient to cover costs is exacerbated by the Postal Service's likely failure to meet UPU quality-of-service "targets" and obtain the maximum terminal dues revenues for inbound First-Class Mail International, as discussed below. The non-compensatory nature of inbound letter post means that domestic mailers continue to subsidize foreign mailers who use the same postal infrastructure, but bear none of the burden of contributing to its institutional cost.

Under the PAEA, the Department of State has lead responsibility for the formulation of international postal policy. The Department of State must carry out this responsibility in close coordination with other agencies, including the Commission. *See* 39 U.S.C. § 407(b)(2), (c). The Commission regularly attends the Postal Operations Council meetings and the Council of Administrations meetings in Bern, Switzerland with lead and/or backup responsibilities for the following work groups:

- Postal Operations Council
  - Letter Post Quality Improvement Group
  - Parcel Post Quality Improvement Group
  - Terminal Dues Group for Letter Post
  - Remuneration Group for Parcel Post
- Council of Administration
  - Reform of the Union Project Group
  - Terminal Dues Governance Issues Project Group
  - Acts of the Union Project Group
  - Universal Postal Service Project Group
  - Interconnectivity Project Group (Extra-territorial Offices of Exchange and International Mail Processing Center codes)
  - Postal Economics
  - Consultative Committee (private sector)

At the UPU Congress in July 2008, members agreed to examine a methodology more reflective of domestic rates. *The Commission will work closely with the Department of State and the Postal Service to negotiate more compensatory terminal dues rates over the next UPU Congress cycle.*

Pursuant to the UPU Convention, the Postal Service (or any postal administration) may opt out of the UPU-established rates by negotiating bilateral or multilateral rate agreements with other countries for some or all of its inbound letter post. This suggests another important option available to the Postal Service to obtain compensatory rates and bring the cost coverage for inbound First-Class Mail International into compliance with the requirements of the PAEA.

Quality of Service Link to Terminal Dues Revenues

Terminal dues revenues are derived from payments for handling and delivering inbound letter post. Under the UPU's "quality of service link to terminal dues" system, payments are adjusted for the quality of delivery service provided in the country of destination for inbound letter post coming from other countries participating in the system.

As an incentive for participating in the system, the Postal Service receives a 2.5 percent increase in its terminal dues payments, and is eligible for a 2.5 percent bonus payment if service performance achieves the UPU-established annual performance "target." For the Postal Service, that target is a percentage of inbound letter post delivered within the overnight, 2-day, and 3-day service standard for First-Class Mail. The UPU-established quality of service target was 86 percent and 88 percent for calendar years 2007 and 2008, respectively. The Postal Service can earn up to 105 percent of its otherwise expected terminal dues revenues for achieving the established target when delivering inbound single-piece First-Class Mail International. However, the Postal Service can also be penalized if its annual service performance does not achieve the target. The penalty is a 1/3 percent (0.0333 percent) reduction of its expected terminal dues payment for each percentage point that service performance falls below the annual service performance target, not to exceed five percent.[49]

[49] Universal Postal Union, *Quality of Service Link to Terminal Dues for Countries in the Target System: Users Manual* (24 March 2007), Module 3 – Remuneration Principles. The remuneration formula is:

In FY 2008, terminal dues payments from participating countries to the Postal Service for delivering inbound single-piece First-Class Mail International did not cover attributable costs. Because the Postal Service did not meet the UPU quality of service target for calendar year 2007, it received less than the 105 percent maximum terminal dues payments for the first quarter (October-December, 2007) of FY 2008. Preliminary service performance data for January through November 2008, however, suggests improvement in achieving the UPU quality of service target compared to the same period last year. The Postal Service attributes the improvement to the retraining of managers at International Service Centers (ISCs) on the business rules of the quality of service link measurement system, and implementation of processes to improve the mailflow through ISCs, among others.[50] Nevertheless, the Postal Service is unlikely to meet the UPU quality of service target for calendar year 2008. As a result, failure to meet the UPU target for calendar year 2008 means the Postal Service will forego the maximum terminal dues revenues, equal to 105 percent, for the last three quarters of FY 2008. The Commission notes the improvement in service performance under the quality of service link to terminal dues system and encourages additional efforts to further improve the service performance for, and the cost coverage (albeit by a relatively small amount) of, inbound single-piece First-Class Mail International.

Negotiated Service Agreements

In FY 2008, the Postal Service had market dominant Negotiated Service Agreements (NSAs) in effect with Bank One Chase (MC2004-3), Discover (MC2004-4), HSBC (MC2005-2), Bookspan (MC2005-3), Bradford (MC2007-4), Lifeline (MC2007-5), and Bank of America (MC2007-1). Each of these except for Bank of America offer discounts designed to encourage higher mail volumes and most include provisions to reduce Postal Service costs. The discounts in the Bank of America NSA are designed to reward the mailer for participating in specified programs and meeting operational benchmarks.

Remuneration = 100 percent - [(Quality of Service Target – Actual Quality of Service) x Penalty Factor] + 2.5 percent Participation Incentive. If, for example, Actual Quality of Service were 70 percent, remuneration would be 100 percent - [(85 percent - 70 percent) x 1/3 percent] = 95 percent + 2.5 percent = 97.5 percent. *Id*.

[50] Response (Non-Public) of the United States Postal Service to Commission Information Request No. 4, Question 5.

The agreement with Bank One Chase expired in FY 2008. The limitation on discounts was reached in the previous year, and the Postal Service reports that the mailer did not use the cost-reducing electronic address correction service (ACS) option. Thus, the agreement had no impact on the Postal Service's finances this year. The agreement with Discover also expired this year, and volumes fell short of the level necessary to qualify for volume incentive discounts. However, the use of electronic ACS generated approximately $68,000 in savings for the Postal Service.

The Bradford NSA was implemented during FY 2008 and generated discounts in its first quarter of operation. The agreement with Lifeline was implemented late in the fiscal year, and no discounts were reported. Due to the annualized discount schedules central to these NSAs, it is necessary to have a full year of data to determine their effect on Postal Service finances. Therefore, no estimates are available for these agreements at this time.

HSBC did not send enough volume to qualify for volume discounts and it did not utilize electronic ACS. It therefore had no effect on Postal Service finances.

Bookspan was the only NSA partner to qualify for volume-incentive discounts in FY 2008, collecting over $350,000 in discounts. Based on the contract year after rates volume, the marginal discount earned, and the Standard Regular own price elasticity, roughly 4 million incremental pieces can be attributed to the discounts. This implies discounts were paid on over 10 million pieces that would have been sent without the incentive. Since the agreement is designed to encourage Standard Mail volume, which is not eligible for free forwarding and return service, there is no provision to generate savings through the use of electronic ACS. The net financial effect of the Bookspan NSA is a loss of about $72 thousand in contribution for the Postal Service.[51] Table VI-16 summarizes the financial effects of volume-incentive NSAs for the past two fiscal years.

The Bank of America NSA, which was implemented in FY 2008, was proposed as a pay-for-performance

[51] The 2008 Standard Mail Regular Elasticity is -0.311, as provided in the attachment to the January 16, 2009 letter from Andrew German. Using this elasticity instead of the 2007 value in the Postal Service filing, the net effect of the Bookspan NSA is $114,948 lost contribution. The Postal Service's calculations in USPS-FY08-30 use fiscal year volume, instead of contract year volume. This apples to potatoes comparison does not generate valid results because the volumes do not correspond to the (contract year) discount schedules. *See* RM2008-4, Order No. 104.

