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POSTAL REGULATORY COMMISSION

Annual Compliance Determination Report

Fiscal Year 2014

March 27, 2015

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EXECUTIVE SUMMARY

This report reviews the Postal Service's performance in Fiscal Year (FY) 2014, fulfilling the Commission's responsibility to produce an annual assessment of Postal Service rates and service mandated by Title 39, section 3653, of the United States Code. It is based on information the Postal Service is required to provide within 90 days after the close of the fiscal year and on comments subsequently received from the public. Specific Commission findings and directives are identified in italics in each chapter.

Consistent with the approach adopted last year, the *Annual Compliance Determination* focuses on compliance issues as defined in 39 U.S.C. §§ 3653(b)(1) and (b)(2). These statutory subsections require the Commission to make determinations on whether any rates and fees in effect during FY 2014 were not in compliance with chapter 36 of Title 39 of the United States Code and whether any service standards in effect during FY 2014 were not met. The Commission's review in this year's ACD is based on the exigency rates approved in Docket No. R2013-11 for Market Dominant products.

The financial analysis that had been incorporated in past ACDs will be expanded and issued as a separate report. The Commission will also issue a separate report on the Postal Service's *2014 Annual Performance Report and 2015 Performance Plan* to fulfill its statutory responsibilities under 39 U.S.C. § 3653(d).

A. Principal Findings: Market Dominant Rate and Fee Compliance

In Chapter 2, the Commission identifies compliance issues related to 48 workshare discounts, finding that 26 of the discounts did not comply with section 3622(e). Workshare discounts that exceed avoided costs adversely affect Postal Service finances because they incent mailers to perform worksharing that the Postal Service could have done on a less costly basis.

- For 18 of the 26 workshare discounts that were not in compliance with section 3622(e), the Postal Service either aligned those discounts more closely with costs or provided a sufficient rationale justifying a statutory exception in its most recent Market Dominant product price adjustment in Docket No. R2015-4.

- For the eight workshare discounts remaining out of compliance with section 3622(e), the Postal Service must either align workshare discounts with avoided costs in the next Market Dominant price adjustment or specify an applicable statutory exception.

B. Principal Findings: Market Dominant Noncompensatory Products

In Chapter 3, the Commission identifies seven noncompensatory Market Dominant products: Periodicals In-County, Periodicals Outside County, Standard Flats, Standard Parcels, Media Mail/Library Mail, Inbound Letter Post, and Stamp Fulfillment Services.

For Periodicals, in the FY 2015 ACR, the Postal Service must provide a detailed analysis of the progress made in improving cost coverage. This analysis shall include:

- The impact of leveraging the Postal Service's pricing flexibility to improve the efficiency of Periodicals pricing
- A detailed analysis of the cost and contribution impact of the worksharing incentives offered for 5-Digit and Carrier Route presortation
- The progress in developing metrics to assess the cost savings impact of operational strategies
- The cost savings from the implementation of operational strategies outlined in Chapter 7 of the *Periodicals Mail Study* and the Flats Strategy
- The progress in implementing pricing strategies outlined in Chapter 7 of the *Periodicals Mail Study*

With respect to Standard Mail Flats, the Commission finds that progress is being made toward addressing the cost coverage shortfall despite the increase in negative contribution. As a result, no further remedial action is required at this time.

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

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

C. Principal Findings: Competitive Products Rate and Fee Compliance

In Chapter 4, the Commission finds that revenues for the following two products did not cover attributable costs and thus did not comply with section 3633(a)(2): International Money Transfer Service – Outbound, and International Money Transfer Service – Inbound. The Commission orders the Postal Service to take corrective action.

D. Principal Findings: Market Dominant Products Service Performance

In Chapter 5, the Commission finds that some products met service performance targets, while others still fail to meet their applicable targets.

- The Postal Service met its service performance targets for Presorted First-Class Letters/Postcards (Overnight and 2-Day), High Density and Saturation Letters, Bound Printed Matter Parcels, Media Mail/Library Mail, and most Special Services products.

- Service performance results for Periodicals, most products in Standard Mail, and Package Services continue to fall short of targets despite Postal Service initiatives to increase performance.

E. Principal Findings: Customer Access and Satisfaction

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

- The Postal Service replaced its Customer Experience Measurement Survey with the Customer Insights methodology. Changing measurement methodology makes it difficult to make year-over-year comparisons of the surveys' results.

CHAPTER 1: INTRODUCTION

A. Statutory Context

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

The Commission has once again decided to report separately on the Postal Service's financial condition and its performance plans and program performance.[2] It plans to issue its financial analysis during April 2015, and anticipates issuing its analysis of the performance plans and program performance, required by 39 U.S.C. § 3653(d), during May 2015. This ACD focuses on the requirements of §§ 3653(b)(1) and (b)(2).[3]

For regulations governing rates and fees, Congress divided mail categories and services between Market Dominant and Competitive products. For Market Dominant products, §§ 3622 and 3626 of Title 39 are relevant for rates and fees; § 3633 is relevant for Competitive products.

The analysis of rates and fees that have been challenged as not in compliance is contained in Chapters 2, 3, and 4. In Chapter 2, the Commission evaluates the workshare discounts for Market Dominant products to determine compliance with 39 U.S.C. § 3622(e). Chapter 2 also includes a discussion about the preferred rate requirements and the price cap. Chapter 3 focuses on other compliance issues related to Market Dominant products' rates and fees. Chapter 4 covers compliance issues related to the rates and fees of Competitive products. In Chapter 5, the Commission discusses service performance and measurement.

There are three appendices to this ACD. Appendix A provides the status of Commission-directed actions from past ACDs and new Commission-directed undertakings in this ACD.

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

[2] *See* Notice Regarding the Postal Service's FY 2014 Performance Report and FY 2015 Performance Plan, February 3, 2015 (Order No. 2342).

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

Appendix B contains a list of Commenters and the comments they filed. Appendix C contains an index of acronyms and abbreviations.

B. Timeline and Review of Report

The Postal Service is required to file the ACR no later than 90 days after the end of each fiscal year (*i.e.*, 90 days after September 30). The Commission is required to complete the ACD within 90 days of receiving the ACR. The Postal Service filed the FY 2014 ACR on December 29, 2014; thus, the Commission must issue this ACD no later than March 29, 2015. However, because March 29 is a Sunday, the Commission may issue the ACD on March 30. *See* 39 C.F.R. § 3001.15.

C. Focus of the ACR

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

D. Other Reports

In conjunction with filing the ACR, the Postal Service must also file its most recent *Comprehensive Statement on Postal Operations*, its *Performance Plan*, and program *Performance Reports*. 39 U.S.C. § 3652(g).

E. Commission Responsibilities

Upon receipt of the ACR, the Commission provides an opportunity for public comment on the Postal Service's submissions. 39 U.S.C. § 3653(a). The Commission is responsible for making a written determination as to whether any rates or fees were not in compliance with applicable provisions of chapter 36 of Title 39 or related regulations, and whether any service standards were not met. 39 U.S.C. § 3653(b). If the Commission makes a timely written determination of non-compliance, it is required to take such action as it deems appropriate. 39 U.S.C. § 3653(c).

F. Procedural History

On December 29, 2014, the Postal Service filed its FY 2014 ACR, covering the period from October 1, 2013, through September 30, 2014.[4] The ACR included an extensive narrative and a substantial amount of detailed public and non-public information contained in library references. The library references include the Cost and Revenue Analysis (CRA), the International Cost and Revenue Analysis (ICRA), cost models supporting workshare discounts, and volume information presented in billing determinants. Library Reference USPS-FY14-9, December 29, 2014, summarizes the other materials included in the ACR, and contains a list of special studies and a discussion of obsolescence[5] in response to § 3050.12 of Title 39 of the Code of Federal Regulations (C.F.R.).

The Postal Service concurrently filed its 2014 *Annual Report* and *Comprehensive Statement on Postal Operations* as part of Library Reference USPS-FY14-17, December 29, 2014, to the FY 2014 ACR.[6] It also filed its *Annual Report* to the secretary of the U.S. Department of the Treasury regarding the Competitive Products Fund, as required by 39 U.S.C. 2011(i), as part of Library Reference USPS-FY14-39, December 29, 2014.

On December 31, 2014, the Commission issued an order providing notice of the Postal Service's filing of the ACR, establishing Docket No. ACR2014 to consider the ACR, appointing a Public Representative to represent the interests of the general public, establishing a deadline for the Postal Service's filing of additional information that had been omitted from the ACR, and establishing February 2, 2015, as the deadline for comments and February 13, 2015, as the deadline for reply comments.[7]

G. Methodology Changes

The FY 2014 ACR generally employs the methodologies used most recently by the Commission.[8] In this ACR proceeding, the Postal Service relies upon 15 approved changes and one pending change to methodologies.[9]

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[4] United States Postal Service FY 2014 ACR, December 29, 2014 (FY 2014 ACR).

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

[6] 2014 *Annual Report* and *Comprehensive Statement on Postal Operations*, December 29, 2014. Included as parts of Library Reference USPS-FY14-17 are the Postal Service's 2014 *Performance Report* and its 2015 *Performance Plan*.

[7] Notice of Postal Service's Filing of *Annual Compliance Report* and Request for Public Comments, December 31, 2014 (Order No. 2313); *see also* 80 FR 906-908 (January 7, 2015). On February 3, 2015, the Commission established separate comment dates for the Postal Service's FY 2014 *Performance Report* and FY 2015 *Performance Plan*. *See* Order No. 2342, Notice Regarding the Postal Service's FY 2014 Performance Report and FY 2015 Performance Plan, February 3, 2015. On February 9, 2015, the Commission designated a substitute Public Representative. *See* Order No. 2351, Notice and Order Designating Substitute Public Representative, February 9, 2015.

[8] *See* FY 2014 ACR at 3-4.

[9] *Id.* at 4-5. Five of the methodologies were approved after the Postal Service submitted its FY 2013 ACR (FY 2013 ACR) and eight methodologies were approved prior to the filing of the FY 2014 ACR. *Id.* Two methodologies were approved after the filing of the FY 2014 ACR. *Id.* at 5 (Proposals Ten and Eleven); Docket No. RM2015-3, Order on Analytical Principles Used in Periodic Reporting (Proposal Ten), January 6, 2015 (Order No. 2315); and Docket No. RM2015-4, Order on Analytical Principles Used in Periodic Reporting (Proposal Eleven), February 9, 2015.

In addition, the Commission posts the most current workshare cost avoidance models on its website.[10] Those models were used in its preparation of the FY 2014 ACD.

H. Product Analysis

The Postal Service provides an analysis of each Market Dominant product, including special services, and domestic and international negotiated service agreements (NSAs) entered into during FY 2014. This analysis includes a discussion of workshare discounts and passthroughs for Market Dominant products, required by 39 U.S.C. § 3652(b). The Postal Service also provides data for Competitive products and discusses the data with reference to standards under 39 U.S.C. § 3633 and 39 C.F.R. § 3015.7. Last, the Postal Service discusses the one Market Dominant market test and three Competitive market tests conducted in FY 2014, as well as two Market Dominant and nine Competitive non-postal products.

I. Service Performance

The ACR also included information regarding service performance, customer satisfaction, and consumer access, as required under 39 U.S.C. § 3652(a)(2) and 39 C.F.R. part 3055.

J. Confidentiality

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

K. Request for Additional Information

Eleven Chairman's Information Requests (CHIRs) were issued with respect to the ACR from January 9, 2015, to March 2, 2015. The Postal Service responded to the CHIRs, often filing supplemental information in support of the responses.[11] The Commission appreciates the Postal Service's responsiveness to these requests.

[10] *See* directory of Commission workshare cost avoidance models at *http://www.prc.gov/sites/default/files/FY%202013%20Workshare%20Cost%20Model%20Directory%2009%2010%202014%20%282%29.pdf.*

[11] Several of the Postal Service's CHIR responses were accompanied by motions requesting late acceptance. *E.g.,* Motion of the United States Postal Service for Late Acceptance of the Filing of Supplemental Information in Response to Order No. 2313, January 15, 2015. Each of the Postal Service's motions for late acceptance is granted.

CHAPTER 2: MARKET DOMINANT PRODUCTS: PRICING REQUIREMENTS

A. Introduction

The PAEA introduced three pricing requirements for Market Dominant products: a class-level price cap based upon changes in the consumer price index for all urban consumers (CPI-U), 39 U.S.C. § 3622(d)(2)(A), a cap on workshare discounts, *id.* § 3622(e)(2), and a cap on preferred rates, *id.* § 3626 (a)(4)-(7). Chapter 2 discusses these requirements.

B. The Class-Level Price Cap

The Commission approved two price increases that went into effect during FY 2014.[12] At the time they were implemented, these price changes complied with the price cap provision. However, changes in prices generally affect the mix of volumes within classes. When applied to actual mail volumes, price increases may produce results that differ from the application of the same price increases to the historical billing determinants used by the Commission during its pre-implementation review of the proposed increases. In past ACDs, the Commission has analyzed the price changes by comparing the percentage change in rates for each class weighted according to two different sets of billing determinants—the historical, pre-implementation billing determinants and the post-implementation billing determinants from the first full year that the rates had been in effect.[13]

Because the rates in effect during the last three quarters of FY 2014 included an exigent price increase,[14] it is not possible to analyze only the effect of the CPI-U price change. For this reason, this ACD does not contain an empirical analysis of the price cap.

C. Workshare Discounts

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

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[12] Docket No. R2013-10, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 21, 2013 (Order No. 1890); Docket No. R2013-11, Order Granting Exigent Price Increase, December 24, 2013 (Order No. 1926).

[13] *See, e.g.,* Docket No. ACR2012, *Annual Compliance Determination,* May 7, 2013, Appendix A (Empirical Review of Price Cap Application).

[14] *See supra,* Order No. 1926 at 4 n.1.

The Commission analyzes the discounts to determine whether they comply with applicable statutory provisions. Section 3653(b)(1) of U.S.C. Title 39 requires the Commission to base its determinations on rates and fees "in effect" during FY 2014. The prices in effect in FY 2014 are the prices approved in Docket No. R2013-11 and include a temporary exigent surcharge of 4.3 percent. Order No. 1926. Discounts evaluated for compliance are based on these prices. Worksharing discounts that are not greater than their avoided costs are in compliance for FY 2014 and require no further discussion.[15]

In this proceeding, the compliance of workshare discounts with 39 U.S.C. § 3622(e)(2) is also affected by a timing issue. Workshare discounts that are the subject of the FY 2014 ACD were established by the notices of price adjustment filed by the Postal Service in Docket Nos. R2013-10 and R2013-11 during September 2013.[16] Those discounts and the rates to which they relate went into effect on January 26, 2014, and remained in effect during the remainder of FY 2014 (*i.e.*, through September 30, 2014). The workshare discounts developed by the Postal Service in those two dockets used cost data from FY 2012, the most recent fiscal year cost data available at the time.

As part of its compliance determination, the Commission compares the discounts in effect during a fiscal year with the cost avoidances for that fiscal year. The 2-year lag between the data the Postal Service used to set the discounts that were in effect during most of FY 2014 and the data the Commission uses in the FY 2014 ACD to evaluate those same discounts result in an increase in the number of discounts that pass through more than 100 percent of avoided costs.

The Postal Service observes that the passthroughs that are above 100 percent result from the lag between estimation of new cost avoidances and pre-existing discounts. FY 2014 ACR at 6, 9-13, 21-25, 34-35. It recognizes that there is no statutory exception that addresses this timing issue. Consequently, the Postal Service does not rely on statutory worksharing exceptions to justify certain worksharing discounts that pass through more than 100 percent of their avoided costs.

The Postal Service acknowledges that the ideal would be "for [its] price adjustment filings to have the benefit of a recently issued ACD." FY 2014 ACR at 6 n.4. The Postal Service asserts that it "will continue to review the timing of its annual price adjustments in order to balance USPS, customer, and regulatory timing needs." *Id.*

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

[16] The Postal Service proposed, in general, an across-the-board price increase of 4.3 percent for all classes of mail. *See* Order No. 1926 at 159-61. The Postal Service, however, deviated from the across-the-board price increase to avoid adverse passthrough changes. *Id.* The Postal Service viewed the passthroughs that resulted from the rates proposed in Docket No. R2013-10 and approved in Order No. 1890 as the original (or baseline) passthroughs. *Id.*

For FY 2015, the Postal Service adjusted its schedule of planned price changes and filed its notice of price adjustment in Docket No. R2015-4 on January 15, 2015.[17] It aligned its discounts with avoided costs based on FY 2014 cost data. The Commission anticipates fewer passthroughs above 100 percent in the FY 2015 ACR.

The sections below are organized by class of mail and review worksharing discounts that are greater than the avoided costs associated with the discount.

1. First-Class Mail

Eight First-Class Mail worksharing discounts exceeded the costs avoided by the corresponding mailer workshare activity (*see* Table II-1):

- Qualified Business Reply Mail (QBRM) Letters
- Automation automated area distribution center (AADC) Letters
- Automation Mixed AADC Cards
- Automation AADC Cards
- Automation 5-Digit Cards
- Automation area distribution center (ADC) Flats
- Automation 3-Digit Flats
- Automation 5-Digit Flats

The calculations that form the basis of these avoided cost passthroughs employ the accepted cost methodology. Below, the Commission discusses passthroughs that were above 100 percent in the order listed above.

The discount for QBRM Letters is 106.3 percent of avoided costs. The Postal Service asserts that the excessive passthrough results from a lag between estimation of new cost avoidances and the setting of discounts. FY 2014 ACR at 9-10. The Postal Service has not provided a statutory reason to justify the excessive passthroughs. *See* 39 U.S.C. § 3622(e). The Commission finds that the discount for QBRM Letters is out of compliance for FY 2014. The Commission recognizes that the Postal Service's reduction of the discount in Docket No. R2015-4 realigns the discount with avoided cost; therefore, no further action is required.

The discounts for Automation AADC Letters reflect a passthrough of 145.0 percent of avoided cost. The Postal Service asserts that the excessive passthrough results from a lag between estimation of new cost avoidances and the setting of discounts. FY 2014 ACR at 10. The Postal Service has not provided a statutory reason to justify the excessive passthroughs. *See* 39 U.S.C. § 3622(e). The Commission finds that the discount is out of compliance for FY 2014. However, the Postal Service's price change in Docket No. R2015-4

[17] The Postal Service intends to implement the new prices on April 26, 2015. Docket No. R2015-4, United States Postal Service Notice of Market-Dominant Price Adjustment, January 15, 2015, at 1.

aligns the Automation AADC Letters discount with avoided cost; therefore, no further action is required.

Automation Mixed AADC Cards, Automation AADC Cards, and Automation 5-Digit Cards, respectively, reflect passthroughs of 136.4 percent, 144.4 percent, and 107.7 percent of avoided costs. The Postal Service asserts that the excessive passthroughs result from a lag between estimation of new cost avoidances and the setting of discounts. FY 2014 ACR at 10-12. The Postal Service has not provided a statutory reason to justify the excessive passthroughs. *See* 39 U.S.C. § 3622(e). The Commission finds that the Automation Cards discounts are out of compliance for FY 2014. However, the Postal Service's price change in Docket No. R2015-4 aligns the discounts for Automation Mixed AADC Cards, Automation AADC Cards, and Automation 5-Digit Cards with avoided costs: therefore, no further action is required.

The Postal Service calculates the following passthroughs of avoided costs for Automation Flats: Automation ADC Flats, 113.8 percent; Automation 3-Digit Flats, 142.5 percent; and Automation 5-Digit Flats, 120.4 percent. The Postal Service asserts that the excessive passthroughs for Automation ADC Flats and Automation 3-Digit Flats result from a lag between estimation of new cost avoidances and the setting of discounts. FY 2014 ACR at 13-14. It has not provided a statutory reason to justify these excessive passthroughs. *See* 39 U.S.C. § 3622(e).

For Automation 5-Digit Flats, the Postal Service contends that the passthrough is necessary to mitigate rate shock. It asserts that reducing the discount to match avoided cost would result in a price increase of 14 percent for this rate category. However, it provides no explanation as to the adverse effects the increase would have on users of Automation 5-Digit Flats. FY 2014 ACR at 13-14.

The Commission finds that the discounts for Automation ADC Flats and Automation 3-Digit Flats are out of compliance for FY 2014. However, the Postal Service's price changes in Docket No. R2015-4 align the discounts with avoided costs; therefore, no corrective action is required.

The Commission also finds that the Postal Service's use of the "rate shock" exception for the Automation 5-Digit Flats discount is not sufficiently supported. However, in Docket No. R2015-4, the Commission found that an "unusual set of circumstances" justified the discount proposed in that docket.[18] *Consequently, no corrective action is required at this time. The Commission expects the Postal Service to align the discount for Automation 5-Digit Flats with avoided costs in the next Market Dominant price adjustment or to provide support for an applicable statutory exception.*

[18] Docket No. R2015-4, Order on Price Adjustments for First-Class Products and Related Mail Classification Changes, February 24, 2015, at 9 (Order No. 2365).

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

Type of Worksharing (Benchmark)	FY 2014		
	Year-End Discount (Cents)	Unit Cost Avoidance (Cents)	Passthrough
First-Class Mail Automation Letters: Barcoding & Presorting			
Automation Mixed AADC Letters (Metered Letters)	4.5	4.6	97.8%
Automation AADC Letters (Automation Mixed AADC Letters)	2.9	2.0	145.0%
Automation 3-Digit Letters (Automation AADC Letters)	0.0	0.5	0.0%
Automation 5-Digit Letters (Hybrid Automation AADC/3-Digit Letters)	2.5	3.1	80.6%
First-Class Mail Non-automation Letters: Barcoding			
Non-automation Presort Letters (Metered Letters)	2.0	5.8	34.5%
First-Class Mail Single Piece Letters: Qualified Business Reply Mail Barcoding			
QBRM (Handwritten Reply Mail)	1.7	1.6	106.3%
First-Class Mail Automation Cards: Barcoding & Presorting			
Automation Mixed AADC Cards (Non-automation Presort Cards)	1.5	1.1	136.4%
Automation AADC Cards (Automation Mixed AADC Cards)	1.3	0.9	144.4%
Automation 3-Digit Cards (Automation AADC Cards)	0.0	0.2	0.0%
Automation 5-Digit Cards (Hybrid Automation AADC/3-Digit Cards)	1.4	1.3	107.7%
First-Class Mail Single Piece Cards: Qualified Business Reply Mail Barcoding			
QBRM (Handwritten Reply Cards)	1.4	1.6	87.5%
First-Class Mail Automation Flats: Barcoding & Presorting			
Automation ADC Flats (Automation Mixed ADC Flats)	9.1	8.0	113.8%
Automation 3-Digit Flats (Automation ADC Flats)	5.7	4.0	142.5%
Automation 5-Digit Flats (Automation 3-Digit Flats)	18.3	15.2	120.4%

Source: Library Reference PRC–LR–ACR2014/3.

2. Periodicals

In FY 2014, one In-County Periodicals passthrough and 13 Outside County Periodicals passthroughs exceeded 100 percent. Table II-2 identifies these passthroughs.

Table II-2
Periodicals Workshare Discounts Exceeding Avoided Cost

Type of Worksharing	Year End Discount (Cents)	Unit Cost Avoidance (Cents)	Passthrough
Outside County			
Presorting			
1. Machinable Non-automation 5-Digit Flats	10.4	8.4	123.8%
2. High Density	3.3	2.5	132.0%
3. Machinable Automation 5-Digit Flats	9.3	7.5	124.0%
4. Non-machinable Non-automation ADC Flats	12.2	8.6	141.9%
5. Non-machinable Non-automation 3-Digit Flats	7.9	3.1	254.8%
6. Non-machinable Non-automation 5-Digit Flats	13.8	8.9	155.1%
7. Non-machinable Automation ADC Flats	10.4	9.1	114.3%
8. Non-machinable Automation 3-Digit Flats	6.5	2.8	232.1%
9. Non-machinable Automation 5-Digit Flats	12.1	9.3	130.1%
Barcoding			
10. Non-machinable Automation Mixed ADC Flats	5.0	–	N/A
Presorting Automation Letters			
11. Automation ADC Letter	4.0	1.5	262.7%
12. Automation 3-Digit Letter	2.2	0.4	595.8%
13. Automation 5-Digit Letter	6.5	2.1	304.6%
In-County			
Presorting			
14. Automation 3-Digit Letter	1.2	1.0	120.0%

Source: Library Reference PRC–LR–ACR2014/5.

Discounts that exceed avoided costs are permissible if a statutory exception applies. *See* 39 U.S.C. § 3622(d). The Postal Service justified Periodicals discounts that exceeded 100 percent on the basis of 39 U.S.C. § 3622(e)(2)(C), which authorizes workshare discounts greater than avoided cost if provided in connection with a subclass that consists exclusively of mail matter with educational, cultural, scientific, or informational (ECSI) value. FY 2014 ACR at 32.

No commenter discussed Periodicals worksharing passthroughs, container cost/price ratios, or bundle cost/price ratios in Docket No. ACR 2014.[19]

[19] In Docket No. R2015-4, MPA—The Association of Magazine Media (MPA) commented on the pallet-handling productivities the Postal Service used in its calculation of pallet costs. Docket No. R2015-4, Comments of MPA-The Association of Magazine Media, February 19, 2015, at 3 (MPA Comments).

The Periodicals class qualifies for ECSI consideration; therefore, the Commission finds that the Periodicals discounts that exceed avoided costs are consistent with 39 U.S.C. § 3622(e).[20] The Postal Service justified these Periodicals workshare discounts based on section 3622 (e)(2)(C), but other statutory requirements and objectives highlight the importance of sending more efficient pricing signals to mailers. Although the Postal Service introduced Flats Sequencing System (FSS) pricing for pallets in FY 2014, it did not change the pricing relationships between workshare categories established in FY 2009. More closely aligning Periodicals workshare discounts with avoided costs would "maximize incentives to reduce costs and increase efficiency" as required by 39 U.S.C. § 3622(b)(1). Reducing the chronic disparity between Periodicals costs and prices also would help the Postal Service, "under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States" as required by 39 U.S.C. § 404(b).

In the FY 2013 ACD, the Commission directed the Postal Service to report on the progress it has made in improving Periodicals cost coverage. FY 2013 ACD at 45. The Commission specifically directed the Postal Service to provide a detailed analysis of the "impact of leveraging its pricing flexibility to improve the efficiency of Periodicals pricing." *Id.* In the FY 2014 ACR, the Postal Service did not provide any analysis of the impact, potential or realized, of leveraging its pricing flexibility to improve the efficiency of Periodicals pricing. The Postal Service discussed Periodicals pricing in a Supplemental Flats Information filing. However, this discussion focused on future Periodicals pricing initiatives.[21]

In FY 2014, the Postal Service implemented the Docket No. R2013-10 and R2013-11 price changes for Periodicals, noting that both price increases were "across the board," raising all Periodicals prices equally. Supplemental Flats Information at 12. The Periodicals price increases implemented in FY 2014 did not make any progress in improving the efficiency of Periodicals price signals, as prices were increased equally across the class.

The Postal Service noted that the planned Market Dominant price adjustment in Docket No. R2015-4 contains "further measures to provide efficient pricing signals to the mailers." Supplemental Flats Information at 13. In Docket No. R2015-4, the Postal Service, with some exceptions, plans to base prices for most bundles and pallets on the estimated costs of handling them. Docket No. R2015-4 Notice at 27. In order to create the price cap room needed to increase bundle and pallet prices for Periodicals, the Postal Service plans to leverage its pricing flexibility by lowering pound prices. *Id.*

With one exception, the Postal Service does not plan to change the piece-related worksharing incentives for Periodicals. *Id.* at 51. In the FY 2013 ACD, the Commission detailed the long-running issue with the Non-machinable Automation Mixed Area

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

[21] Notice of the United States Postal Service of Filing Partial Supplemental Information in Response to Order No. 2313, January 15, 2015, at 12-15 (Supplemental Flats Information).

Distribution Center (Mixed ADC) Flats pre-barcoding discount. FY 2013 ACD at 21-22. In FY 2014, the Postal Service offered mailers a 5-cent discount for pre-barcoded flats that could not be processed on the Automated Flats Sorting Machine (AFSM) but could be processed on the Upgraded Flats Sorting Machine (UFSM). However, this pre-barcoding did not reduce the Postal Service's costs in FY 2014. Therefore, in accordance with the Commission's recommendation in the FY 2013 ACD, the Postal Service will discontinue the discount for the pre-barcoding of Mixed ADC Flats. Docket No. R2015-4 Notice at 51.

The majority—88.5 percent in FY 2014—of Outside County Periodicals volume is presorted to 5-Digit or Carrier Route. The difference in passthroughs for these two categories has widened considerably since FY 2008. Table II-3 details changes for Carrier Route Basic and 5-Digit piece presorting from FY 2008 to FY 2014.

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

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Carrier Route Basic	88.15%	71.52%	71.05%	69.48%	71.33%	77.70%	65.54%
Automation 5-Digit Flats	61.37%	96.63%	102.38%	106.17%	104.82%	121.62%	124.00%

Source: Docket Nos. ACR2009 – ACR2014, Postal Regulatory Commission Library References.

In FY 2014, the price difference between Machinable Automation 5-Digit and Carrier Route increased from 9.8 cents to 10.3 cents, pursuant to the price increase in Docket No. R2013-11.[22] However, the passthrough for Carrier Route decreased to 65.54 percent due to an increase in the Postal Service cost avoided by mailer presortation to Carrier Route. The Postal Service does not address this issue with its planned Docket No. R2015-4 prices.[23]

As the Postal Service has implemented FSS processing, the Commission has encouraged it to leverage its pricing flexibility in the pursuit of efficiency.[24] FY 2013 ACD at 21. In FY 2014, the Postal Service implemented worksharing incentives for Destination Flats Sequencing System (DFSS) dropshipped pounds and DFSS Scheme presorted bundles. During the same period, roughly 20 percent of Periodicals were processed on the FSS, while only 5.6 percent were entered at DFSS facilities, the most efficient FSS entry location. FSS Scheme bundle preparation minimizes the bundle processing the Postal Service has to

[22] The difference in Docket No. R2013-10 CPI-U price increase continues to be 9.8 cents, unchanged from FY 2008. The increase in the discount was due to the equal percent increase calculation for the exigent surcharge.

[23] The prices outlined in Docket No. R2015-4 set discounts well in excess of the cost avoidance for Machinable Automation 5-Digit presortation, but well below the cost avoidance for Carrier Route Basic.

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

perform before sortation on the FSS, and only 4.8 percent of bundles in FY 2014 were presorted to FSS Schemes.[25]

In the FY 2013 ACD, the Commission directed the Postal Service to address the issue of inefficient Periodicals pricing. FY 2013 ACD at 23. The Docket No. R2015-4 planned price adjustment is the first meaningful step the Postal Service has taken to increase pricing efficiency for Periodicals since FY 2009. The planned adjustment will implement a structural change in FSS pricing incentives. Docket No. R2015-4 Notice at 28-29. The Postal Service will require that all Periodicals mail destined for ZIP Codes where Flats are processed via FSS machines pay FSS presort prices.[26] The FSS presortation discount is an average of 3-Digit, 5-Digit, and Carrier Route Basic prices based on the volume of each in FSS zones in FY 2014. This change is part of the Postal Service's overall strategy to process mail on the FSS more efficiently. Pricing bundles and pallets based on the costs of handling them encourages mailers to prepare more efficient mailings, decreasing costs and increasing contribution. By introducing FSS piece prices in Docket No. R2015-4, the Postal Service will take a rational step to increase FSS processing efficiency. However, additional steps are needed to improve Periodicals pricing efficiency.[27]

The Postal Service did not meaningfully respond to the Commission's directive in the FY 2013 ACD to analyze the profitability of increasing Periodicals pricing efficiency. For example, it did not provide worksharing cost avoidance information for the new FSS prices, stating that it "did not consider that establishing a price structure to reflect FSS preparation would also create multiple workshare discount rates."[28] To increase pricing efficiency, it is critical for the Postal Service to fully assess the value and impact of each price signal.

For several years, and again in this docket, the Commission has highlighted the growing disparity between the pricing signals the Postal Service sends mailers that encourage 5-Digit presortation and discourage Carrier Route presortation.[29]

In the FY 2015 ACR, the Postal Service shall provide a detailed analysis of the cost and contribution impact of the worksharing incentives offered for 5-Digit and Carrier Route presortation.

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[25] In Docket No. R2015-4, the Postal Service plans to change the structure of FSS prices. The Postal Service will require that all presorted mail destined for FSS zones pay an FSS price. This change is part of the Postal Service's overall strategy to process mail on the FSS more efficiently. Docket No. R2015-4 Notice at 27.

[26] In other words, mail "destined to" FSS zones.

[27] FSS processing efficiency has steadily decreased since the introduction of the machine. Responses of the United States Postal Service to Questions 1-6, 8, 10, 12-13 and 15-22 of Chairman's Information Request No. 2, January 23, 2015, question 8 (January 23, 2015, Response to CHIR No. 2).

[28] Docket No. R2015-4, Response of the United State Postal Service to Question 2 of Chairman's Information Request No. 6, February 18, 2015, question 2.

[29] With the implementation of FSS prices for FSS zones, the Postal Service has additional incentive to encourage Carrier Route mail in non-FSS zones.

In the FY 2015 ACR, the Postal Service shall provide a report on its progress in improving Periodicals pricing efficiency.

3. Standard Mail

Seventeen Standard Mail worksharing discounts exceeded the costs avoided by those discounts. Those 17 worksharing discounts were for Letters, Flats, and Parcels.

a. Letters

The following six worksharing discounts for Letters exceeded avoided costs in FY 2014:

- Automation Mixed AADC Letters
- Automation AADC Letters
- Non-automation AADC machinable Letters
- Non-automation ADC Non-machinable Letters
- Non-automation 3-Digit Non-machinable Letters
- Non-automation 5-Digit Non-machinable Letters

Each is discussed below. All remaining Letters discounts were less than avoided costs and were thus consistent with 39 U.S.C. § 3622(e) in FY 2014. Table II-4 shows the discounts for the Letters product for FY 2014.