Table VI-16
Summary of NSA Net Effect on Postal Service Contribution
($Thousands)

	FY 2007		FY 2008		
	Discount Incentives	**ACS Net Savings**	**Discount Incentives**	**Net cost Savings**	**Total Net Benefit**
Capital One	–	2,243			2,243
HSBC	–	–	–	–	–
Discover	878	68	–	68	1,013
Bank One Chase	(957)	174	–	–	(783)
Bookspan	92	–	(72)	–	21
Total	13	2,484	(72)	68	2,493

Note: Each figure reflects a contract year that ended during the fiscal year covered by the ACR.

agreement whereby the mailer is rewarded with discounts for participating in specified Postal Service programs (e.g., Intelligent Mail) and achieving benchmark operational performance targets (e.g., read/accept rates). In response to a Commission inquiry, the Postal Service filed selected data for the first six months of operation (April 2008-September 2008).[52]

The Postal Service reports that the established methodology yields an estimated net contribution loss of $3.8 million.[53] The Postal Service goes on to state that it has identified other costs for consultants, software and hardware used solely for this agreement, which add an additional $2.6 million in FY 2008 costs. With the addition of these costs, which were not identified previously for this or any other NSA, the Postal Service estimates it lost $6.4 million in contribution in the first six months of the Bank of America agreement. The Postal Service's response does not identify the extent to which it is achieving the operational benefits that it expected to "provide a convincing reason, despite any estimated reduction in contribution, for proceeding with implementation of the NSA." MC2007-1, Governors' Decision at 5. These losses and lack of identified efficiencies raise serious issues. However, the Commission is concurrently hearing a complaint related to the agreement. *See* Docket No. C2008-3.

PAEA allows for a streamlined review process for both market dominant and competitive NSAs. In FY 2008 the Commission reviewed and approved 17 competitive agreements, many within 15 days. However, no market dominant NSA has been brought before the Commission since the passage of PAEA and the implementation of new NSA rules.

[52] *See* Notice of the United States Postal Service Regarding Material Filed Under Seal as USPS-FY08-NP36 in Response to Question 7 of Commission Information Request No 5. (March 16, 2009).
[53] The Postal Service's calculations have not been fully reviewed by the Commission. The estimate may overstate the net loss in contribution by assuming that the agreement caused the read/accept rate for Bank of America's mail to decrease, leading to higher costs.

CHAPTER VII — COMPETITIVE PRODUCTS

Introduction

Section 3653(b)(1) of title 39 requires the Commission to determine "whether any rates or fees in effect during [the prior fiscal] year (for products individually or collectively) were not in compliance with applicable provisions of this chapter (or regulations promulgated there under)[.]" Section 3633(a) prescribes the legal standards, implemented through Commission regulations, governing the Commission's review of all competitive products.

PRC Order No. 43 adopted regulations establishing standards for determining the lawfulness of competitive products' rates or prices. PRC Order No. 43, October 29, 2007. It first established which products would be considered to be competitive. This competitive product list has been subsequently amended pursuant to 39 USC § 3642. The list of competitive products for Fiscal Year 2008 are shown in Table VII-1.

In this chapter the Commission reviews competitive mail products, both domestic and international, for compliance with the requirement of the PAEA. The Commission's review is guided by section 3633(a) of title 39. section 3633(a) of title 39 sets forth the legal standards applicable to rates for competitive products, directing the Commission to promulgate regulations to:

- Prohibit subsidization of competitive by market dominant products - section 3633(a)(1);
- Ensure that each competitive product covers its attributable costs - section 3633(a)(2); and
- Ensure that collectively competitive products cover an appropriate share of institutional costs of the Postal Service - section 3633(a)(3).

Table VII-1
Competitive Domestic and International Products

DOMESTIC

Express Mail;
Priority Mail;
Parcel Select;
Parcel Return Service;
Premium Forwarding Service;
Domestic Competitive NSA Mail [1]

INTERNATIONAL

Outbound International Expedited Services;
Inbound International Expedited Services;
Outbound Priority Mail International;
Inbound Air Parcel Post;
International Priority Airlift (IPA);
International Surface Airlift (ISAL);
International Direct Sacks M-Bags;
Inbound Surface Parcel Post (at non-UPU rates);
International Money Transfer Service;
International Ancillary Services;
International Competitive NSA Mail[2]

[1] Express Mail Contract 1 was approved in Commission Order No. 94, August 8, 2008. The Postal Service states that this contract had no operational activity in FY 2008; therefore no data exists. *See* USPS ACR at 63.
[2] There were 39 International Negotiated Service Agreements (NSAs), also known as International Customized Mail (ICM) agreements, reported by the Postal Service during FY 2008. In Order No. 43, the Commission determined that each ICM agreement was a product. Docket No. RM2007-1, October 29, 2007, ¶ 2177. PRC-ACR2008-NP-LR3 lists the revenues, attributable costs, and contribution for each ICM agreement.

For FY2008, the Commission's principal findings with respect to competitive products are:

- Revenues from the Postal Service's competitive products as a whole exceeded the sum of their attributable costs, plus group-specific costs. Thus, market dominant products did not subsidize competitive products during FY 2008 and the Postal Service met the requirements of with section 3633(a)(1).
- Revenues from five products rates of "general applicability," and two products with rates "not of general applicability" were less than the costs attributed to them. Accordingly, the Postal Service did not meet the requirements of section 3633(a)(2) during FY 2008.
- The contribution from competitive products to the recovery of the Postal Service's institutional costs was greater than 5.5 percent. Consequently, the Postal Service met the requirements of section 3633(a)(3) during FY 2008.

Section 3633 (a)(1)

The incremental costs of competitive products are used to test whether revenues from market dominant products cross-subsidize competitive products. However, if incremental cost data are unavailable, Commission rules specify the use of competitive products' attributable costs, supplemented to include causally related, group-specific costs.[1] 39 CFR § 3015.7(a).

When it filed its FY 2007 Annual Compliance Report, the Postal Service reported it had not yet developed the capability for calculating group-specific competitive costs. Therefore, in its FY 2007 Annual Compliance Determination (ACD), the Commission evaluated whether revenues from competitive services were greater than their incremental costs by examining whether these revenues exceeded the sum of competitive attributable costs. FY 2007 ACD at 11.

In Order No. 115, the Commission established that a function that "…unambiguously supports only one product group…" would be considered group specific. For this reason, the Commission authorized the Postal Service to establish total group-specific costs as equal to group-specific headquarters' costs contained in Cost Segment 18. Order No. 115, RM2008-2 at 11.

The Commission issued several information requests on this subject.[2] The Postal Service's responses revealed that revenues for certain International Mail products and services reported in the Revenue, Pieces and Weight (RPW) report were lower than revenues reported in the International Cost and Revenue Analysis (ICRA) report. As discussed previously, the Postal Service uses imputed revenues for inbound mail in the ICRA rather than booked revenue.

Based upon revenues from the RPW, the Commission determined that revenues from competitive products were greater than the sum of competitive attributable costs plus competitive group-specific costs in FY 2008. *Consequently, the Commission finds that revenues from market dominant products do not subsidize competitive products. Accordingly, the Commission finds the Postal Service met the requirements of section 3633(a)(1) during FY 2008.*

Section 3633(a)(2)

Section 3633(a)(2) requires revenues from each competitive product to be greater than the costs attributed to that particular product. In making this determination with respect to competitive International Mail products, the Commission relies on the booked revenues from RPW and costs reported in the ICRA for inbound mail products.