Table II-4
Standard Mail Letters (Commercial and Nonprofit)
Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	FY 2014		
	Year-End Discount (Cents)	Unit Cost Avoidance (Cents)	Passthrough
Standard Mail Automation Letters: Presorting (Cents/Piece)			
Automation AADC Letters (Automation Mixed AADC Letters)	2.2	1.6	137.5%
Automation 3-Digit Letters (Automation AADC Letters)	0.0	0.4	0.0%
Automation 5-Digit Letters (Automation 3-Digit Letters)	1.8	2.2	81.8%
Standard Mail Automation Letters: Barcoding (Cents/Piece)			
Automation Mixed AADC Letters (Non-automation Machinable Mixed ADC Letters)	0.8	0.1	800.0%
Standard Mail Non-automation Letters: Presorting (Cents/Piece)			
Non-automation AADC Machinable Letters (Non-automation Mixed AADC Machinable Letters)	1.8	1.6	112.5%
Non-automation ADC Non-machinable Letters (Non-automation Mixed ADC Non-machinable Letters)	8.8	7.4	118.9%
Non-automation 3-Digit Non-machinable Letters (Non-automation ADC Non-machinable Letters)	3.1	2.6	119.2%
Non-automation 5-Digit Non-machinable Letters (Non-automation 3-Digit Non-machinable Letters)	9.3	6.5	143.1%
Standard Mail Letters: Dropship (Cents/Pound)			
DNDC Letters (Origin Letters)	16.6	32.1	51.7%
DSCF Letters (Origin Letters)	21.6	37.6	57.4%

Source: Library Reference PRC–LR–ACR2014/4.

(1) Automation Mixed AADC Letters

The passthrough for Automation Mixed AADC Letters was 800 percent in FY 2014. The Postal Service justifies this excessive passthrough pursuant to 39 U.S.C. § 3622(e)(2)(D), asserting that the barcoding discount encourages mailers to provide an Intelligent Mail barcode (IMb) on their mailpieces, thereby improving operational efficiency. FY 2014 ACR at 21. Moreover, the Postal Service states that it intends to eliminate the portion of this discount above avoided costs as soon as practicable. *Id*.

The Commission finds that the Automation Mixed AADC Letters discount is adequately justified pursuant to 39 U.S.C. § 3622(e)(2)(D) for FY 2014 because encouraging mailers to use IMbs on mailpieces should improve operational efficiency.

(2) Automation AADC Letters, Non-automation AADC Machinable Letters, Non-automation ADC Non-machinable Letters, and Non-automation 3-Digit Non-machinable Letters.

Respectively in FY 2014, Automation AADC Letters, Non-automation AADC machinable Letters, Non-automation ADC Non-machinable Letters, and Non-automation 3-Digit Non-machinable Letters had passthroughs of 137.5 percent, 112.5 percent, 118.9 percent, and 119.2 percent. The Postal Service stated that no statutory exception applied to justify why these passthroughs exceeded 100 percent. FY 2014 ACR at 21-23. The Postal Service also stated that it intended to eliminate the portion of these discounts that exceeded avoided costs in future Market Dominant price adjustments. *Id.*

The Commission finds that these four discounts are not in compliance in FY 2014 because they are not adequately justified pursuant to the requirements of 39 U.S.C. § 3622(e). The Postal Service must either align these discounts with avoided costs during the next general market dominant price adjustment, or provide support for an applicable statutory exception.

In Docket No. R2015-4, the Postal Service proposed to set the Non-automation ADC Non-machinable Letters and Non-automation 3-Digit Non-machinable Letters discounts equal to their avoided costs.[30] However, for the Automation AADC Letters and Non-automation AADC machinable Letters discounts, the Postal Service did not take corrective action to align the discounts with their avoided costs. Instead, it proposed to increase the discounts without sufficient justification. The Commission found that the Postal Service's rationale for increasing the discounts was unsupported by the record.[31] The Commission remanded the Standard Mail price adjustments to allow the Postal Service to submit amended prices that achieve compliance with title 39.[32]

The Commission finds that no corrective action is required for the Non-automation ADC Non-machinable Letters and Non-automation 3-Digit Non-machinable Letters discounts since the Postal Service plans to align the discounts with their avoided costs in Docket No. R2015-4. However, for the Automation AADC Letters and Non-automation AADC machinable Letters discounts, the Commission directs the Postal Service to fully align these discounts with their avoided costs in its next Market Dominant price adjustment, or, alternatively, provide support for an applicable statutory exception.

[30] *See* Docket No. R2015-4, Response of the United States Postal Service to CHIR No. 12, February 20, 2015, Excel file "Revised AttachmentB CHIR12.xls." (Docket No. R2015-4 Postal Service Response to CHIR No. 12). *See also* Response of the United States Postal Service to Order No. 2378, March 12, 2015, Excel file "AttachmentB-Remand.xlsx." (Response to Order No. 2378, Attachment B).

[31] *See* Docket No. R2015-4, Order on Price Adjustment for Standard Mail, Periodicals, and Package Services Products, March 6, 2015, at 12-13 (Order No. 2378).

[32] The Commission's review of the Standard Mail price adjustments proposed in Docket No. R2015-4 is pending. *See id.,* Order on Amended Price Adjustments for Standard Mail, Periodicals, and Package Services Products, March 18, 2015, at 12 (Order No. 2398).

(3) Non-automation 5-Digit Non-machinable Letters

Non-automation 5-Digit Non-machinable Letters had a passthrough of 143.1 percent in FY 2014. The Postal Service justified this excessive passthrough pursuant to 39 U.S.C. § 3622(e)(2)(B). It stated that aligning this discount with its avoided costs would result in a price increase as large as 20.3 percent, which could cause rate shock to mailers. FY 2014 ACR at 23. The Postal Service intends to eliminate the portion of this discount above avoided costs as soon as practicable. *Id*.

The Public Representative contends that in order for a discount to qualify for the rate shock exception, the Postal Service must show that even a modest price increase would not avoid rate shock. PR Comments at 43-44. She agrees with the Postal Service that the Non-automation 5-Digit Non-machinable Letters discount can be justified pursuant to the rate shock exception. *Id*. at 43. She states that even a potential reduction of approximately 7 percent of the FY 2014 discount would cause rate shock. *Id*.

The Commission agrees with the Public Representative and concludes that a substantial reduction in the passthrough percentage would likely adversely affect users. Thus, the Commission finds that this discount is adequately justified pursuant to 39 U.S.C. § 3622(e)(2)(B) for FY 2014.

b. Flats

Six worksharing discounts for Flats exceeded avoided costs in FY 2014 (*see* Table II-5):

- Automation Mixed ADC Flats
- Automation 3-Digit Flats
- Automation 5-Digit Flats
- Non-automation ADC Flats
- Non-automation 3-Digit Flats
- Non-automation 5-Digit Flats.

Each is discussed below. All remaining Flats discounts were less than avoided costs and thus were consistent with 39 U.S.C. § 3622(e).

Table II-5
Standard Mail Flats (Commercial and Nonprofit)
Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	FY 2014		
	Year-End Discount (Cents)	Unit Cost Avoidance (Cents)	Passthrough
Standard Mail Automation Flats: Presorting (Cents/Piece)			
Automation ADC Flats (Automation Mixed ADC Flats)	2.9	4.0	72.5%
Automation 3-Digit Flats (Automation ADC Flats)	5.2	4.2	123.8%
Automation 5-Digit Flats (Automation 3-Digit Flats)	8.6	8.5	101.2%
Standard Mail Automation Flats: Barcoding (Cents/Piece)			
Automation Mixed ADC Flats (Non-automation Mixed AADC Flats)	4.9	2.1	233.3%
Standard Mail Non-automation Flats: Presorting (Cents/Piece)			
Non-automation ADC Flats (Non-automation Mixed ADC Flats)	5.1	4.6	110.9%
Non-automation 3-Digit Flats (Non-automation ADC Flats)	5.4	4.7	114.9%
Non-automation 5-Digit Flats (Non-automation 3-Digit Flats)	6.8	5.1	133.3%
Standard Mail Flats: Dropship (Cents/Pound)			
DNDC Flats (Origin Flats)	16.1	24.4	66.0%
DSCF Flats (Origin Flats)	21.6	27.7	78.0%
Standard Mail Flats: Dropship (Cents/Piece)			
DFSS Flats (Origin Flats)	4.5	5.8	77.6%

Source: Library Reference PRC–LR–ACR2014/4.

(1) Automation Mixed ADC Flats

The passthrough for Automation Mixed ADC Flats was 233.3 percent in FY 2014. The Postal Service justified this excessive passthrough pursuant to 39 U.S.C. § 3622(e)(2)(D). It stated that this barcoding discount encouraged mailers to continue preparing their flats for FSS processing. FY 2014 ACR at 26. Additionally, the Postal Service intends to further reduce this discount over time. *ld*.

The Public Representative states that she would expect successful barcoding discounts to be reduced each year. PR Comments at 43. She remains unconvinced that a further reduction of the discount would impede the efficient operation of the Postal Service. *ld*.

The Commission finds that the Automation Mixed ADC Letters discount is adequately justified pursuant to 39 U.S.C. § 3622(e)(2)(D), as the barcoding discount encourages mailers to prepare their flats for FSS processing.

(2) Automation 3-Digit Flats, Automation 5-Digit Flats, Non-automation ADC Flats, and Non-automation 3-Digit Flats

Respectively in FY 2014, Automation 3-Digit Flats, Automation 5-Digit Flats, Non-automation ADC Flats, and Non-automation 3-Digit Flats had passthroughs of 123.8 percent, 101.2 percent, 110.9 percent, and 114.9 percent. The Postal Service stated that no statutory exception applied to justify why these passthroughs exceeded 100 percent. FY 2014 ACR at 24-26. The Postal Service intends to eliminate the portion of these discounts that exceed their avoided costs in future Market Dominant price adjustments. *Id.*

The Commission finds that these four discounts are not in compliance in FY 2014 because they are not adequately justified pursuant to the requirements of 39 U.S.C. § 3622(e). The Postal Service must either align these discounts with avoided costs during the next general market dominant price adjustment, or provide support for an applicable statutory exception.

In Docket No. R2015-4, the Postal Service plans to set the Non-automation ADC Flats discount less than its avoided costs, thus satisfying 39 U.S.C. § 3622(e).[33] However, for the Automation 3-Digit Flats, Automation 5-Digit Flats, and Non-automation 3-Digit Flats discounts, the Postal Service did not take corrective action, stating that it was unable to align the discounts with their avoided costs because of its proposed new FSS pricing structure.[34] The Postal Service explained that aligning these discounts with their avoided costs would cause it to have to set higher prices for its new FSS price categories, thereby reducing the incentive for flats mailers to prepare their mail for FSS processing.

The Postal Service asserted that its proposed Docket No. R2015-4 discounts for Automation 3-Digit Flats, Automation 5-Digit Flats, and Non-automation 3-Digit Flats qualified for the operational efficiency statutory exception in 39 U.S.C. § 3622(e)(2)(D) for discounts that exceed avoided costs.

The Commission concludes that there is no corrective action necessary for the Non-automation ADC Flats discount because the Postal Service plans to remedy the passthrough in Docket No. R2015-4. However, corrective action is necessary for the Automation 3-Digit Flats, Automation 5-Digit Flats, and Non-automation 3-Digit Flats discounts because the Postal Service is not able to align these discounts with their avoided costs in Docket No. R2015-4. The Commission directs the Postal Service to fully align these discounts with their avoided costs in its next Market Dominant price adjustment, or, alternatively, provide support for an applicable statutory exception.

[33] Docket No. R2015-4 Postal Service Response to CHIR No. 12 and Response to Order No. 2378, Attachment B.

[34] In Docket No. R2015-4, the Postal Service established separate FSS prices for Standard Mail Flats. *See* Docket No. R2015-4, United States Postal Service Notice of Market-Dominant Price Adjustment, January 15, 2015, at 22. The Postal Service also eliminated the FSS price categories for the Carrier Route Flats, High Density Flats, High Density Plus Flats price categories. *Id.* Carrier Route Flats destined to an FSS zone will be required to be sent under the new FSS price structure for Standard Mail Flats. *Id.,* Response to CHIR No. 1, question 2. However, the requirement is optional for High Density Flats and High Density Plus Flats. *Id.*

(3) Non-automation 5-Digit Flats

Non-automation 5-Digit Flats had a passthrough of 133.3 percent in FY 2014. The Postal Service justifies this excessive passthrough pursuant to 39 U.S.C. § 3622(e)(2)(B), stating that aligning this discount with its avoided costs would result in a price increase as large as 7.3 percent, which could cause rate shock. FY 2014 ACR at 26. The Postal Service stated that it intended to eliminate the portion of this discount above avoided costs as soon as practicable. *ld*.

The Public Representative does not believe that the Postal Service has met the burden of proof required to use the rate shock exception for the Non-automation 5-Digit Flats discount. PR Comments at 43-44.

The Commission concludes that the Postal Service's use of the rate shock exception is not sufficiently supported, as it does not explain how the price increase necessary to reduce the Non-automation 5-Digit Flats passthrough to 100 percent would adversely affect users of Non-automation 5-Digit Flats. The Commission finds that the Non-automation 5-Digit Flats discount is not adequately justified pursuant to 39 U.S.C. § 3622(e)(2)(B) for FY 2014.

In Docket No. R2015-4, the Postal Service did not align the Non-automation 5-Digit Flats discount with its avoided costs.[35] Similar to its explanation for the other presort Flats discounts that exceeded avoided costs in Docket No. R2015-4, the Postal Service stated that aligning the Non-automation 5-Digit Flats discount with its avoided costs would cause it to have to set higher prices for its new FSS price categories, thereby reducing the incentive for Flats mailers to prepare their mail for FSS processing. *Id.,* United States Postal Service Notice of Market-Dominant Price Adjustment, January 15, 2015, at 49. It stated that the proposed discount qualified for the operational efficiency statutory exception for discounts that exceed avoided costs [39 U.S.C. § 3622(e)(2)(D)].

The Commission directs the Postal Service to align the Non-automation 5-Digit Flats discount with its avoided costs in its next Market Dominant price adjustment or, alternatively, provide support for an applicable statutory exception.

c. Parcels

Five worksharing discounts for Parcels exceeded avoided costs in FY 2014 (*see* Table II-6 and Table II-7):

- Network distribution center (NDC) Irregular Parcels
- NDC Marketing Parcels
- Mixed NDC Machinable Barcoded Parcels
- Mixed NDC Irregular Barcoded Parcels
- Mixed NDC Barcoded Marketing Parcels

[35] *See* Docket No. R2015-4 Postal Service Response to CHIR No. 12 and Response to Order No. 2378, Attachment B.

Each is discussed below. All remaining Parcels discounts were less than avoided costs and thus were consistent with 39 U.S.C. § 3622(e).

Table II-6
Standard Mail Parcels (Commercial and Nonprofit)
Presort and Barcode Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	FY 2014		
	Year-End Discount (Cents)	Unit Cost Avoidance (Cents)	Passthrough
Nonprofit Standard Mail Parcels: Presorting (Cents/Piece)			
NDC Machinable Parcels (Mixed NDC Machinable Parcels)	37.5	51.4	73.0%
5-Digit Machinable Parcels (NDC Machinable Parcels)	26.9	64.8	41.5%
NDC Irregular Parcels (Mixed NDC Irregular Parcels)	32.4	23.2	139.7%
SCF Irregular Parcels (NDC Irregular Parcels)	34.6	50.9	68.0%
5-Digit Irregular Parcels (SCF Irregular Parcels)	10.8	59.1	18.3%
Nonprofit Standard Mail Parcels: Barcoding (Cents/Piece)			
Mixed NDC Machinable Barcoded Parcels (Mixed NDC Machinable Non-barcoded Parcels)	6.7	3.7	181.1%
Mixed NDC Irregular Barcoded Parcels (Mixed NDC Irregular Non-barcoded Parcels)	6.7	3.7	181.1%
Standard Marketing Parcels: Presorting (Cents/Piece)			
NDC Marketing Parcels (Mixed NDC Marketing Parcels)	39.2	31.4	124.8%
SCF Marketing Parcels (NDC Marketing Parcels)	29.8	41.0	72.7%
5-Digit Marketing Parcels (SCF Marketing Parcels)	12.3	66.0	18.6%
Standard Marketing Parcels: Barcoding (Cents/Piece)[a]			
Mixed NDC Barcoded Marketing Parcels (Mixed NDC Non-barcoded Marketing Parcels)	6.7	3.7	181.1%

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

Source: Library Reference PRC–LR–ACR2014/4.

Table II-7
Standard Mail Parcels (Commercial and Nonprofit)
Dropship Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	FY 2014		
	Year-End Discount (Cents)	Unit Cost Avoidance (Cents)	Passthrough
Nonprofit Standard Mail Machinable Parcels: Dropship (Cents/Pound)			
DNDC Machinable Parcels (Origin Machinable Parcels)	23.1	61.3	37.7%
DSCF Machinable Parcels (Origin Machinable Parcels)	47.9	79.5	60.3%
DDU Machinable Parcels (Origin Machinable Parcels)	66.4	97.3	68.2%
Standard Mail Marketing Parcels: Dropship (Cents/Pound)			
DNDC Marketing Parcels (Origin Marketing Parcels)	23.1	61.3	37.7%
DSCF Marketing Parcels (Origin Marketing Parcels)	47.9	79.5	60.3%
DDU Marketing Parcels (Origin Marketing Parcels)	66.4	97.3	68.2%
Nonprofit Standard Mail Irregular Parcels: Dropship (Cents/Pound)			
DNDC Irregular Parcels (Origin Irregular Parcels)	23.1	61.3	37.7%
DSCF Irregular Parcels (Origin Irregular Parcels)	47.9	79.5	60.3%
DDU Irregular Parcels (Origin Irregular Parcels)	66.4	97.3	68.2%

Source: Library Reference PRC–LR–ACR2014/4.

(1) NDC Irregular Parcels and NDC Marketing Parcels

In FY 2014, NDC Irregular Parcels and NDC Marketing Parcels had passthroughs of 139.7 percent and 124.8 percent, respectively. The Postal Service justified these excessive passthroughs pursuant to 39 U.S.C. § 3622(e)(2)(B). It stated that immediately aligning the discounts with their avoided costs would require a 7.78 percent price increase for NDC Irregular Parcels and a 7.62 percent increase for NDC Marketing Parcels. FY 2014 ACR at 27-28. Additionally, the Postal Service intends to continue reducing the discount in future market dominant price adjustments. *ld*.

The Public Representative does not believe that the Postal Service has met the burden of proof required to use the rate shock exception for these discounts. PR Comments at 43-44.

The Commission concludes that the Postal Service's use of the rate shock exception is not sufficiently supported, as it does not explain how the price increases necessary to reduce both passthroughs to 100 percent would adversely affect users. The Commission finds that the discounts are not adequately justified pursuant to 39 U.S.C. § 3622(e)(2)(B) for FY 2014.

In Docket No. R2015-4, the Postal Service did not propose corrective action to align the NDC Irregular Parcels and NDC Marketing Parcels discounts with their avoided costs. Instead, it proposed to increase the discounts without sufficient justification. *See* Docket No. R2015-4 Postal Service Response to CHIR No. 12. The Commission found that the Postal Service's rationale for increasing the discounts was unsupported by the record. Order No. 2378 at 14. The Commission remanded the Standard Mail price adjustments to allow the Postal Service to submit amended prices that achieve compliance with title 39. *Id.* at 32.

The Commission directs the Postal Service to fully align these discounts with their avoided costs in its next Market Dominant price adjustment or provide support for an applicable statutory exception.

(2) Nonprofit Mixed NDC Machinable Barcoded Parcels, Nonprofit Mixed NDC Irregular Barcoded Parcels, and Mixed NDC Barcoded Marketing Parcels

Nonprofit Mixed NDC Machinable Barcoded Parcels, Nonprofit Mixed NDC Irregular Barcoded Parcels, and Mixed NDC Barcoded Marketing Parcels each had passthroughs of 181.1 percent in FY 2014. The Postal Service justified these excessive passthroughs pursuant to 39 U.S.C. § 3622(e)(2)(D), stating that it has been sending a strong signal to mailers through the non-barcoded surcharge to develop a fully barcoded parcels mailstream. FY 2014 ACR at 28. It further stated that it had plans to soon require barcodes on all ground parcels and that a fully barcoded mailstream would permit the elimination of keying stations on parcel sorters, thereby increasing the efficiency of postal operations. *ld*.

The Commission finds that these three discounts were adequately justified pursuant to 39 U.S.C. § 3622(e)(2)(B) because having a fully barcoded mailstream would increase operational efficiency.

4. Package Services

Three Package Services products offered workshare discounts in FY 2014: Media Mail/Library Mail, Bound Printed Matter (BPM) Flats, and BPM Parcels.

a. Media Mail/Library Mail

Four discounts were offered for Media Mail/Library Mail in FY 2014. Table II-8 shows the FY 2014 discounts, avoided costs, and passthroughs for this product.

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

Type of Worksharing (Benchmark)	FY 2014		
	Year-End Discount (cents)	Unit Cost Avoidance (cents)	Passthrough[a]
Media Mail: Presorting (Cents/Piece)			
Basic (Single-Piece)	49	28	175.0%
5-Digit (Basic)	39	64	60.9%
Library Mail: Presorting (Cents/Piece)			
Basic (Single-Piece)	47	28	167.9%
5-Digit (Basic)	37	64	57.8%

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

Source: Library Reference PRC–LR–ACR2014/6.

The Basic presort discount for the Media Mail/Library Mail categories exceeded avoided costs in FY 2014. The passthroughs were 175.0 percent and 167.9 percent, respectively. The Postal Service justified the FY 2014 passthroughs pursuant to section 3622(e)(2)(C) because Media Mail/Library Mail consists of mail matter with ECSI value. The Postal Service explained that it planned to move the discounts toward their unit avoided costs over time, while avoiding any drastic changes that could cause rate shock. FY 2014 ACR at 33-34.

With respect to Media Mail/Library Mail, the Commission concludes that the Basic presort discounts are justified pursuant to 39 U.S.C. § 3622(e)(2)(C) because the product qualifies for the ECSI exemption.

b. BPM Flats and BPM Parcels

In FY 2014, 13 discounts were offered for BPM Flats and 12 for BPM Parcels. Table II-9 and Table II-10 show the FY 2014 discounts, avoided costs, and passthroughs for these products.

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

Type of Worksharing (Benchmark)	FY 2014		
	Year-End Discount (cents)	Unit Cost Avoidance (cents)	Passthrough[a]
Presorting (Cents/Piece)[b]			
Basic Flats (Single-Piece Flats)	34.4	*See* Note b	N/A
Carrier Route Flats (Basic Flats)	9.9	14.9	66.4%
Presorting (Cents/Piece)[b]: Basic, Carrier Route Flats (Single-Piece Flats)			
Zones 1 & 2	4.6	*See* Note b	N/A
Zone 3	6.1	*See* Note b	N/A
Zone 4	5.7	*See* Note b	N/A
Zone 5	6.2	*See* Note b	N/A
Zone 6	7.1	*See* Note b	N/A
Zone 7	6.9	*See* Note b	N/A
Zone 8	7.2	*See* Note b	N/A
Barcoding (Cents/Piece)[c]			
Single-Piece Automation Flats (Single-Piece Non-automation Flats)	0.0	*See* Note c	N/A
Basic Automation Flats (Basic Non-automation Flats)	0.0	*See* Note c	N/A
Carrier Route Automation Flats (Carrier Route Non-automation Flats)	0.0	*See* Note c	N/A
Dropship (Cents/Piece)			
Basic, Carrier Route DNDC Flats (Basic Origin Flats)	14.1	11.6	121.6%
Basic, Carrier Route DSCF Flats (Basic Origin Flats)	64.0	58.3	109.8%
Basic, DFSS Flats (Basic Origin Flats)	64.0	58.3	109.8%
Basic, Carrier Route DDU Flats (Basic Origin Flats)	79.1	75.1	105.3%

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

[b] 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.

[c] These barcode discounts were eliminated in Docket No. R2013-10.

Source: Library Reference PRC–LR–ACR2014/6.

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

Type of Worksharing (Benchmark)	FY 2014		
	Year-End Discount (Cents)	Unit Cost Avoidance (Cents)	Passthrough[a]
Presorting (Cents/Piece)[b]			
Basic Parcels (Single-Piece Parcels)	66.6	*See* Note b	N/A
Carrier Route Parcels (Basic Parcels)	9.9	14.9	66.4%
Presorting (Cents/Pound)[b]: Basic, Carrier Route Parcels (Single-Piece Parcels)			
Zones 1 & 2	6.1	*See* Note b	N/A
Zone 3	6.6	*See* Note b	N/A
Zone 4	6.1	*See* Note b	N/A
Zone 5	6.2	*See* Note b	N/A
Zone 6	6.6	*See* Note b	N/A
Zone 7	4.4	*See* Note b	N/A
Zone 8	4.7	*See* Note b	N/A
Dropship (Cents/Piece)			
Basic, Carrier Route DNDC Parcels (Basic Origin Parcels)	14.1	11.6	121.6%
Basic, Carrier Route DSCF Parcels (Basic Origin Parcels)	64.2	58.3	110.1%
Basic, Carrier Route DDU Parcels (Basic Origin Parcels)	79.1	75.1	105.3%

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

[b] 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.

Source: Library Reference PRC–LR–ACR2014/6.

The destination network distribution center (DNDC) dropship discount for BPM Flats and BPM Parcels exceeded unit avoided costs in FY 2014. Both products had a passthrough of 121.6 percent. In Docket No. R2013-11, the Postal Service set the DNDC dropship discounts for BPM Flats and BPM Parcels equal to their respective unit avoided costs.[36] However, those discounts were set using FY 2012 unit avoided costs data. Since the Docket No. R2013-11 proceeding, the unit avoided costs have decreased, resulting in passthroughs greater than 100 percent for FY 2014.

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

The Postal Service stated its intent to align the discounts with their unit avoided costs in its next Market Dominant price adjustment. FY 2014 ACR at 34. In Docket No. R2015-4, the Postal Service set these discounts equal to their unit avoided costs. Docket No. R2015-4 Notice at 52.

The destination sectional center facility (DSCF) dropship discount for BPM Flats and BPM Parcels exceeded unit avoided costs in FY 2014. The passthroughs for BPM Flats and BPM Parcels were 109.8 percent and 110.1 percent, respectively. In Docket No. R2013-11, the Postal Service set the DSCF dropship discounts for these products below their respective unit avoided costs.[37] However, those discounts were set using FY 2012 unit avoided costs data. Since the Docket No. R2013-11 proceeding, the unit avoided costs decreased, resulting in passthroughs greater than 100 percent for FY 2014.

The Postal Service stated its intent to align the discounts with their unit avoided costs in its next Market Dominant price adjustment. FY 2014 ACR at 35. In Docket No. R2015-4, it set these discounts at 100 percent[38] for BPM Flats and 103.9 percent[39] for BPM Parcels. The Postal Service asserted that the BPM Parcels passthrough exceeding 100 percent was justified pursuant to 39 U.S.C. §§ 3622(e)(2)(B) and 3622(e)(2)(D) and explained that aligning the discount with unit avoided cost would have decreased rates for non-workshared mail in an irrational manner and would likely have caused rate shock. *Id.* It stated that it intends to align this workshare discount with unit avoided cost as soon as practicable. *Id*.

The DFSS dropship discount for BPM Flats exceeded unit avoided cost in FY 2014, its passthrough was 109.8 percent. In Docket No. R2013-11, the DFSS and DSCF dropship discounts were equivalent, and the DSCF unit avoided cost was used as a proxy for the DFSS unit avoided cost.[40] In the same docket, the Postal Service set the DSCF dropship discount for BPM Flats below the unit avoided cost. However, that discount was set using FY 2012 unit avoided cost data. Since the Docket No. R2013-11 proceeding, the unit avoided cost of DSCF dropship discount for BPM Flats decreased, resulting in passthroughs greater than 100 percent for DSCF and DFSS in FY 2014.

The Postal Service stated its intent to align the discount with the unit avoided cost in its next Market Dominant price adjustment. In Docket No. R2015-4, it set this discount at 101.7 percent, asserting this was necessary to maintain a consistent relationship between the price cells so mailers in non-FSS zones would not experience a further rate increase

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[37] *See* Docket No. R2013-11, Price Adjustment Calculations for Package Services, Library Reference PRC-LR-R2013-11/6, December 24, 2013; Excel file "R2013-11 Package Services Worksharing.xls," which shows that the DSCF dropship discounts for BPM Flats and BPM Parcels were 64.0 cents and 64.2 cents, respectively. Unit avoided costs were 64.8 cents for each product.

[38] Docket No. R2015-4 Notice at 52.

[39] Docket No. R2015-4, Response of the United States Postal Service to Questions 1-5 of Chairman's Information Request No. 1, January 30, 2015, question 5 (Docket No. R2015-4, January 30 Response to CHIR No. 1).

[40] Revised Response to the United States Postal Service to Question 15 of Chairman's Information Request No. 7 – Errata, February 23, 2015, question 15 (Revised Response to CHIR No. 7).

while still incentivizing mailers to "enter scheme containers of mail at the DFSS (which is of economic benefit to the Postal Service)."[41]

The destination delivery unit (DDU) dropship discount for BPM Flats and BPM Parcels exceeded unit avoided costs in FY 2014, each with passthroughs of 105.3 percent. In Docket No. R2013-11, the Postal Service set the DDU dropship discounts for both products equal to their respective unit avoided costs.[42] However, those discounts were set using FY 2012 unit avoided costs data. Since the Docket No. R2013-11 proceeding, the unit avoided costs decreased, resulting in FY 2014 passthroughs that exceeded 100 percent.

The Postal Service stated its intent to align the discounts with their unit avoided costs in its next Market Dominant price adjustment. FY 2014 ACR at 35-36. In Docket No. R2015-4, it set the BPM Flats discount at 100 percent[43] and the BPM Parcels discount at 104.3 percent.[44] It asserted that the passthrough for BPM Parcels was justified pursuant to 39 U.S.C. §§ 3622(e)(2)(B) and 3622(e)(2)(D), explaining that to align the discount with unit avoided cost would have decreased rates for non-workshared mail in an irrational manner and would likely have caused rate shock. *Id*. It stated that it intends to align this workshare discount with unit avoided cost as soon as practicable. *Id*.

The Public Representative recognizes that the Postal Service does not offer a statutory exemption to justify the BPM products with passthroughs greater than 100 percent. PR Comments at 44.

Section 3622(e)(2) requires the Commission to ensure workshare discounts do not exceed estimated unit avoided costs unless justified by a statutory exception. For FY 2014, the Commission concludes that nine Package Services workshare discounts exceeded unit avoided costs: Media Mail Basic presort, Library Mail Basic presort, BPM Flats DNDC dropship, BPM Flats DSCF dropship, BPM Flats DFSS dropship, BPM Flats DDU dropship, BPM Parcels DNDC dropship, BPM Parcels DSCF dropship, and BPM Parcels DDU dropship. Workshare discounts for the other Package Services did not exceed their respective unit avoided costs, and thus complied with 39 U.S.C. § 3622(e) in FY 2014.

With respect to the DNDC, DSCF, DFSS, and DDU dropship discounts for BPM Flats and the DNDC, DSCF, and DDU dropship discounts for BPM Parcels, the Commission finds that the discounts are not in compliance with section 3622(e).

The Commission finds that no corrective action is required for the DNDC, DSCF, and DDU dropship discounts for BPM Flats and the DNDC dropship discount for BPM Parcels because

[41] Docket No. R2015-4, January 30 Response to CHIR No. 1, question 5.

[42] *See* Docket No. R2013-11, Price Adjustment Calculations for Package Services, Library Reference PRC-LR-R2013-11/6, December 24, 2013; Excel file "R2013-11 Package Services Worksharing.xls," which shows that the DDU dropship discount and unit avoided costs were 79.1 cents for both BPM Flats and BPM Parcels.

[43] Docket No. R2015-4 Notice at 52.

[44] Docket No. R2015-4, January 30 Response to CHIR No. 1, question 5.

the Postal Service plans to align the discounts with their avoided costs in Docket No. R2015-4. The Postal Service plans to set the DFSS dropship discount for BPM Flats higher than the unit avoided cost pursuant to 39 U.S.C. § 3622(e)(3)(B) in Docket No. R2015-4. The Postal Service plans to set the DSCF and DDU dropship discounts for BPM Parcels higher than their avoided costs pursuant to 39 U.S.C. §§ 3622(e)(2)(D) and 3622(e)(2)(B) in Docket No. R2015-4. Accordingly, the Commission finds that no corrective action is required.

D. Preferred Rate Requirements

Section 3626 of Title 39 of the U.S.C. identifies preferred rate requirements applicable to Periodicals, Standard Mail, and Package Services prices.

Periodicals is a preferred class of mail and receives several statutory discounts in section 3626, such as a 5 percent discount for nonprofit and classroom publications. In Docket No. R2013-11, prices for Periodicals were set to be consistent with statutory preferences for mail in that class.[45]

Section 3626(a)(6) of Title 39 requires nonprofit prices in Standard Mail to be set in relation to their commercial counterparts regardless of nonprofits' independent costs. In Docket No. R2013-11, nonprofit prices were set to yield average per-piece revenues of 60.1 percent of commercial per-piece revenues at the class level.[46] The Commission calculates that the actual per-piece revenue from Standard Mail nonprofit pieces was 57.9 percent in FY 2014. Changes in the mix of mail after price changes make it difficult to precisely attain the 60 percent relationship required by law.

One preferred mail requirement applies to Media Mail/Library Mail, a product in Package Services: Section 3626(a)(7) of Title 39 requires Library Mail prices to be set at 95 percent of Media Mail prices. Docket No. R2013-11 set these prices accordingly.[47]

The Commission finds that prices in FY 2014 were in compliance with all the preferred rate requirements identified in 39 U.S.C. § 3626.

[45] *See* Docket No. R2013-11, Library Reference PRC-LR-R2013-11/5, Excel file "PRC-CAPCALC-PER-R2013-11-5.xls."