For FY 2008, the Commission finds there were five products with rates of general applicability whose revenues did not exceed their respective attributable costs. All of them were international products:

- International Priority Airmail (IPA);
- International Money Transfer Service;
- Inbound International Expedited Services;
- Inbound Air Parcel Post; and
- Inbound Surface Parcel Post (at Non-UPU rates).

In addition, there were two International Customized Mail (ICM) agreements that did not generate sufficient revenues to cover their corresponding attributable costs. A more detailed

[1] Group-specific costs are "those costs which cannot be attributed to individual products, but which are caused by either competitive or market dominant products as a group." Order No. 115, RM2008-2 at 4.

[2] *See* Commission Information Request (CIR) No. 1, Question 10, and CIR No. 2, Questions 3 and 4.

discussion of competitive international products of general applicability and ICM agreements, with respect to section 3633(a)(2), is set forth below.

Section 3633(a)(3)

In implementing section 3633(a)(3), the Commission established that if the contribution earned by competitive products was equal to 5.5 percent or more of the institutional costs of the Postal Service, then competitive products would be making an appropriate contribution toward the recovery of its institutional costs.[3] Thus, the Postal Service's competitive products as a whole would meet the requirements of section 3633(a)(3) if the dollar value of the sum of their contributions were equal to or greater than 5.5 percent of the Postal Service's institutional costs.

In Order No. 115, Docket No. RM2008-2, the Commission determined that group-specific costs should not be subtracted from institutional costs in order to arrive at a new definition of institutional costs.[4] In order to remain consistent, and maintain historical relationships between the contribution associated with competitive products and traditionally measured institutional costs, the Commission also decided that the appropriate use of group-specific costs should be limited to the incremental cost test. *See* section 3633(a)(1). Thus, group-specific costs would neither be subtracted from institutional costs, nor added to competitive costs, when determining whether the contribution from competitive products equaled at least 5.5 percent of the Postal Service's institutional costs.

In the FY 2007 ACD, the Commission determined that the contribution from the Postal Service's competitive products was greater than 5.5 percent of its institutional costs.[5] This year, the Postal Service reports institutional costs of $32.219 billion and a contribution from competitive products that exceeds 5.5 percent of this amount. FY 2008 (ACR) at 66.

As a result of the updated information obtained through several Commission Information Requests, the Commission calculates a revised estimate of the contribution provided by competitive products. Based upon these calculations, the Commission estimates that competitive products must provide more than $1.77 billion in contribution in order to provice 5.5 percent of the Postal Service's FY 2008 total institutional costs of $32.14 billion. For FY 2008, the Commission calculates that competitive products provided $1.83 billion in contribution, representing 5.54 percent of total institutional costs. *Consequently, the Commission finds the Postal Service met the requirements of section 3633(a)(3) in FY2008.*

Competitive International Mail Products

Effective May 12, 2008, new competitive (and market dominant) outbound rates and fees were implemented by the Postal Service following a period of review by the Commission, pursuant to provisions of the PAEA. Inbound International Mail products, rates and fees for competitive inbound mail products are established through the UPU or pursuant to bilateral agreements. With respect to certain other competitive outbound (and some inbound) International Mail products, however, rates and fees are established pursuant to one or more International Customized Mail (ICM) agreements—individually negotiated agreements between the Postal Service and a qualifying mailer or foreign postal administration.

Excluding ICM agreements, there are seven competitive outbound International Mail products: International Expedited Services, Priority Mail International, International Priority Airmail (IPA), International Surface Airlift (ISAL), International Direct Sacks-M-Bags, International Ancillary Services, and International Money Transfer Service (IMTS). Competitive inbound International Mail products consist of International Expedited Services, Air Parcel Post, and Surface Parcel Post (at Non-UPU rates). During FY 2008, competitive International Mail products collectively covered their costs and provided a net contribution to the institutional costs of the Postal Service. In the sections below, the Commission discusses competitive outbound International Mail products, competitive inbound International Mail products, and ICM agreements.

Competitive Outbound International Products. Competitive outbound international products generated sufficient revenues to cover attributable costs during FY 2008. Within competitive outbound mail, the following products provided contribution to institutional costs: Priority Mail International, International Expedited Services, consisting of Global Express Guaranteed and Express Mail International, International Surface Airlift (ISAL), International Direct

[3] 39 CFR § 3015.7(c).
[4] Order No. 115 at 14.
[5] Postal Regulatory Commission, Annual Compliance Determination at 113, March 27, 2008.

Sacks M-Bags, and International Ancillary Services.[6] *The Commission concludes that each of the competitive outbound international products referenced above satisfy the requirements of section 3633(a)(2).* However, the Postal Service reports that two competitive outbound products—International Priority Airmail (IPA) Service and International Money Transfer Service (IMTS)—did not cover their attributable costs. ACR at 64.

International Priority Airmail service is offered at published rates and negotiated (i.e., contract) rates established in ICM agreements. The Postal Service separately reported the financial performance of IPA at published rates for the first time in the FY 2008 ICRA. Prior to that time, the Postal Service reported IPA service at published rates and contract rates together. For FY 2008, the Postal Service observes that the total net contribution of IPA at published rates and contract rates was positive.[7]

However, the Commission's obligation under section 3633(a)(2) is to determine whether each competitive product covers its attributable costs. Consequently, the Commission concludes that the competitive product IPA at published rates did not comply with the requirements of section 3633(a)(2). The Postal Service acknowledges the need to monitor and improve the cost coverage of IPA. *Id.* Toward this end, the Postal Service states that management is reviewing initiatives to reduce IPA costs. *Id.* Moreover, published rates for IPA Service were raised 12.5 percent in May 2008, and will increase another 20.8 percent in May 2009.[8]

The Postal Service reports the financial results for outbound and inbound International Money Transfer Service together,[9] which show that IMTS did not cover its attributable costs. In response to this result and as part of a plan to add IMTS to the Competitive Products List, the Postal Service continues to analyze IMTS to better estimate volume variable (and product-specific) costs by identifying "specific cost drivers" for this service.[10] On March 10, 2009, the Postal Service formally requested the addition of IMTS to the Competitive Products List.[11] That request proposes the establishment of a separate IMTS-Outbound product featuring prices of "general applicability" for postal money orders cashed (and electronic transfers accessed) in foreign countries, and a separate IMTS-Inbound product, consisting of ten agreements with foreign postal administrations that govern Postal Service payment of foreign money orders presented to post offices in the U.S. The Postal Service states that the agreements are "functionally equivalent," with many similar cost and market characteristics.[12] *The Commission will review this request in Docket No. MC2009-19.*

Competitive Inbound International Mail Products. Using booked revenues rather than imputed revenues, competitive inbound international products did not generate sufficient revenues during FY 2008 to cover attributable costs. As noted elsewhere, competitive inbound international products consists of inbound surface parcel post (at Non-UPU rates), inbound international expedited service (i.e., express mail), and inbound Air Parcel Post.

Revenues for inbound Surface Parcel Post (at Non-UPU rates) did not cover attributable costs during FY 2008. The Postal Service states that this "situation . . . is similar to that experienced" in FY 2007[13]. The Postal Service further states that it has undertaken to improve the financial performance of inbound Surface Parcel Post "through the negotiation of new rates for inbound parcels tendered by Canada Post, which the Commission recently approved" in Docket No. MC2009-8 (CP2009-9).