[46] *See id.*, Library Reference PRC-LR-R2013-11/4, Excel file "PRC-CAPCALC-SM-R2013-11-4.xls," tab "Price Change Summary."

[47] *See id.*, Library Reference PRC-LR-R2013-11/6, Excel file "R2013-11 Package Services Price Adjustment Calculations.xls."

CHAPTER 3: MARKET DOMINANT PRODUCTS: OTHER RATE AND FEE COMPLIANCE ISSUES

A. Introduction

Commenters raise other rate and fee compliance issues, most of which relate to the objectives and factors established by 39 U.S.C. § 3633 and to the policies of Title 39 of the U.S.C. These issues include noncompensatory products, negotiated service agreements (NSAs)[48], and pricing issues related to perceived cost coverage disparities.

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

B. Noncompensatory Products

1. Periodicals

a. FY 2014 Financial Results

The cost coverage for Periodicals in FY 2014 was 76.2 percent, virtually unchanged from the 76.1 percent cost coverage in FY 2013. FY 2014 ACR at 32. In FY 2013, the cost coverage for Periodicals increased for the first time since FY 2008. FY 2013 ACD at 42. The Postal Service states that it is on track to improve cost coverage for the Periodicals class because the FY 2014 cost coverage was an improvement over FY 2012 (72.1 percent). FY 2014 ACR at 31. The Commission notes, however, that since the enactment of the PAEA, the cost coverage for Periodicals has declined from 83 percent to approximately 76.1 percent, as Table III-1 illustrates.

[48] NSAs are written contracts between a mailer and the Postal Service, effective for a defined period of time, that provide for mailer-specific rates, fees, or terms of service according to the contract. 39 C.F.R. § 3001.5(r). The mailer often receives discounts (rebates) designed to encourage higher mail volumes and contributions.

Table III-1
Periodicals Cost Coverage, FY 2007–FY 2014 ($ Millions)

Fiscal Year	Volume	Revenue	Cost	Cost Coverage	Contribution
2007	8,795	$2,188	$2,636	83.01%	-$448
2008	8,605	$2,295	$2,732	84.00%	-$437
2009	7,953	$2,038	$2,680	76.04%	-$642
2010	7,269	$1,879	$2,490	75.46%	-$611
2011	7,077	$1,821	$2,430	74.94%	-$609
2012	6,741	$1,732	$2,402	72.10%	-$670
2013	6,359	$1,658	$2,179	76.10%	-$521
2014	6,045	$1,625	$2,134	76.16%	-$509
					-$4,447

Source: Library Reference PRC–LR–ACR2014/5.

Revenue per piece for the Periodicals class as a whole increased from 26.1 cents in FY 2013 to 26.9 cents in FY 2014. FY 2014 ACR at 31-32. However, cost per piece also increased, from 34.3 cents to 35.3 cents in the same period. *Id.* at 32. As a result, contribution per piece declined in FY 2014. Table III-2 details the unit cost, revenue, and contribution for Periodicals during the PAEA era.

Table III-2
Periodicals Unit Cost, Revenue, and Contribution, FY 2007–FY 2014

Fiscal Year	Cost/Piece	Revenue/Piece	Contribution/Piece
2007	$0.2997	$0.2488	-$0.0509
2008	$0.3175	$0.2667	-$0.0508
2009	$0.3370	$0.2563	-$0.0807
2010	$0.3425	$0.2585	-$0.0841
2011	$0.3434	$0.2573	-$0.0860
2012	$0.3562	$0.2568	-$0.0994
2013	$0.3427	$0.2608	-$0.0819
2014	$0.3531	$0.2689	-$0.0842

Source: Library Reference PRC–LR–ACR2014/5.

In past ACRs, the Postal Service has discussed the difficulty of improving the financial performance of the Periodicals class while limited to CPI-U price increases. FY 2013 ACR at 32-33. In FY 2014, the Postal Service implemented both a CPI-U price increase and an exigent surcharge; after implementation of both Docket Nos. R2013-10 and R2013-11 in FY 2014, Periodicals prices increased 5.9 percent. As Table III-1 and Table III-2 demonstrate, however, the financial performance of Periodicals did not improve, even with prices above the CPI-U.

As part of Docket No. R2013-11, the Postal Service projected that with the exigent surcharge, Outside County Periodicals cost coverage would increase to 80.7 percent in FY 2014. January 23, 2015, Response to CHIR No. 2, question 6. Instead, "actual unit costs exceeded projected unit costs (37.5 cents versus 35.9 cents), but actual unit revenues fell short of projected (28.4 cents versus 29.0 cents)." *Id.* Because the price increases failed to increase revenues as much as projected and costs increased more than projected, the cost coverage for Periodicals fell well short of the Postal Service's estimate.

It is important to examine the underlying reasons why the Periodicals class failed to meet the Postal Service's financial projections. The difference between expected revenue and actual revenue is examined below. The difference between expected unit cost and actual unit cost is discussed in Section C below.

The total price of a Periodicals mailing is a combination of five price elements: pounds, pieces, bundles, sacks, and pallets. The pricing structure of the Periodicals class is designed to provide mailers incentives to lower Postal Service processing costs. For the piece element, the impact of mailer worksharing is measured by comparing the presorting discounts with the avoided mail processing and delivery costs. For bundles, sacks, and pallets, the impact of mailer worksharing is measured by price-cost ratios.[49]

Ideally, the presort discounts for pieces and the price-cost ratios of bundles, sacks, and pallets should be designed to encourage mailers to engage in mail preparation behavior that reduces Postal Service costs to the maximum extent possible.[50] When a mailer increases the level of a mailing's worksharing, it receives a discount and the revenue to the Postal Service from that mailing decreases. Periodicals are highly presorted, and mailers respond to the price incentives the Postal Service offers. For example, the Carrier Route discount increased from 9.8 cents to 10.3 cents in FY 2014 and the percentage of Outside County Periodicals presorted to Carrier Route increased from 63.8 percent in FY 2013 to 65.2 percent in FY 2014.[51]

The increase in Carrier Route presorted volume amounted to 73 million additional pieces. In FY 2014, the discount for presorting to Carrier Route was 11.6 cents, and the avoided cost was 17.7 cents. Thus, the additional Carrier Route presorted volume reduced Postal

[49] The ratios of prices to mail processing costs for bundles, sacks, and pallets, by presort and entry level are set forth in Library Reference PRC–LR–ACR2014/5. The ratios compare the price of the bundle, sack, or pallet with the amount of processing cost incurred by the Postal Service.

[50] Unlike workshare discounts, price-cost ratios are not discounts that directly relate the difference in price to the costs avoided by improved mailer preparation. However, the ratios do reflect to some degree how a mailer's choice of container and presort bundle level affect the Postal Service's handling costs.

[51] *See* Docket No. R2010-4R, Renewed Exigent Request of the United States Postal Service in Response to Commission Order No. 1059, September 26, 2013, Attachment A at 40-41. The Postal Service's filing in Docket No. R2010-4R was subsequently re-docketed in Docket No. R2013-11. Docket No. R2013-11, Notice and Order Concerning Exigent Request, September 30, 2013.

Service revenues by $8.5 million—but it should have also reduced Postal Service costs by $13 million. In FY 2014, 78 percent of Periodicals pounds were dropshipped,[52] an increase from 77.3 percent in FY 2013.[53] If worksharing incentives are aligned with Postal Service cost savings, the decrease in revenue per piece for the Postal Service should be offset by a lower cost per piece.

The average weight and advertising content of the mailings also affect Periodicals revenue. Average weight decreased from 6.24 ounces per piece in FY 2013 to 6.16 ounces in FY 2014. Furthermore, advertising pounds, which pay higher prices, decreased from 39.6 percent of total Outside County Periodicals pounds in FY 2013 to 39.3 percent in FY 2014.

The decline in FY 2014 per-piece Periodicals revenue was primarily caused by two factors: an increase in mailer presortation and a decrease in the average weight. The decrease in average weight and advertising content reduced Periodicals revenue by $7.2 million in FY 2014. January 23, 2015, Response to CHIR No. 2, question 6.[54] If the Postal Service had realized this additional revenue, the cost coverage of Periodicals would have been 76.49 percent instead of the actual 76.19 percent. Also, average per-piece revenue for Outside County Periodicals would have been 28.5 cents instead of 28.4 cents. Thus, only a small amount of the deviation from the Postal Service projected revenue per piece of 29 cents with the exigent surcharge was due to the change in weight per piece.

b. Comments

Commenters Utah Hispanic Chamber of Commerce (UHCC), the National Taxpayers Union (NTU), Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. (Valpak), and the Public Representative urge the Commission to take steps to address the chronically low cost coverage of the Periodicals class.[55] Although the Public Representative notes that in FY 2014 the financial results for Periodicals were mostly stable, "[t]aking into account the consistent failure of Periodicals to cover attributable costs, the Public Representative strongly advises the Postal Service [to] expend greater efforts to more actively implement cost savings and productivity improvement measures." PR Comments at 36. Her comments reflect concern over the Postal Service's admission that it "has not taken steps to date to change the Periodicals classification" as recommended by the 2011 *Periodicals Mail Study*[56] and by the Commission in the FY 2013 ACD, but instead has

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[52] To the destination delivery unit, destination sectional center facility, Destination Flats Sequencing System, or destination area distribution center.

[53] If Periodicals pounds were entered with the FY 2013 dropship distribution in FY 2014, Periodicals revenue would have increased by roughly $900,000. For example, 39.4 percent of Periodicals pounds were entered at destination sectional center facility prices in FY 2013 and 41.6 percent of Periodicals pounds were entered at destination sectional center facility/Destination Flats Sequencing System prices in FY 2014. The shift to deeper dropship entry reduces revenue from pounds. *See* Library Reference PRC–LR–ACR2014/5.

[54] An increase of average weight from 6.16 ounces to 6.24 ounces would have led to 32.2 million additional pounds, or $6.8 million in revenue, at the average price of $0.213 per pound. An increase in advertising content from 39.3 percent to 39.6 percent would have led to an additional 6.4 million advertising pounds, which paid an average price of $0.055 more per pound than editorial pounds, for additional revenue of $0.4 million. *See* Library Reference PRC–LR–ACR2014/5.

[55] *See* UHCC Comments at 1, NTU Comments at 1, Valpak Initial Comments at V-1-2, and PR Comments at 36.

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

continued its strategy of increasing Periodicals rate elements "across the board." *Id.* at 36; Supplemental Information Attachment A at 12.[57]

The Magazine Publishers of America, Inc., and Alliance of Nonprofit Mailers reject the idea that inefficient pricing strategy is at the root of Periodicals' chronically low cost coverage. MPA & ANM Reply Comments at 2. Instead, they contend that the Postal Service's failure to control Periodicals cost—despite large investments in automation equipment and increased worksharing by mailers—is the primary reason Periodicals continually fail to cover costs. *Id.*

The Postal Service's Reply Comments did not address Periodicals.

c. Postal Service Response to FY 2013 ACD Direction

In the FY 2013 ACD, the Commission directed the Postal Service to include the following information in the FY 2014 ACR (FY 2013 ACD at 45):

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

The Postal Service did not provide information in response to the Commission's FY 2013 directives as part of its initial ACR filing. *See* FY 2014 ACR at 32 n.14. On January 15, 2015, the Postal Service filed Supplemental Information in its response to Order No. 2313 (Supplemental Information), which contained its response to the Periodicals directives from the FY 2013 ACD. Several CHIRs were filed in an attempt to gather further information regarding the implementation of Flats operational strategies and realized cost savings.[58]

The first and third FY 2013 ACD Periodicals directives involved pricing. As discussed in Chapter 2 Section C. 2., the Postal Service did respond to the first directive and leverage its flexibility to improve the pricing efficiency of Periodicals in FY 2014. The Postal Service notes that it will take "further measures to provide efficient pricing signal to the mailers" in Docket No. R2015-4. Supplemental Information Attachment A at 13.

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[57] Notice of the United States Postal Service of Filing Partial Supplement Information in Response to Order No. 2313, January 15, 2015 (Supplemental Information).

[58] *See* February 19, 2015, Response to CHIR No. 4, questions 5-7 and 10-12; January 23, 2015, Response to CHIR No. 2, questions 1-6, 8, 10, 12-13, and 15-22; January 29, 2015, Response to CHIR No. 2, questions 7, 9, 11, and 14; January 30, 2015, Response to CHIR No. 3, questions 1-2, 5-11, and 13-14; February 5, 2015, Response to CHIR No. 3, questions 3-4; February 6, 2015, Response to CHIR No. 4, questions 1-4, 8-9, and 13-17.

Regarding the third directive, the Postal Service states that it "has not taken steps to date to change the Periodicals classification to align with First-Class Mail and Standard Mail as recommended in Chapter 7 of the Periodicals Mail Study." *Id.* at 12.

The second FY 2013 ACD Periodicals directive required the Postal Service to report on the impact of its Flats operational strategies. In the Supplemental Information, the Postal Service qualitatively detailed 11 operational strategies but did not provide a quantitative analysis of their impact, stating, "[n]o analysis has been performed to isolate the cost savings resulting from the above initiatives, assuming such an analysis [was] even possible with available data." *Id.* at 4.

In its February 19, 2015, Response to CHIR No. 4, questions 10-12, the Postal Service detailed its progress in implementing the Flats operational strategies it provided in Docket No. R2010-4, Library Reference USPS-R2010-4/9, Operations Plans for Flats; it has implemented 22 of the 28 operational strategies it also discussed in Docket No. R2010-4. The Postal Service was unable to provide a cost savings estimate for the implemented strategies, stating, "For the vast majority of programs the Postal Service has no system in place today to accurately measure the isolated cost impact of a single program [or initiative], due to the number of factors impacting costs in a given operation." February 19, 2015, Response to CHIR No. 4, question 11.

As detailed above, the unit cost of Periodicals in FY 2014 was significantly higher than the Postal Service projected in Docket No. R2013-11. The Periodicals Outside County unit cost in FY 2014 was 37.5 cents per piece, 4.5 percent higher than the Postal Service projection of 35.9 cents. January 23, 2015, Response to CHIR No. 2, question 6. The Postal Service did not isolate specific reasons why unit costs exceed projections. *Id.,* question 7. Generally, unit costs for the major cost categories of Mail Processing, Delivery, and Transportation increased in FY 2014. As part of its projections, the Postal Service estimated that Periodicals Outside County unit costs would decrease from FY 2013 to FY 2014. The following table details the change in Periodicals Outside County unit costs from FY 2013 to FY 2014.

Table III-3
Change in Periodicals Outside County Unit Costs, FY 2013–FY 2014

Activity	FY 2013	FY 2014
Mail Processing	11.69	12.25
Delivery	9.38	9.63
Transportation	3.89	3.83
	36.35	**37.53**

Source: Library Reference PRC–LR–ACR2014/5.

As Table III-3 shows, unit costs increased by 1.18 cents and most of the increase occurred in Mail Processing and Delivery. The cause of the Delivery cost increase is related to the amount of delivered volume, as a higher percentage of Periodicals were delivered on rural routes in FY 2014 than in FY 2013. The Mail Processing cost increase was caused by declining processing productivity. The productivity of selected operations for the Automated Flats Sorting Machine 100, Small Parcel Bundle Sorter/Automated Parcel Bundle Sorter, Automated Package Processing System, and FSS, which are the automation equipment used to sort Periodicals, declined in FY 2014. In fact, the productivity of all but FSS has declined since FY 2007. January 23, 2015, Response to CHIR No. 2, question 8. *See* Table III-4.

Table III-4
Change in Productivity for Selected Flats Processing Operations, FY 2007–FY 2014

Operation	Productivity Change
Automated Flats Sorting Machine 100 Incoming Secondary	-13%
Small Parcel Bundle Sorter/Automated Parcel Bundle Sorter Incoming	-17%
Automated Package Processing System Incoming	-49%

Source: Library Reference PRC–LR–ACR2014/5.

Additionally, the productivity of the FSS has declined by 8 percent since its introduction in FY 2011. January 23, 2015, Response to CHIR No. 2, question 8. The gap in unit cost between the Postal Service's projections and the actual FY 2014 results is directly tied to the efficiency with which the Postal Service processes Periodicals. The Postal Service points to the decline in Flats volume to explain the decreased productivity. In the January 23, 2015, Response to CHIR No. 2, question 8, it stated:

> "The cited [Automated Flats Sorting Machine 100, Small Parcel Bundle Sorter/Automated Parcel Bundle Sorter, and Automated Package Processing System] operations have all seen significant declines in workload over the FY2007-FY2014 period, reflecting the declining volume trends for flat-shape mail. The process of reducing workhours in the face of declining volumes may involve lags, to whatever extent it may be reasonable to expect workhours and workloads to adjust proportionally over the long run."

The Postal Service has continually projected improved Flats processing performance, notably in Docket Nos. R2010-4, R2010-4R, and N2012-1.[59] However, it has yet to achieve any of the projected increase in productivity.

[59] In Docket No. R2010-4, the Postal Service projected a FY 2011 Periodicals unit cost of 32.5 cents compared with the actual unit cost of 34.4 cents. *See* Docket No. R2010-4, Rate Adjustment Due to Extraordinary or Exceptional Circumstances, Statement of Stephen J. Masse on Behalf of the United States Postal Service, July 6, 2010, at Attachment 11. In Docket No. N2012-1, the Postal Service projected Flats productivity

d. Commission Analysis

In its Supplemental Information, the Postal Service notes that, while it will continue to pursue available enhancements in efficiency, it is "extremely doubtful," given the limitations imposed by the CPI-U price cap, that the Periodicals class can achieve 100 percent cost coverage. Supplemental Information Attachment A at 15.

It is troubling that the Postal Service was unable to improve cost coverage for Periodicals, even when the limitation imposed by the CPI-U price cap was not in effect in FY 2014. As detailed above, the Postal Service has implemented dozens of operational strategies designed to improve the efficiency of Flats processing operations, yet it has not developed cost savings figures associated with any of the strategies.

In Chapter 7 of the *Periodicals Mail Study*, the Postal Service provided savings estimates for three operational strategies: Implementing the FSS, Moving Flats up the Automation Ladder, and Implementation of the Automation Parcel and Bundle Sorter. All three of these strategies have been implemented since the release of that report. For the Automation Parcel and Bundle Sorter, the Postal Service states that it projected savings of $1.8 billion over 10 years, yet it "has no system in place today to accurately measure the isolated cost impact" of the program. February 19, 2015, Response to CHIR No. 4, question 11. Moreover, the financial results show continued failure to realize operational improvements, regardless of the success or failure of any one initiative. Thus, in FY 2015 the Postal Service should use available data to develop metrics to meaningfully analyze the impact of its operational strategies related to Periodicals.

The Postal Service states that it does not have the information it needs to assess the impact of its operational strategies for improving the financial performance of its Flats operations. Given the persistent nature of the Periodicals cost coverage issue, the Commission urges the Postal Service and postal stakeholders to redouble their efforts to improve cost coverage.

To that end, in the FY 2015 ACR, the Postal Service must provide a detailed analysis of the progress made in improving Periodicals cost coverage. This report shall include:

- The impact of leveraging the Postal Service's pricing flexibility to improve the efficiency of Periodicals pricing
- The progress in developing metrics to assess the cost savings impact of operational strategies
- The cost savings from the implementation of operational strategies outlined in Chapter 7 of the *Periodicals Mail Study* and in the Postal Service's Flats Operational and Pricing Strategies in Docket No. R2010-4[60]

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increases of up to 25 percent. *See* Docket No. N2012-1, Direct Testimony of Frank Neri on Behalf of the United States Postal Service (USPS–T–4), December 15, 2011, at 29-30.

[60] See Docket No. R2010-4, Library Reference USPS–R2010–4/9, July 6, 2010.

- The progress in implementing pricing strategies, also outlined in Chapter 7 of the *Periodicals Mail Study*

2. Standard Mail Flats

a. Introduction

In FY 2014, Standard Mail Flats had a cost coverage of 83.2 percent, a 1.9 percentage point decrease compared with FY 2013.[61] As shown in Table III-5, prior to FY 2012, the cost coverage for Standard Mail Flats decreased every fiscal year since 2008. In FY 2012 and FY 2013, its cost coverage improved, rising from 79.5 percent in FY 2011 to 80.9 percent in FY 2012, and from 80.9 percent in FY 2012 to 85.1 percent in FY 2013. The cost coverage reversed direction in FY 2014, but remains higher than Standard Mail Flats cost coverage between FY 2009 and FY 2012.

Table III-5
Standard Mail Flats Cost Coverage and Contribution, FY 2008–FY 2014

Fiscal Year	Cost Coverage	Contribution (millions)
FY 2008	94.4%	-$217.8
FY 2009	82.1%	-$615.6
FY 2010	81.8%	-$577.0
FY 2011	79.5%	-$643.2
FY 2012	80.9%	-$527.9
FY 2013	85.1%	-$375.9
FY 2014	83.2%	-$411.0

Source: Library Reference PRC–LR–ACR2014/4.

In its review of the financial performance of Standard Mail Flats for FY 2014, the Commission must consider the Postal Service’s compliance with its FY 2010 ACD directive regarding Standard Mail Flats. Below, the Commission discusses this directive, the Postal Service’s FY 2014 ACR response to it, and commenters’ concerns regarding the financial performance of Standard Mail Flats for FY 2014. The Commission also makes a finding on whether further remedial action is needed regarding Standard Mail Flats.

b. FY 2010 ACD Directive for Standard Mail Flats

In the FY 2010 ACD, the Commission determined that Standard Mail Flats prices in effect in FY 2010 did not comply with 39 U.S.C. § 101(d) and directed the Postal Service to increase the product’s cost coverage through a combination of cost reductions and above-average price adjustments, consistent with the price cap requirements, until such time that

[61] The Commission’s calculated cost coverage includes fees in the revenues for each product; the Postal Service’s calculation does not. This is why the figures differ.

revenues exceed attributable costs. FY 2010 ACD at 106. In addition, the Commission directed the Postal Service to provide the following information in each of its subsequent ACRs:

- A description of operational changes designed to reduce Flats costs in the previous fiscal year and an estimation of the financial effect of such changes
- A description of all costing methodology or measurement improvements made in the previous fiscal year and the estimated financial effects of such changes
- A statement summarizing the historical and current fiscal year subsidy of the Flats product, and the estimated timeline for phasing out this subsidy (*Id.* at 107)

The Postal Service appealed the Commission's FY 2010 ACD findings and directive to the United States Court of Appeals for the District of Columbia Circuit. In *USPS v. Postal Regulatory Comm'n*, 676 F.3d 1105 (D.C. Cir. 2012), issued April 17, 2012, the court rejected the Postal Service's contention that the Commission acted outside of the scope of its statutory authority by considering the general standards of 39 U.S.C. § 101(d) in an ACD "at least in extreme circumstances." *Id*. at 1108. The court remanded the case to the Commission "for a definition of the circumstances that trigger [section] 101(d)'s failsafe protection, and for an explanation of why the particular remedy imposed here is appropriate to ameliorate that extremity … " *Id*. at 1109. In response, the Commission issued Order No. 1427, clarifying that its analysis of the circumstances that would trigger 39 U.S.C. § 101(d) depended on the totality of circumstances.[62]

The Commission identified the following specific factors which, in the case of Standard Mail Flats, may trigger 39 U.S.C. § 101(d)'s protections: a significant and growing cost coverage shortfall; the duration of the shortfall over a significant period; evidence that the shortfall is likely to increase further and have a significant adverse impact on users of other products; failure of the Postal Service to address the shortfall; and the failure of the Postal Service to take remedial steps. Order No. 1427 at 9. The Commission affirmed that the factors presented in the FY 2010 ACR constituted "extreme circumstances." *Id.* Additionally, in discussing the appropriateness of the remedy it ordered in its FY 2010 ACD, the Commission stated that it "does not interpret section 101(d) to require 'only 100% cost coverage, and nothing short of 100%,' to satisfy the fair and equitable cost apportionment standard, provided an adequate explanation for a failure to improve cost coverages is offered." *Id*. at 14.

While the court case was pending, the Commission found in its FY 2011 ACD that the rates and fees for Standard Mail Flats remained out of compliance and that Standard Mail prices continued to reflect an unfair and inequitable apportionment of the costs of postal operations to all Standard Mail users. FY 2011 ACD at 118-19. However, because litigation regarding the FY 2010 ACD was still pending, the Commission held action in this area in abeyance pending receipt of the court's decision, and did not require further remedial action. *Id*. at 16, 119.

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

On September 21, 2012, the Commission issued an order confirming termination of the stay it had granted pending resolution of the Postal Service's appeal.[63] The Commission directed that, as part of its FY 2012 ACR, the Postal Service should respond to the specific remedy adopted by the FY 2010 ACD. *Id*. at 3.

In its FY 2012 and FY 2013 ACDs, the Commission found that the Postal Service made progress toward addressing the issues raised in the FY 2010 ACD, and concluded that no further remedial action was required at the time. *See* FY 2012 ACD at 116; FY 2013 ACD at 54.

c. Response to FY 2010 ACD Directive

In its FY 2014 ACR, the Postal Service provides a 2-year schedule of above-consumer price index (CPI) price increases for the Standard Mail Flats product. FY 2014 ACR at 20. The Postal Service plans to increase Standard Mail Flats prices by CPI multiplied by 1.05 in 2015 and 2016. It reiterates its position stated in Docket Nos. R2013-10 and ACR2013 that a 2-year outlook for scheduling above-average price increases for Standard Mail Flats is appropriate because the Commission's review of the system for regulating rates and classes for Market Dominant products is slated to begin at the end of 2016 pursuant to 39 U.S.C. § 3622(d)(3).[64] *Id*.

The Postal Service provides some of the information required by the Commission's FY 2010 ACD directive: a description of operational changes designed to reduce Standard Mail Flats costs, a description of all costing methodology changes made in FY 2014 that affect Standard Mail Flats costs, and the historical and current fiscal year subsidy of the Standard Mail Flats product. Supplemental Information Attachment A at 1-11. Each is discussed below.

The Postal Service describes 11 operational initiatives that it took during FY 2014 to make processing Standard Mail Flats more efficient: FSS Scorecard; Move Mail Up the Ladder; Bundle Operation; Service Performance Diagnostics Tool; High Speed Flats Feeder; FSS Bi-weekly Meetings; Flat Recognition Improvement Program – Software Upgrade; Lean Mail Processing; FSS Training; FSS Mail Preparation; and Reduce Bundle Breakage. *Id*. at 4-11. It maintains that these initiatives are expected to improve efficiencies and productivities, as well as reduce overall Standard Mail Flats costs. *Id*. at 4.

Although the FY 2010 ACD directive requires the Postal Service to provide an estimation of the financial effect of the operational initiatives it undertook to reduce Standard Mail Flats costs, the Postal Service did not do so. Instead, it states that "[n]o analysis has been performed to isolate the cost savings resulting from these initiatives, assuming that such an analysis were even possible with available data." *Id.* at 4.

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

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

The Postal Service identifies three costing methodology changes that affected Standard Mail Flats costs in FY 2014: Docket No. RM2014-4, Proposal Two (Transportation Cost System Air Subsystem change for the Fed Ex Night Turn air carrier); Docket No. RM2014-6, Proposal Six (updating the highway transportation variabilities); and Docket No. RM2015-4, Proposal Eleven (change in the attribution of debit and credit card fees). *ld.* at 2. It asserts that these methodology changes accounted for 0.11 percent of the unit attributable costs for Standard Mail Flats in FY 2014. *ld.*

The Postal Service provides the historical and current fiscal year subsidy of the Standard Mail Flats product. *ld*. at 3. However, it neglects to provide a timeline for phasing out the subsidy, asserting that it is difficult to predict when the shortfall for the product will be phased out. *ld*. It also states that it is unlikely that the shortfall will be eliminated by the end of 2016, when the Commission commences its review of the rate system, and that "[t]he prospects for eliminating the shortfall thereafter will depend not only on pricing and cost saving initiatives, but also on any changes made to applicable regulations by the Commission." *Id.* The Postal Service notes that the FY 2014 Standard Mail Flats shortfall is less than what it was when the shortfall peaked in FY 2011. *Id.*

d. Comments on Standard Mail Flats

The Commission received comments from the American Catalog Mailer Association (ACMA), American Postal Workers Union, AFL-CIO (APWU), Valpak, Association for Postal Commerce (PostCom), and the Public Representative relating to the financial performance of Standard Mail Flats in FY 2014. The comments generally address Standard Mail Flats costs, Standard Mail pricing, and compliance with the Commission's Standard Mail Flats FY 2010 ACD directive.

(1) Standard Mail Flats Costs

ACMA claims that precipitous increases in Standard Mail Flats' costs raise serious questions about their validity. ACMA Comments at 5. It posits that several factors could have caused these anomalous costs. *Id.* at 9. First, volume declines could have led to excess capacity. *Id*. Second, costing systems could be generating costs that do not relate to the behavior of operations, meaning the costs are above marginal. *Id.* Third, some scale economies may have been lost. *Id.* It asserts that its review of the behavior of mail processing costs, city carrier street costs, and city carrier in-office costs also indicate that Standard Mail Flats costs are unreliable. *ld*. at 10-20. Under these circumstances, ACMA suggests that the actual cost coverages for Standard Mail Flats may be considerably higher than those being reported in the Postal Service's ACRs. *Id*. at 22. It suggests that substantial price increases for Standard Mail Flats would hinder the Postal Service's efforts to develop its new FSS price structure and force additional mail volume out of the mail system. *Id.*

In response to ACMA's claims regarding unreliable Standard Mail Flats costs, Valpak states that the Commission and the Postal Service "have spent years developing a costing methodology which they have determined is as accurate as possible, and must be employed in an even-handed way." Valpak Reply Comments at 16. Valpak also states that the Postal Service's Response to CHIR No. 2, question 8. e., strongly suggests that the increase in unit costs for Standard Mail Flats reflects lower productivity resulting from the decline in Flats volume. *Id.* at 16-18. Finally, Valpak contends that ACMA's assertions about the variability of mail processing costs and excess capacities as a reason for increasing Standard Mail Flats costs are unsupported. *Id.* at 19.

The Postal Service also filed comments in response to ACMA's, maintaining that its claims about unreliable costs for Standard Mail Flats are baseless. Postal Service Reply Comments at 23. It states that ACMA is mistaken about the increasing city carrier costs and asserts that there is no reason to believe that ACMA's other arguments on the increasing Standard Mail Flats costs are not equally flawed. *Id*.

(2) Standard Mail Pricing

The Public Representative states that the decline in Standard Mail Flats' cost coverage "breaks the hope for improvement … inspired by the two-year modest increase in cost coverage." PR Comments at 31. She urges the Postal Service to continue providing above-CPI price increases to Standard Mail Flats, but points out that the lack of elasticity estimates creates additional problems in setting prices for the product. *Id.* at 32. She reiterates the Public Representative's recommendation in Docket No. ACR2013 for the Postal Service to "employ a demand-based pricing policy when setting prices for Standard Mail products," asserting that such a policy would "ensure a greater product contribution to institutional costs, and result in a positive effect … on the general public and other mail users in accordance with 39 U.S.C. § 3622(c)(3)." *Id.* at 34.

Valpak asserts that Standard Mail pricing violates 39 U.S.C. § 101(d), which requires postal rates "apportion the costs of all postal operations to all users of the mail on a fair and equitable basis." It highlights the 156.4 percent cost coverage disparity between High Density and Saturation Letters and Standard Mail Flats as "the very definition of unfair and inequitable." Valpak Initial Comments at IV-1, IV-3. It also points to the unit contribution gap between Standard Mail Flats and all other profitable Standard Mail products to support its recommendation that the Commission declare Standard Mail Flats out of compliance with the PAEA. *Id.* at IV-4, IV-5.

Valpak also urges the Commission to reconsider evaluating Postal Service pricing based on the model it initially proposed in Docket No. ACR2013. *Id.* at IV-8. It asserts that individual product elasticity estimates are not required for underwater products because the appropriate price adjustments for such products require pricing above costs whether the elasticity is high or low. *Id.* at IV-15.

(3) Compliance with the Commission's Standard Mail Flats FY 2010 ACD Directive

Valpak maintains that the Postal Service's compliance with the Commission's FY 2010 ACD directive has been ineffective. It observes that with four ACD dockets since the FY 2010 ACD directive, the cost coverage for Standard Mail Flats is unchanged and the unit loss has increased.[65] Valpak elaborates that although aggregate losses have decreased, they have

[65] Valpak's Initial Comments were filed prior to the Postal Service's revised costs data for Standard Mail Flats. *See* Library Reference USPS–FY14–45, Supplemental Material Relating to IOCS Tally Analysis Provided in Response to Order No. 2313, February 3, 2015. In its supplemental filing, the Postal Service concludes that because of the new FSS preparation requirements, some FSS-marked pieces were attributed to

only done so because the volume of Standard Mail Flats decreased by approximately 2 billion pieces. *Id*. at II-6, II-7.

Valpak further states that the Postal Service has interpreted the Commission's FY 2010 ACD directive as requiring increases for Standard Mail Flats that are only minimally greater than CPI. It points out that, meanwhile, costs of Standard Mail Flats have increased by CPI or more, and do not appear to be decreasing. *Id*. at II-8. It urges the Commission to "issue a further remedial order requiring the Postal Service to rapidly and substantially increase prices for Standard Flats, offset by reductions in price to products with the highest coverages, led by High Density [and] Saturation Letters …" *Id*. at II-11.

ACMA asserts that Valpak's position that cost coverage for Standard Mail Flats must be immediately improved to 100 percent may be above the level that the Commission found necessary to satisfy 39 U.S.C. § 101(d). ACMA Reply Comments at 2. ACMA asserts that costs for Standard Mail Flats are too unreliable to support Valpak's prescription to improve the cost coverage. ACMA Reply at 4-5.

In response to Valpak's comments, the Postal Service states that it offered a variety of explanations in its February 5, 2015, Response to CHIR No. 3, question 3, including transitional complications associated with the implementation of FSS Scheme preparation, that mitigate against using the FY 2014 cost increases as an indictment of the Postal Service's remedial efforts to reduce Standard Mail Flats costs. Postal Service Reply Comments at 22. The Postal Service also states that Valpak's arguments ignore the 3.6 percentage point increase in Standard Mail Flats cost coverage since the FY 2011 ACD. *Id*.