The Commission acknowledges that the January 2009 implementation of new rates should help improve financial performance going forward. Nevertheless, the Commission observes that the negative contribution per piece for inbound Surface Parcel Post from Canada

[6] Registered Mail was the only the special services within the competitive International Ancillary Services product that did not cover its attributable costs.
[7] Response (Non-Public) of the United States Postal Service to Commission Information Request No. 1, Question 4(a).
[8] *See* Docket No. CP2009-23, Notice of the United States Postal Service of Changes in Rates of General Applicability for Competitive Products Established in Governors' Decision No. 09-01, February 10, 2009, Attachment A, at 2.
[9] ICRA, A Pages (c), at page A-2, Note 5.
[10] Response (Non-Public) of the United States Postal Service to Commission Information Request No. 1, Question 4(b).
[11] *See* Request of the United States Postal Service to Add Postal Products to the Mail Classification Schedule in Reponses to Order No. 154, Docket No. MC2009-19, March 10, 2009 (herein "MC2009-19 Request). In order No. 154, IMTS was determined to meet the definition of a postal service and the Postal Service was directed to file a request to formally add IMTS to the Mail Classification Schedule. For draft IMTS language, see Docket No. CP2009-8, Notice of the Untied States Postal Service of Changes in Rates of General Applicability for Competitive Products Established in Governor's Decision No. 08-19, Attachment B at 102-104, November 13, 2008
[12] MC2009-19 Request, at 9.
[13] United States Postal Service FY 2008 Annual Compliance Report (herein "FY 2008 ACR"), at 64, citing the Commission's Fiscal Year 2007 Annual Compliance Determination (ACD), at 122.

increased from FY 2007.[14] This is due, in part, to a relatively small increase in revenue from higher rates during part of FY 2008 pursuant to a pre-existing bilateral agreement and a decrease in volume. Most importantly, however, it reflects a 31 percent increase in unit costs.[15] Information on this large unit cost increase was not available prior to Commission approval of the new rates for inbound parcels. Based upon this new information, if such a trend continues in FY 2009, the recent implementation of new rates is unlikely to generate revenues that exceed the much larger increase in costs. *Moreover, a continuation of this trend for another year is highly problematic because it means domestic mailers would continue subsidizing foreign mailers.*

The Postal Service should carefully monitor and take corrective action to control costs and, if necessary, negotiate additional rate increases, to ensure positive cost coverage and bring inbound Surface Parcel Post from Canada into compliance with the PAEA.

Inbound international Expedited Services and inbound Air Parcel Post show a positive contribution with imputed revenues, but a negative contribution with booked revenues. The Commission expects the Postal Service to resolve this revenue issue before the next ACR so that there is only one measure of the revenue. This will enable the Commission to determine whether each product meets the requirements of section 3633(a)(2). On the basis of the conflicting revenue estimates provided in the FY 2008 ACR, it is not possible for the Commission to determine with a reasonable degree of certainty if the revenues for these products cover their respective attributable costs. For this reason, the Postal Service must move quickly to resolve the problem.

International Customized Mail Agreements

For FY 2008, the Postal Service provided data on each International Customized Mail Agreement.[16] Such agreements often require minimum volume and revenue commitments by mailers or foreign postal administrations in exchange for discounted rates from the Postal Service.

Pursuant to the Competitive Products List established by the Commission, each non-functionally equivalent ICM is classified as a separate competitive product. Order No. 43, sections 2177, 3001. As such, each ICM product must be evaluated by the Commission for its consistency with section 3633(a)(2), which requires that each competitive product cover its costs attributable.

Based upon volume, revenue and cost data provided by the Postal Service, *the Commission determines that only two, out of a total of 39, ICM agreements did not cover their costs.* These two ICM agreements do not comply with the requirements of section 3633(a)(2), referenced above. While the resulting reduction in total contribution from these two ICM agreements was *de minimis*. *The Postal Service should renegotiate or terminate money-losing ICM agreements.*

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[14] Compare Commission Library References PRC-ACR2007-NP3, worksheet ACR2007 Intl Mail and PRC-ACR2008-NP2, worksheet. ACR2008 Intl Mail for inbound Surface Parcel Post (at non-UPU rates).

[15] *Id.*

[16] The Postal Service is to be commended for its much improved reporting of ICM agreements this fiscal year as compared to FY 2007.

APPENDIX A — FINANCIAL RESULTS UNDER PREVIOUS CLASSIFICATION

The table in this appendix presents FY 2008 volumes, revenue, costs, and contribution to institutional costs by subclass, reflecting the previous mail classification. This allows comparison of FY 2008 with the financial results from previous fiscal years.

Table A-1
Fiscal Year 2008 Volume, Revenue, Cost and Cost Coverage by Class Previous Classification (Subclasses)

	Volume (000)	Revenue ($ 000)	Attributable Cost ($ 000)	Contribution to Institutional Cost ($ 000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
COMPETITIVE MAIL								
Total Competitive Mail and Services	**1,574,923**	**8,381,705**	**6,599,814**	**1,781,891**	**532.198**	**419.056**	**113.141**	**127.0%**
MARKET DOMINANT MAIL								
First-Class Mail								
Letters, Flats & Parcels	85,874,846	36,032,045	17,537,979	18,494,066	41.959	20.423	21.536	205.5%
Cards	5,401,857	1,243,958	728,866	515,092	23.028	13.493	9.535	170.7%
Standard Mail								
Regular	55,329,649	13,190,293	8,136,859	5,053,434	23.839	14.706	9.133	162.1%
Non-profit	12,501,358	1,741,354	2,047,038	(305,684)	13.929	16.375	(2.445)	85.1%
Regular and Non-profit	**67,831,007**	**14,931,647**	**10,183,898**	**4,747,750**	**22.013**	**15.014**	**6.999**	**146.6%**
Enhanced Carrier Route (ECR)	28,926,668	5,405,019	2,748,131	2,656,888	18.685	9.500	9.185	196.7%
Non-profit ECR	2,326,480	249,626	231,373	18,254	10.730	9.945	0.785	107.9%
ECR and NECR	**31,253,148**	**5,654,645**	**2,979,503**	**2,675,142**	**18.093**	**9.533**	**8.560**	**189.8%**
Periodicals								
Within County	830,887	90,614	94,344	(3,730)	10.906	11.355	(0.449)	96.0%
Outside County	7,774,339	2,204,242	2,637,966	(433,724)	28.353	33.932	(5.579)	83.6%
Package Services								
Single-Piece Parcel Post	89,536	720,004	784,025	(64,021)	804.147	875.650	(71.503)	91.8%
Bound Printed Matter	598,184	692,290	556,763	135,527	115.732	93.076	22.656	124.3%
Medid Mail	148,349	394,932			266.218			
Library Rate	10,156	25,834			254.380			

Table A-1

Fiscal Year 2008 Volume, Revenue, Cost and Cost Coverage by Class Previous Classification (Subclasses)—Continued