The Postal Service asserts that it is in full compliance with the Commission's orders and directives, as evidenced by: the implementation of two above-average price increases in Docket Nos. R2013-1 and R2013-10; the proposal for a third above-average price increase in Docket No. R2015-4; the proposal in Docket No. R2015-4 of a new FSS price structure designed to encourage more Flats mail being prepared for FSS processing; the improvement of Standard Mail Flats' cost coverage since FY 2011; the ongoing operational efforts to reduce Flats costs; and its commitment to continue implementing the schedule of above-average price increases. *Id*. at 22-23. It concludes that while it shares Valpak's goal of achieving 100 percent cost coverage for all underwater products, Valpak's preferred remedy does not provide a superior alternative to the Commission's current approach. *Id*. at 23. The Postal Service, therefore, proposes that the Commission not implement any additional remedial orders for Standard Mail Flats. *Id*.

Standard Mail Flats when they should have been attributed to Carrier Route Flats and High Density and Saturation Flats. *Id*. at 8. It further concludes that Standard Mail Flats costs were overstated by 1.8 percent in its original FY 2014 ACR filing. *Id*.

e. Commission Analysis

The cost coverage for Standard Mail Flats was 83.2 percent in FY 2014.[66] Although a significant cost coverage shortfall still exists in FY 2014, as shown in Table III-5 the shortfall is lower than it was between FY 2009 and FY 2012. Additionally, as shown in Table III-6, the unit contribution for Standard Mail Flats decreased from negative 6.8 cents in FY 2013 to negative 8.1 cents in FY 2014. Still, the unit contribution of Standard Mail Flats in FY 2014 is greater than what it was between FY 2010 and FY 2012.

Table III-6
Standard Mail Flats Unit Contribution, FY 2008–FY 2014

Fiscal Year	Unit Contribution
FY 2008	-2.2
FY 2009	-7.9
FY 2010	-8.2
FY 2011	-9.5
FY 2012	-8.9
FY 2013	-6.8
FY 2014	-8.1

Source: Library Reference PRC–LR–ACR2014/4.

The Commission observes that the Postal Service has taken steps to address the cost coverage shortfall, including proposing above-CPI price increases in recent Market Dominant price adjustment proceedings and undertaking operational initiatives to reduce costs. Further, in Docket No. R2015-4, the Postal Service proposed a 2.686 percent price increase for Standard Mail Flats,[67] 0.622 percentage points higher than the minimum of CPI x 1.05 (2.064 percent for Docket No. R2015-4) that the Postal Service proposed in response to the FY 2010 ACD directive. Additionally, in Docket No. R2015-4, the Postal Service proposed a new FSS price structure for Standard Mail Flats to encourage the preparation of more Flats mail for FSS processing, thereby reducing mail processing costs.[68]

The Commission finds that progress is being made toward addressing the issues it raised in the FY 2010 ACD. As a result, no further remedial action is required at this time. However, the Postal Service should continue improving cost coverage for Standard Mail Flats.

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[66] *See* Library Reference PRC–LR–ACR2014/1.

[67] Docket No. R2015-4, Response of the United States Postal Service to Order No. 2378, March 12, 2015, Excel file "CAPCALC-STD-R2015-4-Remand-USPS.xls," tab "LFP Revenues@New Prices."

[68] *Id.*, United States Postal Service Notice of Market Dominant Price Adjustment, January 15, 2015, at 14-15, 22-23.

Although the Commission is not ordering further remedial action for Standard Mail Flats, it remains concerned that the product's financial performance has diverged from the positive trend demonstrated in the last two fiscal years. The Postal Service must take aggressive action to reduce the unit costs or propose above-CPI price increases in each subsequent Market Dominant price adjustment proceeding to ensure financial performance improves each fiscal year.

Further, though the Postal Service has described new and ongoing operational initiatives during FY 2014 to make processing Standard Mail Flats more efficient, it was not able to quantify their financial effects. Generally, cost savings programs or initiatives target one or more specific activities to produce cost savings. As the Commission has stated, the Postal Service's cost saving initiatives should have specific measurable targets by which the benefits of the program can be evaluated. *See* FY 2012 ACD at 116 and FY 2013 ACD at 54. The Commission remains concerned that the Postal Service has not been able to quantify the cost savings from operational changes designed to reduce Standard Mail Flats costs. *In this chapter's discussion of the noncompensatory cost coverage for Periodicals, the Commission further expresses its concerns with the Postal Service's inability to quantify the cost savings of its initiatives to reduce costs for flat-shaped mail. In that discussion, the Commission recommends the Postal Service take further action concerning its cost reduction initiatives for flat-shaped mail. As such, all the recommendations pertaining to reducing Periodicals' costs also apply to Standard Mail Flats.*

Finally, the Commission is not persuaded by the Alliance of Nonprofit Mailer's comments that the costs for Standard Mail Flats are unreliable. As the Commission stated in its FY 2011 ACD, "the fact that some costs rise faster than others is not *per se* an indicator that cost estimates are incorrect or anomalous." FY 2011 ACD at 119. The Commission expressed that the "CRA level costs are reasonably accurate for evaluating product costs and related prices." *ld*. Additionally, the Commission noted that "[p]ersuasive evidence is required to discard and replace a litigated costing framework that has been developed and refined for over 40 years." *ld*. Nevertheless, it may be possible to improve the costing approach for Standard Mail Flats within the CRA framework to rectify possible anomalies. The Commission encourages interested parties to present alternate methodologies for distributing costs, or initiate a rulemaking to explore alternative methodologies to distribute costs.

3. Standard Mail Parcels

In FY 2014, Standard Mail Parcels had a cost coverage of 70.2 percent, 2.3 percentage points more than in FY 2013.[69] In FY 2014, volumes for Standard Mail Parcels decreased by 8.5 percent. Additionally, unit revenues increased by 5.7 percent and unit attributable costs increased by 2.2 percent compared with FY 2013. This resulted in a 5.2 percent increase in unit contribution in FY 2014 compared with FY 2013.

[69] The Commission's calculated cost coverage differs from the Postal Service's figure because the Commission includes fees in the revenues for each product and the Postal Service does not.

The Postal Service explains that it has proposed above-average price increases over the last 3 years to address the cost coverage for Standard Mail Parcels. FY 2014 ACR at 18. However, it states that the realignment and reclassification of Parcels in the Standard Mail class since FY 2012 has resulted in the remaining Standard Mail Parcels product retaining a significantly higher proportion of nonprofit Parcels, thereby driving down the product's cost coverage.[70] *Id.*

Table III-7 displays the unit revenues, unit attributable costs, unit contributions, cost coverage, and volumes for Standard Mail Parcels from FY 2012 to FY 2014. Table III-8 displays the distribution of commercial and nonprofit volumes for Standard Mail Parcels from FY 2012 to FY 2014. Both tables illustrate the effect of Parcels realignment and reclassification on the recent financial performance of Standard Mail Parcels since FY 2012.

Table III-7
Standard Mail Parcels Financial Comparison, FY 2012–FY 2014

	FY 2012	FY 2013	FY 2014	FY 2012 to FY 2013 Change	FY 2013 to FY 2014 Change	FY 2012 to FY 2014 Change
Unit Revenues	$0.952	$1.034	$1.094	8.7%	5.7%	14.91%
Unit Attributable Costs	$1.113	$1.524	$1.557	36.9%	2.2%	39.92%
Unit Contribution	-$0.161	-$0.489	-$0.464	-203.4%	5.2%	-187.50%
Cost Coverage	85.5%	67.9%	70.2%	-20.6%	3.5%	-17.87%
Volumes	303,558,642	71,966,232	65,845,949	-76.3%	-8.5%	-78.31%

Source: Library Reference PRC–LR–ACR2014/4.

Table III-8
Standard Mail Parcels Commercial to Nonprofit Volume Distributions, FY 2012–FY 2014

	FY 2012	FY 2012 Distribution	FY 2013	FY 2013 Distribution	FY 2014	FY 2014 Distribution
Commercial Volume	285,925,057	94.2%	55,275,452	76.8%	48,028,038	72.9%
Nonprofit Volume	17,633,585	5.8%	16,690,780	23.2%	17,817,911	27.1%
Total Volume	**303,558,642**	**100.0%**	**71,966,232**	**100.0%**	**65,845,949**	**100.0%**

Source: Library Reference PRC–LR–ACR2014/4.

As Table III-8 shows, between FY 2012 and FY 2013, commercial volume decreased by 230 million pieces, while nonprofit volume remained about the same. During the same period,

[70] On January 22, 2012, a large portion of the Standard Mail Parcels product was transferred to the Competitive product list. *See* Docket No. MC2010-36, Order Conditionally Granting Request to Transfer Commercial Standard Mail Parcels to the Competitive Product List, March 2, 2011 (Order No. 689); Docket No. CP2012-2, Order Approving Changes in Rates of General Applicability for Competitive Products, December 21, 2011 (Order No. 1062). Simultaneously, a portion of the remaining Parcels product became Marketing Parcels with different mailing standards. *See* Docket No. R2012-3, United States Postal Service Notice of Market-Dominant Price Adjustment, October 18, 2011, at 19-22.

as seen in Table III-7, unit attributable cost for all Standard Parcels increased by 36.9 percent. Because unit revenue increased only 8.7 percent, the unit contribution decreased by 203.4 percent, resulting in a decrease in cost coverage from 85.5 percent in FY 2012 to 67.9 percent in FY 2013.

To improve Standard Mail Parcels cost coverage, the Postal Service states that it will continue proposing above-average price increases. FY 2014 ACR at 19. Most recently, in Docket No. R2015-4, the Postal Service proposed a price increase for Standard Mail Parcels of approximately 9.3 percent, more than 7 percent higher than the average price increase for Standard Mail.[71]

The Public Representative asserts that there has been sufficient time since the transfer of Standard Mail commercial parcels for the Postal Service to improve the cost coverage for the resulting Standard Mail Parcels product. PR Comments at 30-31. She recommends that the Postal Service continue taking meaningful measures to improve the cost coverage for Standard Mail Parcels by proposing above-average price increases in future price adjustments. *ld.*

The Commission concludes that FY 2014 revenues for Standard Mail Parcels were not sufficient to cover attributable costs. However, it concludes the Postal Service's approach to improve cost coverage through above-average price increases in future Market Dominant price adjustments is appropriate.

4. Media Mail

In FY 2014, Media Mail/Library Mail had a cost coverage of 94.0 percent, a 9.0 percentage point increase compared with FY 2013.[72] Unit contribution increased 36.2 cents per piece from FY 2013 to FY 2014. *Id.* This is the eighth consecutive year that Media Mail/Library Mail did not generate sufficient revenues to cover attributable costs. The Postal Service intends to continue improving the cost coverage over time through above-average price increases. FY 2014 ACR at 33.

The Public Representative notes that Media Mail/Library Mail has not covered its attributable costs for the eighth consecutive year, and notes the increase in the product's cost coverage for FY 2014 over FY 2013. PR Comments at 38. Furthermore, she believes the increase in cost coverage corresponds with the Postal Service's goal to improve cost coverage stated in Docket No. R2013-11, and supports the Postal Service's intent to continue improving the cost coverage over time through above average price increases. *ld.*

Media Mail/Library Mail did not cover its attributable costs or make a contribution to institutional costs in FY 2014. Though the product may not be consistent with cost coverage requirements in 39 U.S.C. § 3622(c)(2), the Commission must also consider the 9

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[71] *See* Docket No. R2015-4, United States Postal Service Notice of Market Dominant Price Adjustment, January 15, 2015, at 21 (Docket No. R2015-4 Notice).

[72] *See* Library Reference PRC–LR–ACR2014/1, Excel file "Summary_LR1_FSS Adj."

objectives and 14 factors in their totality, such as the pricing factor outlined in 39 U.S.C. § 3622(c)(11). This section, which is especially relevant to Media Mail/Library Mail, requires the Commission to consider the ECSI value to the recipient of the mail matter.

The Postal Service has used its pricing flexibility to propose above-inflation price increases for Media Mail/Library Mail in order to bring its revenues closer to 100 percent cost coverage. The above-inflation price increases tend to produce prices that are consistent with 39 U.S.C § 3622(b)(5) that would assure adequate revenues to maintain financial stability.

Therefore, the Commission does not find the product inconsistent with 39 U.S.C. § 3622 in FY 2014. Table III-9 shows the history of price increases for Media Mail/Library Mail under the PAEA.

Table III-9
Media Mail/Library Mail
Price Adjustment vs. Price Adjustment Authority

Docket No.	Price Adjustment	Price Adjustment Authority (Price Cap)
R2008-1	4.538%	2.900%
R2009-2	7.468%	3.800%
R2011-2	1.964%	1.741%
R2012-3	2.581%	2.133%
R2013-1	3.469%	2.570%
R2013-10	2.061%	1.696%
R2015-4	2.313%	1.966%

Source: Postal Regulatory Commission Package Services Price Cap Adjustment Workpapers.

In the most recent Market Dominant price adjustment, the Postal Service proposed above-average price increases for Media Mail/Library Mail. Docket No. R2015-4 Notice at 29. The Commission encourages the Postal Service to continue pricing the Media Mail/Library Mail product in a way that brings the product toward full cost coverage.

5. Stamp Fulfillment Services

The Stamp Fulfillment Services (SFS) product fulfills stamp orders placed by mail, phone, fax, or online to the Stamp Fulfillment Services Center in Kansas City, Missouri. It was added to the *Mail Classification Schedule* as a Market Dominant product in FY 2010. In every fiscal year since SFS was introduced, its costs have exceeded revenues and its cost coverage has been below 100 percent. However, cost coverage improved substantially in FY 2013, increasing 11.5 percent over FY 2012; in FY 2014, it decreased 3.3 percent points to 77.5 percent. *See* Table III-10.

Table III-10
Stamp Fulfillment Services Cost Coverage, FY 2010–FY 2014

Fiscal Year	Cost Coverage
FY 2010	53.1%
FY 2011	59.7%
FY 2012	59.3%
FY 2013	80.8%
FY 2014	77.5%

Source: February 26, 2015, Response to CHIR No. 12, question 1 and FY 2013 ACD at 58.

To explain this change, the Postal Service states:

> "[g]oing from FY 2013 to FY 2014, the total number of transactions dropped, as did the average cost per transaction. There was, however, a larger drop in average revenue per transaction, as fewer customers placed orders for purchases of greater than $50. As a result of average revenue declining proportionately a bit more than average cost, the cost coverage decreased to 77.5 percent for FY 2014."[73]

The Postal Service also contends that "[t]here is a possibility that the exigent surcharge, which resulted in a price increase of $0.10, caused customers to choose to make purchases for smaller amounts to avoid the higher SFS fees associated with orders greater than $50." *Id.,* question 2. The Postal Service adds that it "will keep an eye on how volume reacts to a lack of price change in the current Market Dominant price change proposal in Docket No. R2015-4 and, at the time of the next price change, will use the knowledge gained during the intervening period to determine an appropriate action to improve cost coverage." *Id.* The Postal Service continues to agree with the Commission's comments from the FY 2012 ACD, at 142.

The Commission finds that the costs and revenues associated with the SFS product do not entirely capture the value that the Services Center adds to the Postal Service and to other Postal Service products. Although SFS does not cover its attributable costs, the Services Center promotes the objectives of reducing costs and increasing efficiency. See 39 U.S.C. §§ 3622(b)(1) and (c)(12).

6. Inbound Letter Post

The Inbound Letter Post product consists of international mail (generally referred to as Letter Post) that originates in foreign countries and is delivered in the United States.[74] Foreign postal operators remunerate the Postal Service for delivering Inbound Letter Post

[73] Response to CHIR No. 12, question 1.

[74] *Mail Classification Schedule*, Section 1130.6. "Letter Post" refers to international mail that is not classified as Parcel Post or Express Mail. It consists of mail items similar in content to domestic First-Class Mail, Periodicals, Standard Mail, BPM, and Media Mail/Library Mail, weighing up to 4.4 pounds (2 kilograms).

items at prices set by the Universal Postal Union (UPU)[75] which are called terminal dues. The Postal Service also concludes bilateral and multilateral agreements with foreign postal operators for the entry of Letter Post at negotiated rates.

a. Inbound Letter Post at UPU Terminal Dues

In FY 2014, though revenues for the Inbound Letter Post product did not cover attributable costs,[76] its financial results were better than in FY 2013. (The FY 2014 reported loss was $74.8 million; it was $78.5 million in FY 2013.) Cost coverage also increased to 70 percent from 65.6 percent in FY 2013.

The increase in contribution and cost coverage from FY 2013 through FY 2014 reflects a 9.2 percent increase in total unit revenue and a 1.8 percent increase in total unit cost. The Postal Service states that the increase in total unit revenue likely resulted from the increase in UPU terminal dues, which became effective January 1, 2014. FY 2014 ACR at 8.