	Volume (000)	Revenue ($ 000)	Attributable Cost ($ 000)	Contribution to Institutional Cost ($ 000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
Media and Library Mail	**158,505**	**420,767**	**478,782**	**(58,015)**	**265.460**	**302.061**	**(36.602)**	**87.9%**
U.S. Postal Service Mail	823,685							
Free Mail	71,975		51,973	(51,973)		72.210		
Market Dominant International Mail	420,034	915,752	791,497	124,255	218.019	188.436	29.582	115.7%
Total Market Dominant Mail	**201,128,003**	**62,905,964**	**36,825,595**	**26,080,369**	**31.277**	**18.310**	**12.967**	**170.8%**
Market Dominant Services:								
Certified Mail	268,917	717,822	602,622	115,200	266.931	224.092	42.838	119.1%
COD	1,155	8,136	6,835	1,301	704.361	591.750	112.611	119.0%
Insurance	51,595	144,582	143,865	716	280.223	278.835	1.388	100.5%
Registered Mail	3,861	56,883	57,744	(860)	1,473.211	1,495.489	(22.279)	98.5%
Stamped Envelopes		23,421	10,046	13,375				233.1%
Stamped Cards	49,375	987	1,364	(377)	2.000	2.763	(0.763)	72.4%
Money Orders	149,125	223,336	152,789	70,548	149.765	102.457	47.308	146.2%
Post Office Box Service	15,068	896,656	640,346	256,310	5,950.739	4,249.715	1,701.024	140.0%
Other Special Services		734,472	533,670	200,802				137.6%
International Services	2,053	26,652	62,728	(36,076)				42.5%
Other Income		708,521		708,521				
Total Mail and Services	**202,702,926**	**74,829,138**	**45,637,420**	**29,191,718**	**36.916**	**22.514**	**14.401**	**164.0%**
Institutional Costs			32,136,447					
Appropriations: Revenue Forgone		103,148						
Investment Income		35,934						
Total Revenues		**74,968,220**						
Total Costs			**77,773,867**					
Net Income (Loss)		**(2,805,647)**						

Source: PRC-ACR2008-LR1: FY 2008 Postal Service's Finances

APPENDIX B — COST ATTRIBUTION AND DISTRIBUTION ISSUES

In its FY 2008 ACR filing, the Postal Service adopted the cost attribution and distribution methodology approved by the Commission in Docket No. FY 2007 ACR in general but made a number of relatively minor changes. Some of these changes were approved in Order No. 115 prior to submission of the Postal Service's FY 2008 ACR. Others were identified by the Commission subsequent to the Postal Service's filing. Commission Order No. 169 sought clarification of these changes. Many of the methodology changes are applicable to specific classes of mail and are discussed in Chapter VII. Other changes are broader in nature and are discussed below.

The Commission also reviewed the carrier cost data systems although no methodology changes were proposed in these areas.

Group Specific Costs

Section 3633(a) (1) of Title 39 requires the Commission to implement rules prohibiting the subsidization of competitive products by market dominant products. On October 29, 2007, the Commission issued Order No. 43 implementing Rule 3015.7(a) prescribing incremental costs be used in the testing for cross subsidies, or attributable costs supplemented by group specific costs be substituted in cases of unavailability of incremental costs data. At the time of filing the FY 2008 Annual Compliance Report, the Postal Service was not able to provide reliable incremental cost data nor could it identify group specific costs to enable the Commission in testing for cross subsidization under Rule 3015.7(a) and Title 39, section 3633(a).

On October 10, 2008, the Commission, in Order No. 115, deliberated on the nine proposals submitted by the Postal Service for amending the established costing methodologies for purposes of preparing the FY 2008 Annual Compliance Report. Proposals One, Two and Five of Order No. 115 relate to the determination of costs that are not causally related to a specific individual product but are related to a particular group of products. When there is no reliable incremental cost data available to the Commission, it proposes to use the group specific costs identified in this manner in conjunction with attributable costs to test for cross subsidization by the market dominant products group.

In Order No. 115 Proposal One, the Commission ruled in favor of the inclusion as group specific costs, costs that were exclusively attributable to one of the two product groups in Cost Segment 18. Costs that were not exclusively related to a specific group of products were not to be included in group specific costs given that there would be substantial subjectivity involved in their determination through the use of the "but for" test proposed by the Postal Service. Costs identified by the Postal Service, under Proposal One, were $9.6 million for competitive group of products and $17 million for market dominant group of products.

In Order No. 115 Proposal Two, the Commission, cognizant of the Postal Service's initial attempt at identifying group specific costs, approved its treatment of advertising costs for Click-N-Ship and Carrier Pickup as specific to the competitive group of products, even though the costs included Merchandise Return Service, a market dominant product. The Postal Service's assertion that the advertising program for Carrier Pickup preceded the inclusion of Merchandise Return Service, resulting in a relatively minor volume dependent on the advertising program, for the latter product, and the leniency accorded for the Postal Service's first attempt at identifying group specific costs, was the rationale given by the Commission in accepting this Proposal. Costs identified, by the Postal Service under Proposal Two, were $7.6 million for the competitive group of products.

In Order No. 115 Proposal Five, the Commission accepted the Postal Service's treatment of the non attributed portion of the cost of delivery of Express Mail by Clerks as group specific costs to the competitive products group as these costs solely supported domestic and International Express Mail, both of which are competitive products. Costs identified by the Postal Service under Proposal Three, were $32.3 million for the competitive group of products.

In the FY 2008 Annual Compliance Review, the Postal Service categorizes Cost Segment 18 administrative costs obtained from accounting data, into separate groups, using the exclusivity test in conjunction with responses from surveys, conducted in June and July 2008, of headquarters managers within the administrative units and programs. The group specific costs for FY 2008 include the above categorized costs along with advertising costs for

Click-N-Ship and Carrier Pickup as well as the non attributable portion of Express Mail delivery by Clerks.

The Commission agreed with many commenters that analyzing activities benefiting a single product is less complicated than analyzing activities supporting multiple groups of products and authorized the Postal Service to use the "exclusivity test", where an activity supports a single product. The general approach proposed by the Postal Service, with lack of specific decision rules or a balanced plan for analyzing relevant activities for group causation and standards and manner of such application, did not provide the Commission and the public with the necessary level of detailed information necessary in evaluating the impact of the changes to the established costing methodology. The Commission did not approve in advance the inclusion of other non-administrative activities in other cost segments as no causal relationship had been demonstrated between such costs and Cost Segment 18.

The Commission, while acknowledging the initial efforts of the Postal Service in identifying group specific costs, encourages it to expand its analysis to include other Cost Segments, in addition to implementing an annual validity check verifying that activities underlying Finance Numbers remain unchanged. This would dictate the frequency of administration of surveys.

TRACS

The Transportation Cost System (TRACS) consists of four statistical sampling subsystems for Commercial Air, Network Air, Highway, and Rail. These sampling systems are all continuous/ongoing and used to estimate quarterly distribution keys for purchased transportation costs.

The TRACS methodology for calculating these estimates has been slowly evolving particularly since 2006 within the Commercial Air subsystem. These sampling system methodological changes in Commercial Air have centered around pound-miles to pounds data element changes and distribution keys based on assigned pounds rather than billed pounds. In ACR2008, beginning in April 1, 2008 with PQ308 and PQ408, a redesigned sampling system was implemented for the Commercial Air subsystem. The sampling design for PQ108 and PQ208 remains unchanged from ACR2008. While the Commission applauds the expanded and greatly improved detail in the sampling documentation, the reader is still only directed to Appendix B to seek out the methodology changes for Commercial Air subsystem in ACR2008. *It would be particularly helpful if the Postal Service would continue noting the specific changes within the methodology section of the TRACS documentation as it did in the ACR2007, to facilitate an assessment of the detailed TRACS sampling documentation.*

The ACR2008 methodology changes within the Commercial Air subsystem appear to be reasonable and an improvement in the general sampling process. These changes include the use of recent historical extracts of assigned pounds taken from the Enterprise Data Warehouse (EDW) and improvements in the process of selecting the actual sample units.

In ACR2008, starting in October 1, 2007, TRACS started to use RPW volumes to estimate the Global Express Guaranteed (GXG) distribution key for the Intra-SCF Highway statistical subsystem. The distribution key proportions for Express Mail International (EMI) and Global Express Guaranteed (GXG) include a) the combined values for all TRACS modes, except Highway intra-SCF, which are reported as EMI, and b) the EMI and GXG aggregated proportion for Highway intra-SCF which is reallocated to these subclasses in proportion to their total RPW weight.

The Commission notes that in constructing distribution keys for Cost Segment 3 costs in ACR2007, the Commission requested that the Postal Service perform further study to explore differences in distribution keys, such as the use of RPW volumes (and weights) and others, for the development of accurate keys for the distribution of costs to products. Providing some detail when methodology changes are made, such as the current use of RPW volumes (and weights) for the development of Highway transportation costs distribution keys, is useful for an assessment of the success of a change. Secondly, in the Commission's analysis of the SAS computer output of the distribution keys that are inputs into the CRA "B" Workpapers and the International Cost & Revenue Analysis (ICRA) Report, a few small discrepancies were noted within the Highway distribution keys for PQ1 and PQ2 for a few international products. An assessment of the SAS log suggests that the distribution key may not be calculated fully using the sampling design that is documented. It is important that documentation fully reflects the methodologies and any changes to methodologies that are used in developing distribution keys.

The Commission asks that the Postal Service provide detail for future methodology changes within TRACS as well as the SAS programs for all PQs along with the SAS output that has been provided in the past.

The Postal Service uses a relative measure of sampling error, the Coefficient of Variation (CV), for each mail product in the distribution key. A CV is a normalized measure of dispersion of a probability distribution. The TRACS measurement system provides small CVs for the mail products within the TRACS samples indicating that purchased transportation costs are tightly clustered around their mean and not sensitive to small changes since the mean is not close to zero in general.

Cost Segment 3 Cost Pools

In ACR2007, total LDC 15 costs were allocated to the COA, PARS, APPS, LETTER and FLAT image streams based on keying hours logged at consoles at the Remote Encoding Centers (REC), which are not sampled in IOCS. However, part of the total LDC 15 costs always included activities at the Letter Mail Labeling Machines (LMLM) which are usually found at plants and, thus sampled in IOCS. The Postal Service makes a refining correction in the ACR2008 to allocate only the non-LMLM portion of the LDC 15 costs, which are not sampled in IOCS, to the image streams at the RECs. The LMLM costs are distributed to the products based on the IOCS tallies associated with the LMLM MODS operation or with the LMLM IOCS operation if the tally does not have either a MODS operation code nor has an invalid MODS operation code. This refinement can now separate out a non-volume variable cost portion within LMLM operations that can be identified with an IOCS fixed activity code. The Commission finds this refinement reasonable and a more appropriate allocation of costs for a more accurate distribution of costs to products.

In ACR2008, Cost Segment 3 out-of-office Express Mail costs are still calculated from the IOCS Question 18A07, option A – "Express Mail Pickup, Delivery or Transport (Express Mail only)," as it was calculated in ACR2007. The 43 percent measure for volume variability for out-of-office Express Mail costs is calculated from Base Year 2000 Cost Segment 3.4 data on Special Delivery Messengers. These costing methods based on Proposal Five were approved under Commission Order No. 115.

In ACR2007, most of the costs of all mixed mail tallies in allied operations were assigned to all shapes and classes. Now in ACR2008 due to the use of additional information collected from IOCS surveys regarding the contents of containers, the number of allied "all shape and class" tallies is reduced in the IOCS file, as they can now be assigned to letter, flat, and parcel mail shapes as appropriate. This results in a majority of the allied operations costs being attributed to the correct shape. These costing methods based on Proposal Three were approved under Commission Order No. 115.

The coefficient of variation (CVs) is a calculation of the relative measure of data dispersion compared to the mean. The IOCS system provides small CVs for the mail products indicating that cost segment 3 costs are tightly clustered around their mean. Also, since the means are not close to zero the CVs will not be so sensitive to small changes.

Window Service

Library Reference USPS-FY08-20 documents the development of window service volume variable costs by shape for First-Class Mail Presort, Standard Mail Regular, Carrier Route, High Density and Saturation Letters, and High Density and Saturation Flats and Parcels. There is no corresponding Non- Public document. USPS-FY08-20 relies upon the 2008 IOCS data set in USPS-FY08-NP21 and replicates cost distribution and cost pool assignment methodology in USPS-FY08-7. Also relied upon are window service piggyback factors developed in USPS-FY08-24, and "D" Report Final Adjustment factors and volume inputs from USPS-FY08- 26. The output from this Library reference is utilized in FY08-3 (FY 2008 Discounts and Passthroughs of Workshare Items).

The "D" Report adjustment factor is a new methodology not utilized in ACR2007 nor presented previously to the Commission. It involves the transfer of costs from High Density /Saturation letters to High Density/Saturation Flats to account for that certain letters that do not meet machinability requirements and are rated for postage as Flats. An adjustment factor of 0.912478, taken from USPS-FY08-26, is applied at the product level to transfer costs from letters to flats in the same ratio as the misidentified volume. *See* page 66 (Chapter VI Standard Mail Worksharing Methodology). For Windows Service Costs the transfer from Letters to Flats is approximately $17,000.

The Postal Service has provided the computer code which generate its window service costs as well as and many of the associated input files. These programs are written in the FORTRAN language and have not been audited (which would be difficult).

Carrier Costs

The City Carrier Cost System (CCCS) is a continuous, ongoing cross-sectional statistical study or probability sample of city carrier route-days. For each selected route-day, a sample of mail is selected, and for each selected mailpiece, the class, product, and other characteristics are recorded directly into a portable microcomputer using the Computerized ON-Site Data Entry Systems (CODES) software.

The CCCS gathers data for distributing major portions of carrier's salaries, benefits and related costs to the categories of mail for rate making and other management purposes. Accrued carrier costs, available from payroll data are total amounts and are not generally associated with any particular class of mail or service. Therefore special methods are needed to determine the costs associated with the mail categories.

City delivery is organized and operated in terms of individual routes. Because of their different operating characteristics, routes are divided for cost development into two groups: letter routes and special purpose routes. Letter routes account for more than 95 per cent of street activity costs. The CCCS considers only regular letter routes.

Total accrued labor costs for city carriers are prorated between office activity, Cost Segment 6 (CS6) and street activity Cost Segment 7 (CS7) on the basis of time proportions estimates generated from the In-Office Cost System (IOCS). The data from the CCCS are used for apportioning street activity costs to categories of mail. Carrier street activity primarily of delivering mail to customers located within the zones served by city delivery. In addition, it includes certain other street-related activities such as delivering relays, making collections and pickups, and moving mail to and from other post offices and other postal facilities.

Data from the CCCs are used to distribute volume variable costs across classes, products-including extra services, and price categories. The delivery portion of the CCCS provides the mail category data for the distribution of volume variable mail delivery costs. Beginning with data collected in Quarter 1, Fiscal Year 2008, and CCCS was redesigned to align with the results of the City Carrier Street Time Stud (CCSTS). As a result of this redesign, the CCCS no longer collects data by stop type.

The programs and descriptions for sample frame development and sample selection were provided in USPS-LR-L11 in Docket No. R2006 and were not separately provided here. These programs have not been audited or reproduced as part of this audit. The final SAS output files, including data pertaining to DAL's volumes, which are subsequently incorporated as inputs to the CS 6 and 7 spreadsheets have been audited and found to be substantially correct. The Cost Segment 6 and 7 spreadsheets were extensively reviewed and appear correct and internally consistent.

The Postal Service also has provided the Coefficient of Variation for the proportions generated by the CCCS. The Coefficient of Variation is defined as the ratio of the standard deviation to the mean. It is thus, a normalized measure of the dispersion of a probability distribution. Generally speaking, an abnormally high CV could be reason for questioning the reliability of data, although abnormally high is quite a subjective term. In addition, CV's may tend to be unreliable in mail classes with low proportions. We have reviewed the CV's provided by the Postal Service and find them for the most part to be acceptable. Nearly all this instances of relatively high CV's occur in where the proportion is also relatively low.

The RCCS, like the CCCS, is also an ongoing statistical study or probability sample of rural carrier route-days. For each selected route-day, a sample of mail is selected and for each selected mailpiece, the class, product, compensation category and shape of mail is directly recorded.

The RCCS gathers data for distributing major portions of carrier's salaries, benefits and related costs to the categories of mail for rate making and other management purposes. Accrued carrier costs, available from payroll data are total amounts and are not generally associated with any particular class of mail or service. Therefore special methods are needed to determine the costs associated with the mail categories.

Rural carrier activity consists of delivering mail to and collecting mail from delivery receptacles or customers located on Rural Routes. In addition, it includes certain activities such as providing extra services, collecting postage and selling stamps. A

Rural carrier conducts almost all of the activities of a post office. Rural delivery is organized and operated in terms of individual routes. Rural routes are divided into two broad categories, depending on the way the carrier is paid. Most rural routes are evaluated routes, that is, the route is evaluated in terms of time standards and the carrier is paid a salary based on the evaluated time. Evaluated time is based on route factors such as route length, boxes served and quantity of mail delivered.

Total accrued costs for rural carriers are summarized in Cost Segment 10 (CS10). The costs are divided into separate components for evaluated routes and other routes, based on payroll records. The route factors are measured during the National Mail Count, which is usually conducted annually in the spring. During the National Rural Mail Count, all mail for a large portion of the rural routes is counted, and time measurements for other factors are evaluated. Therefore, factors related to volume (volume variable cost drivers) and factors independent of volume (fixed cost drivers) are measured during the National Rural Mail Count.

The volume variable costs of rural carrier workhours are determined by a variability analysis developed in accordance with the evaluated time and factors of workload derived from the rural routes participating in the National Rural Mail Count. Volume variable costs are determined for each of the evaluated and other route components of Cost Segment 10. Data from the RCCS are used to distribute volume variable costs across classes, products-including extra services, and price categories. The delivery portion of the RCCS provides the mail category data for the distribution of mail delivery costs. The RCCS produces two types of estimates-volumes and distribution keys (volume proportions). Estimates are generally computed on a quarterly and annual basis, and the annual volume estimates are the sum of the four quarterly estimates.

The programs and descriptions for sample frame development and sample selection were provided in USPS-LR-L12 in Docket No. R2006 and were not separately provided here. These programs have not been audited or reproduced as part of this audit. The final SAS output files, including data pertaining to DAL's volumes, which are subsequently incorporated as inputs to the CS10 spreadsheets have been audited and found to be substantially correct. The Cost Segment 10 spreadsheets were extensively reviewed and appear correct and internally consistent.

The Postal Service also has provided the Coefficient of Variation (CV) for the proportions generated by the RCCS. The Coefficient of Variation is defined as the ratio of the standard deviation to the mean. It is thus, a normalized measure of the dispersion of a probability distribution. Generally speaking, an abnormally high CV could be reason for questioning the reliability of data, although abnormally high is quite a subjective term. In addition, CV's may tend to be unreliable in mail classes with low proportions. We have reviewed the CV's provided by the Postal Service and find them for the most part to be acceptable. Nearly all this instances of relatively high CV's occur in where the proportion is also relatively low.

APPENDIX C — ABBREVIATIONS AND ACRONYMS

Abbreviations and Acronyms

Long Version	Abbreviation/Acronym
FY 2007 Annual Compliance Report	ACR
area distribution center	ADC
automated area distribution center	AADC
Automated Flat Sorting Machine	AFSM
Automated Package Processing System	APPS
Automated Tray Handling System	ATHS
bulk mail centers	BMCs
Bulk Metered Mail	BMM
City Carrier Cost System	CCCS
Civil Service Retirement System	CSRS
Collect on Delivery	COD
Consumer Price Index for all urban consumers	CPI-U
Consumer Price Index for all workers	CPI-W
cost and revenue analysis	CRA
Cost of Living Adjustments	COLA
Customer Satisfaction Measurement	CSM
delivery point sequence	DPS
delivery point sequenced	DPS'd
Destinating Sectional Center Facilities	DSCF
detached address label	DAL
educational, cultural, scientific or informational [value]	ECSI
enhanced carrier route	ECR
Equal Employment Opportunity	EEO
External First-Class Measurement System	EXFC
Global Express Guaranteed	GXG
Integrated Financial Plan	IFP
Intelligent Mail Barcode	IMB
International Cost and Revenue Analysis	ICRA
International Customized Mail	ICRA
International Mail Measurement System	IMMS
International Priority Airmail	IPA
International Surface Airlift	ISAL
irregular pieces and packages	IPPs
letter post	LC/AO
Labor Distribution Code	LDC

Abbreviations and Acronyms—Continued

Long Version	Abbreviation/Acronym
Mail Classification Schedule	MCS
Mailers Technology Advisory Council	MTAC
Management Operating Data System	MODS
mixed area distribution center	MADC
multiline optical character reader information system service	MLOCR-ISS
Negotiated Service Agreement	NSA
Office of Personnel Management	OPM
Occupational Safety and Health Administration	OSHA
personal computer software and solution	PC SAS
Postal Accountability and Enhancement Act	PAEA
Postal Reorganization Act	PRA
qualified business reply mail	QBRM
Remote Encoding Center	REC
Postal Service Retirement Health Benefits Fund	PSRHBF
Premium Forwarding Service	PFS
Priority Mail International	PMI
Revenue, Pieces, and Weights	RPW
Rural Carrier Cost System	RCCS
Small Parcel Bundle Sorter	SPBS
software and solution	SAS
Total Factor Productivity	TFP
unit delivery costs	UDC
United States Postal Service FY 2007 Annual Compliance Report	ACR
Universal Postal Union	UPU
Voice of the Employee	VOE

APPENDIX D — OTHER ISSUES RAISED IN PUBLIC COMMENTS

Initial and reply comments were filed by 23 participants. (*See Figure* at the conclusion of this appendix.) These comments cover a broad spectrum of issues. As was the case last year, a number of the comments address broad issues of general applicability to the Annual Compliance Review (ACR) process, to the methodologies used for data analysis, and to the relation of the ACR to rate adjustment proceedings. Prompted by the Public Representative's initial comments, several participants have also addressed broader public policy questions raised by recent trends in the Postal Service's finances.

What follows is a summary and evaluation of the comments addressing issues of general applicability. Comments addressing other issues are discussed throughout the chapters of this document. Those remaining comments address: volume and finance trends; service performance; costs and cost coverage; revenues and pricing; strategic Postal Service goals; worksharing; negotiated service agreements; and data and analysis issues.

Last year's ACR was the first one filed following enactment of the PAEA. It covered a period that was subject to the requirements of both the Postal Reorganization Act (PRA) and the Postal Accountability and Enhancement Act (PAEA). As a result, there were numerous transition issues requiring solutions. In this year's ACR, the Postal Service noted that remaining transition issues are not as acute. Report at 1. For example, although the Mail Classification Schedule was not finalized until after the start of FY 2008 and although final rules governing the form and content f the ACR have not yet been adopted, substantial progress has been made in creating a report that meets the PAEA's reporting requirements. *Id.*at 2. In its initial comments, Valassis commends the Postal Service for the improvements in the FY 2008 ACR. Valassis Comments at 1. More specifically, Valassis noted improved methodologies, more refined data collection, and more reliable and better attuned product groupings. *Id.* Valassis also believes that workpapers and spreadsheets were, in general, better organized, except for what Valassis characterized as the added difficulty created by the separation of CRA and workpapers into public and non-public files. *Id.*

The Commission agreed that substantial progress has been made by the Postal Service in both the organization and quality of information presented in this year's ACR. The Commission urged the Postal Service to continue its efforts to improve and further refine its methodologies and data collection procedures during the coming year.

Valpak identified two challenges presented by the timing of the annual compliance review and the schedule being followed by the Postal Service for filing market dominant and competitive product price adjustments. Valpak Comments at 4-5. The annual compliance review covers the Postal Service's fiscal year that begins on October 1 and ends on September 30 of the following year. The ACR covering each fiscal year must be filed within 90 days of the end of the fiscal year—*viz*. on or about December 29. Rate adjustments for market dominant and competitive products are being filed on a schedule which results in their implementation on dates that do not correspond with the Postal Service's fiscal year[1]. As a result, each annual compliance review must compare costs from the fiscal year with the two sets of rates for both market dominant and competitive products that were in effect during the same fiscal year[2]. Valpak characterizes this as a "recurring problem." *Id.*

The second challenge that results from the inconsistent schedules described above is that by the time the Commission issues the ACD, prices for market dominant and competitive products have already been announced for that year. *Id.* This creates the risk that any Commission findings of non-compliance could result in unexpected and disruptive price changes for mailers that would not be synchronized with the Postal Service's planned schedule for rate adjustments. *Id.*

The Commission agreed that the challenges identified by Valpak exist. However, Valpak did not suggest, and the Commission is unaware of, any actions that the Commission could take to eliminate those challenges. The schedule for the annual compliance review is fixed by law. The schedules for market dominant and competitive product rate adjustments

[1] The Postal Service plans to change prices for competitive products each January and to change market dominant prices each May.
[2] During the fiscal year, different prices will be in effect between October 1 and a date in January of the following calendar year; and from that January date through the following September 30. Different market dominant prices will be in effect between October 1 and a date during May of the next calendar year; and from that May date through the following September 30.

are, by virtue of the PAEA, the prerogative of the Postal Service so the Commission cannot dictate when the Postal Service should make its rate adjustments.

The Public Representative requested that the Commission require the Postal Service to publish current financial data and financial predictions used by its management in order to enable the Commission and the public to evaluate the need for exigent rate cases, compliance remedies, and the performance of the PAEA's regulatory regime. Public Representative Comments at 19. In making this suggestion, the Public Representative referred to Congressional testimony by the Commission's Chairman on January 28, 2009 seeking access to current Postal Service financial information and projections.[3] The Postal Service responded to the Public Representative's comments by referencing its initial and reply comments in Docket No. RM2008-4[4], in which it explained its opposition to analogous reporting requirements previously proposed by the Commission[5].

The Commission believes that its position on the need for current financial information and projections was clearly expressed in the Congressional testimony cited by the Public Representative and will be adequately addressed in pending and future Commission proceedings, in the context of Congressional oversight, and in the ongoing dialogue between the Commission and the Postal Service.

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[3] Postal Regulatory Commission Chairman Dan G. Blair, Statement before the Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, January 28, 2009 ("January, 2009 Senate Testimony"). In his testimony, Chairman Blair, speaking on behalf of the Commission, recommended that Congress require the Postal Service to provide a comprehensive, forward-looking financial plan. January, 2009 Senate Testimony at 4. Also on behalf of the Commission, the Chairman urged the Postal Service to resume its prior practice of making its monthly accounting period statements available to Congress and the Commission. *Id.* at 5..

[4] Notice Of Proposed Rulemaking Prescribing Form and Content of Periodic Reports, Docket No. RM2008-4, issued August 22, 2008.

[5] Initial Comments of the Postal Service in Response to Order No. 104 at 22-23, October 16, 2008; and Reply Comments of the United States Postal Service in Response to Order No. 104 at 18-21, November 14, 2008.

Comments to Annual Compliance Report, 2008

Commenter	Comment Citation	Citation Short Form
ABM American Business Media	Reply Comments of American Business Media, February 13, 2009	ABM Comments
APWU American-Postal Workers Union, AFL-CIO	Initial Comments of American-Postal Workers Union, AFL-CIO, January 30, 2009	APWU Comments
	Reply Comments of American-Postal Workers Union, AFL-CIO, February 13, 2009	APWU Reply Comments
ACMA American Catalog Mailers	Initial Comments of the American Catalog Mailers Association, January 30, 2009	ACMA Comments
GCA Greeting Card Association	Reply Comments of the Greeting Card Association, February 13, 2009	GCA Comments
MPA-ANM	Reply Comments of Magazine Publishers of America, Inc. and Alliance of non-profit Magazine Publishers of America, Inc. and Alliance of non-profit Mailers Mailers, February 13, 2009	MPA-ANM Comments
MMA Major Mailers Association	Initial Comments of Major Mailers Association on the Annual Compliance Report of the United States Postal Service, January 30, 2009	MMA Comments
NAPUS National Association of Postmasters of the United States	Reply Comments of the National Association of Postmasters of the United States, February 13, 2009	NAPUS Comments
NPPC National Postal Policy Council	Reply Comments of National Postal Policy Council, February, 13, 2009	NPPC Comments
NAA Newspaper Association of America	Association of America, February 13, 2009	Reply Comments of the Newspaper NNA Comments
PSA Parcel Shippers Association	Comments of the Parcel Shippers Association on United States Postal Service FY 2008 Annual Compliance Report, January 30, 2009	PSA Comments
Pitney Bowes Pitney Bowes, Inc.	Comments of Pitney Bowes, Inc., January 30, 2009	Pitney Bowes Comments
	Reply Comments of Pitney Bowes, Inc. February 13, 2009	Pitney Bowes Reply Comments
Public Representative	Public Representative Comments, January 30, 2009	Public Representative

		Comments
	Public Representative Reply Comments, February 17, 2009	Public Representative Reply Comments
PostCom Association for Postal Commerce	Comments of the Association for Postal Commerce in Response to Orders No. 161 and 169, January 30, 2009	PostCom Comments
Stamps.com Stamps.com Inc.	Comments, January 30, 2009	Stamps.com Comments
The Nation The Nation Company, L.P. and Magazine of Politics, Policy, and Current Events Coalition	Reply Comments of The Nation Company, L.P. and of the Magazine of Politics, Policy, and Current Events Coalition (MPPACE), February 13, 2009	The Nation-MPPACE Comments
Time Warner Time Warner Inc.	Initial Comments of Time Warner Inc. on ACR2008 in Response to Order No. 161, January 30, 2009	Time Warner Comments
	Reply Comments of Time Warner Inc. On ACR2008 in Response to Order No. 161, February 13, 2009	Time Warner Reply Comments
Postal Service United States Postal Service	Reply Comments of the United States Postal Service, February 13, 2009	Postal Service Comments
Valassis-SMC Valassis Direct Mail, Inc. Saturation Mailers Coalition	Initial Comments of Valassis Direct Mail, Inc. and the Saturation Mailers Coalition Concerning the Postal Service's FY2008 Annual Compliance Report, January 30, 2009	Valassis-SMC Comments
	Reply Comments of Valassis Direct Mail, Inc. and the Saturation Mailers Coalition Concerning the Postal Service's FY2008 Annual Compliance Report, February 13, 2009	Valassis-SMC Reply Comments
Valpak 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 2008 Annual Compliance Report, January 30, 2009	Valpak Comments
	Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Reply Comments on the United States	Valpak Reply Comment

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