The Postal Service explains that the "continued failure of Inbound Letter Post [revenue] to cover its attributable costs stems from the product's unique pricing regime." *Id.* Prices are set according to a UPU terminal dues formula, which for most of the mail is based upon a percentage of the 1-ounce retail Single-Piece First-Class Mail price. *Id.* For the remainder of the mail, prices are based on a set rate per kilogram instead of actual Postal Service costs. *Id.* The formula is renegotiated in the UPU once every 4 years. Thus, the Postal Service maintains that it does not "independently determine the prices [paid by foreign postal operators] for delivering foreign origin mail" in the United States. *Id.*

The Commission recognizes that the pricing regime for the Inbound Letter Post product, based upon the current UPU formula, results in noncompensatory terminal dues rates. As a result, domestic mailers continue to subsidize the entry of Inbound Letter Post by foreign mailers who use the same postal infrastructure but bear none of the burden of contributing to its institutional cost.

To address this issue during the past several years, the United States delegation to the UPU—which included representatives from the Department of State, Postal Service and the Commission—played an active role in UPU negotiations. This led to the adoption of a more compensatory terminal dues formula, effective January 1, 2014. The Commission notes that the formula requires further increases in UPU terminal dues during CY 2015, CY 2016, and CY 2017. Continued terminal dues increases, if accompanied by modest cost increases, should have a positive effect on Inbound Letter Post revenue and cost coverage during the same period.

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[75] The UPU is a United Nations technical agency comprising 192 member countries, including the United States. Member countries negotiate international agreements governing the exchange of international mail, including applicable rates.

[76] Unless stated otherwise, this section analyzes revenue and expenses for international mail products developed according to the "booked" accounting method. The use of booked revenue and expenses ensures that the Commission's financial analyses are consistent with the Postal Service's audited financial statements. The Postal Service also reports "imputed" revenue, presented in the FY 2014 ICRA. Imputed revenue differs from booked revenue, which is consistent with revenue reported in the Postal Service's financial statements and the Revenue, Pieces, and Weight report.

Under current circumstances, the Commission does not recommend any remedial action at this time. However, it does recommend continued efforts to develop a more compensatory UPU terminal dues formula for 2018 to 2021.

b. Quality of Service Link to UPU Terminal Dues

Despite improved financial results for Inbound Letter Post in FY 2014, the Postal Service did not maximize the product's revenue. This is because under the UPU's Quality Link Measurement System, terminal dues can be adjusted downward if service performance fails to achieve the UPU-established annual quality-of-service performance target. In 2013, the Postal Service's final on-time service performance score did not meet the 88 percent quality-of-service target.[77] As a result, the Postal Service lost potential revenue in 2013, which included the first quarter of FY 2014 (*i.e.,* October through December).

Preliminary on-time service performance scores from January through November 2014 show, except for January, a decrease in the preliminary monthly scores compared with the final monthly scores for the same period in 2013. *Id.* Consequently, the annual on-time service performance score for 2014, when finalized,[78] will likely be less than the final 2013 score. For these reasons, in 2014 the Postal Service could expect to forego even more revenue than in 2013, assuming constant volumes. This means a larger loss in Inbound Letter Post revenue for FY 2014, Quarters 2 through 4 (*i.e.*, January through September).

The Postal Service maintains that test pieces used to measure service performance from April to December 2013 were not compliant with the technical design of the UPU Global Monitoring System.[79] Issues of noncompliance concern the entry of test pieces at the New York International Service Center at John F. Kennedy International Airport rather than the Morgan Processing and Distribution Center in Manhattan, New York, and insufficient test pieces from Great Britain from January through March 2013.[80] In response to a Postal Service appeal seeking alternatives to these measurement results, the UPU rejected the alternatives and relied on only the actual results for test pieces entered between January and March 2013 to calculate the 2013 final service performance score. *Id.*

For 2014, the Postal Service attributes the decrease in preliminary monthly service performance scores to force majeure.[81] It cited weather-related events in January, February, and March that affected transportation and caused delays in processing and delivering domestic and international mail. February 6, 2015, Response to CHIR No. 4,

[77] Responses of the United States Postal Service to Questions 1-2, 3a-b, 3d, 4, 6, 7a-e, 8-9, and 11-21 of Chairman's Information Request No. 1, January 16, 2015, question 1, filed under seal in Library Reference, USPS-FY14-NP30.

[78] The UPU finalizes quality-of-service scores following the close of each calendar year. It has not yet finalized service performance scores for 2014.

[79] *See http://www.upu.int/en/activities/global-monitoring-system/gms-description.html*.

[80] February 6, 2015, Response to CHIR No. 4, question 17.b. International Service Centers are postal facilities that receive inbound mail for processing and delivery in the United States and process outbound international mail for dispatch to foreign countries. They are located in New York, Miami, Chicago, Los Angeles, and San Francisco.

[81] Force majeure, literally "greater force," is a term used in contracts or other agreements that excuses a party from performing its obligations following an unforeseen event beyond the party's control, such as war, natural disasters, or other "acts of God."

question 17.a. The Postal Service also cited a fire at a Federal Aviation Administration facility in Illinois that damaged air traffic control systems and contributed to major transportation delays and mail backlogs at the Chicago International Service Center. *Id.*

Except for January, the preliminary monthly on-time service performance scores for 2014 are consistently below the final monthly scores for the same period in 2013. The Commission's analysis of these monthly service performance scores suggests that factors other than unique or one-time events beyond the Postal Service's control are largely responsible for this deterioration in reported monthly service performance.

The impact of the winter storms in January, February, and March 2014 on the preliminary on-time service performance scores is not clear. The January 2014 service performance score increased, not only compared with the same month a year earlier, but also relative to December 2013. The February 2014 service performance score increased relative to January. It seems unlikely that winter storms explain the decrease in preliminary monthly service performance scores for all subsequent months compared with the prior year. Nor is it clear how a fire at a Federal Aviation Administration facility in Illinois explains the across-the-board decrease in preliminary monthly service performance scores (excluding January), notwithstanding the impact at the Chicago International Service Center. Moreover, the decrease in 2014 preliminary monthly service performance scores is measured against lower domestic service standards which became effective in 2013 for purposes of UPU service performance measurement.

These observations suggest that larger, more systemic factors are at work—factors that have not been addressed—that prevent the Postal Service from achieving the UPU quality-of-service target on a monthly or calendar year basis. Given the regular occurrence of winter storms, for example, it is reasonable to expect the Postal Service to factor the impact of such events on service performance into its operations. These observations are further bolstered by the fact that the Postal Service's final quality service performance scores met the UPU quality-of-service target in only one calendar year since enactment of the PAEA.

The Commission concludes that the 2014 preliminary on-time service performance scores indicate systemic problems that will continue to prevent the Postal Service from receiving the maximum revenue possible under the UPU terminal dues system.

The Commission directs the Postal Service to report within 90 days on its plans to improve on-time service performance scores for Inbound Letter Post. In its report, the Postal Service shall identify systemic problems preventing on-time service performance scores from achieving the UPU quality-of-service target each year and its plans to address these problems.

c. Market Dominant International Products Consisting of NSAs

As an alternative to UPU terminal dues, the Postal Service enters into bilateral NSAs with foreign postal operators that include negotiated rates for some or all of their inbound Letter Post items. These negotiated rates are designed to improve the overall cost coverage for inbound Letter Post items compared with the cost coverage at UPU default terminal dues.

The Postal Service reports financial results for two inbound international products that consist of NSAs: Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 and Inbound Market Dominant Exprès Service Agreement 1. Both are included on the Market Dominant product list. In addition, the Postal Service reports financial results for Global Direct Entry with Foreign Postal Administrations (Global Direct Entry). The two inbound international products and Global Direct Entry govern the entry of Letter Post pursuant to negotiated agreements with foreign postal operators.

The Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 product comprises 11 bilateral agreements with seven foreign postal operators: the Australia Postal Corporation, Canada Post, the China Post Group, Hongkong Post, Korea Post, Royal PostNL,[82] and Singapore Post. For FY 2014, the Postal Service reports that these NSAs generated sufficient revenues to cover attributable costs.

Although revenues exceeded attributable costs for the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 product as a whole, the Postal Service reports that revenues for three NSAs in the product did not cover attributable costs. The foreign postal operators with which these NSAs were concluded and the corresponding NSAs (identified by docket number) in effect during FY 2014 were Royal PostNL (Docket No. R2013-4), Hongkong Post (Docket Nos. R2013-3 and R2014-4), and the Australian Postal Corporation (Docket Nos. R2012-2 and R2014-2). The 2-year NSA with Royal PostNL is coterminous with 2013 and 2014, so its reported FY 2014 financial results occur entirely within the 2-year term.

Inbound Letter Post at UPU terminal dues tendered as Exprès and displaying the Common Logo of Exprès service is authorized under Inbound Market Dominant Exprès Service Agreement 1. This product arises from Postal Service accession to the Exprès Service Agreement, a multilateral agreement with the designated postal operators of 24 UPU member countries. For FY 2014, Letter Post entered pursuant to the Inbound Market Dominant Exprès Service Agreement 1 product generated sufficient revenue to cover costs.

In addition, within domestic First-Class Mail, a handling charge of $0.01 per piece applies to foreign-origin, inbound direct entry of Single-Piece First-Class Mail (excluding Single-Piece Double Cards) tendered by foreign postal operators, subject to the terms of an authorization arrangement.[83] The Postal Service has authorization arrangements in effect with eight foreign postal operators; such arrangements, which predate the PAEA, are not classified as a product on the Market Dominant product list. The Postal Service presented financial results for the inbound direct entry of First-Class Mail in the ICRA report. For FY 2014, the inbound direct entry of Single-Piece First-Class Mail generated sufficient revenues to cover costs.

[82] This agreement is with the postal operator for the Netherlands.

[83] *Mail Classification Schedule*, Section 1105.5, n.2.

The FY 2014 financial results for the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 product appear to validate the Postal Service's strategy, advocated in previous ACRs, of negotiating bilateral NSAs with some of the larger foreign postal operators that exchange Letter Post items with the Postal Service.[84] Over time, pursuit of this strategy should continue to improve the overall cost coverage for inbound Letter Post.

The statutory test for compliance of Market Dominant NSAs is found in 39 U.S.C. §§ 3622(c)(10)(A)(i) and (ii), and requires that the Commission determine whether such NSAs improve the net financial position of the Postal Service or enhance the performance of certain operations. To make this determination, the Commission compares the cost coverage for each NSA at negotiated rates with the cost coverage at UPU terminal dues.

In response to an information request, the Postal Service provided financial results for each NSA based upon the UPU terminal dues. For the NSAs with Royal PostNL (Docket No. R2013-4) and the Australian Postal Corporation (Docket No. R2012-2), the cost coverage at the UPU terminal dues exceeded the cost coverage at the negotiated rates. These results indicate that the NSAs did not improve the Postal Service's net financial position.

The Commission finds that the NSA with Royal PostNL did not comply with 39 U.S.C. § 3622(c)(10)(A). The Commission directs the Postal Service to report within 90 days on the following: the factors that caused the Royal PostNL NSA cost coverage at the UPU terminal dues to exceed the cost coverage at the negotiated rates; the extent to which the Postal Service incorporated knowledge of these factors into its financial model for the successor NSA that was the subject of Docket No. R2015-3; and whether the successor NSA with Royal PostNL will improve the Postal Service's net financial position during FY 2015.

The Commission finds that the NSA with the Australian Postal Corporation did not comply with 39 U.S.C. § 3622(c)(10)(A). No remedial action is required because the Australian Postal Corporation NSA expired in FY 2014 and the successor NSA that was the subject of Docket No. R2014-2 covered costs in FY 2014.

The Commission finds that the Hongkong Post NSA satisfies the applicable statutory requirement, because the cost coverage at the negotiated rates exceeded the cost coverage at the UPU terminal dues.

7. Other Issues

The Utah Hispanic Chamber of Commerce and Valpak comment on loss-making products in general. The former proposes that the Postal Service implement substantial price increases for loss-making products, and urges the Postal Service to examine the viability of offering these products if they continue to lose money. UHCC Comments at 2.

Valpak reiterates its belief, stated in previous ACDs, that loss-making products are a financial threat to the Postal Service's viability. Valpak Initial Comments at V-5. It points

[84] Docket No. ACR2012, United States Postal Service FY 2012 Annual Compliance Report, December 2, 2012, at 9 (FY 2012 ACR).

out that in FY 2014, losses were mitigated by extra revenues received due to the temporary exigent surcharge, and projects that the Postal Service's losses will exceed $100 million once the surcharge is removed. *Id.* at V-5, V-6. Valpak asserts that these losses are the primary causes of liquidity shortages, which in turn contribute to a failure to make needed capital investments. *Id.* at V-6. It predicts that contribution from First-Class Mail will continue to decline, adding to the Postal Service's financial losses. *Id*. at V-11. Valpak calls upon the Commission to "prevent the further deliberate underpricing of postal products" by Postal Service management. *Id.* at V-13, V-14.

The Postal Service states that Valpak's argument that underwater products receive rapid and substantial price increases fails to correctly consider the interplay of the price cap and demand trends for underwater products. Postal Service Reply Comments at 20. It elaborates that the unique strictures of the price cap make it unlikely that Valpak's preferred course of action will materially benefit the Postal Service's overall finances. *Id*.

The Commission shares commenter concerns about underwater products. Nevertheless, it determines that the Postal Service's approach in recent Market Dominant price adjustments of proposing above-average price increases for underwater products is reasonable. It encourages the Postal Service to use its pricing flexibility to improve the cost coverage of underwater products through the combination of above-average price increases and cost reduction initiatives. The Commission suggests that the Postal Service propose as high an above-average price increase as is practicable in each Market Dominant price adjustment proceeding.

C. Domestic Market Dominant NSAs

Market Dominant NSAs must comply with 39 U.S.C. § 3622(c)(10), which requires them to improve the Postal Service's net financial position by reducing costs or increasing the overall contribution to institutional costs.[85] They also must not cause unreasonable harm to the marketplace. *Id.* § 3622(c)(10)(B).

After approving a Market Dominant NSA, the Commission also evaluates that NSA in the ACD to ensure that the agreement continues to meet the requirements of 39 U.S.C. § 3622(c)(10). It bases its review on the NSA's performance during "contract years," 12-month periods measured from the time the contract was implemented. In ACDs, the Commission reviews the contract year that ends during the fiscal year of the ACD.

In FY 2014, three domestic Market Dominant NSAs were in effect: PHI Acquisitions, Inc. (PHI) NSA, Valassis Direct Mail, Inc. (Valassis) NSA, and Discover Financial Services (Discover) NSA.[86] The Commission evaluates these NSAs based on their performance during the following contract years:

[85] 39 U.S.C. § 3622(c)(10)(A)(i). Alternatively, NSAs must "enhance the performance of mail preparation, processing, transportation, or other functions[.]" *Id.* § 3622(c)(10)(B).

[86] FY 2014 ACR at 37. International Market Dominant NSAs are discussed in section B. 6. c., *supra*.

- PHI NSA: First Quarter of Contract Year 1 (July 1, 2014 through September 30, 2014)
- Valassis NSA: Contract Year 2 (August 23, 2013 through August 22, 2014)
- Discover NSA: Contract Year 3 (April 1, 2013 through March 31, 2014)

Table III-11 shows the net effect of these NSAs on the contribution to institutional costs for the contract years that ended during FY 2014 using the current accepted analytical principle.[87]

Table III-11
Summary of Net Effect on Contribution for
Domestic Market Dominant NSAs in Effect During FY 2014
($ Thousands)

	FY 2012	FY 2013	FY 2014	Total
Discover	-$4,338	-$6,861	-$14,179	-$25,378
Valassis		$0	$0	$0
PHI[a]			$263	$263

[a] The PHI NSA was in effect for only one quarter of FY 2014.

Source: Library Reference PRC–LR–ACR2014/8.

1. Current Accepted Analytical Principle

For domestic Market Dominant NSAs, the current accepted analytical principle for estimating volume changes due to the Postal Service's pricing incentive programs uses price elasticity to estimate the new volume generated by pricing incentive programs.[88] This principle states that "the financial impact of price incentives to increase mail volume or to shift mail volume between products should be based on the Postal Service's best estimate of the price elasticity of the discounted product." *Id*. at 3.

The Postal Service argues that it "should have the flexibility to determine and employ relevant and appropriate methodologies compatible with its business model." USPS Reply Comments at 11. It contends that no statutory requirement mandates the use of any one methodology. *Id.*

In all ACRs, including this ACR, the Postal Service is required to use accepted analytical principles. 39 C.F.R. § 3050.10. The Commission has applied the current elasticity-based

[87] The estimated impact of the PHI NSA reflects the first quarter of activity. Responses of the United States Postal Service to Chairman's Information Request No. 8, February 20, 2015 (Response to CHIR No. 8). Volumes sent during the remainder of the first contract year may alter these results. Responses of the United States Postal Service to Questions 1-6, 8, 10, 12-13, and 15-22 of Chairman's Information Request No. 2, January 23, 2015, question 5 (January 23, 2015, Response to CHIR No. 2); PHI Comments at 3-4.

[88] Docket No. RM2010-9, Order Terminating Proceeding, May 27, 2011, at 1 (Order No. 738).

accepted analytical principle since the PAEA was enacted in 2006[89]; in 2010, the Commission initiated a rulemaking to consider changing this principle.[90] It evaluated comments from several interested persons, including the Postal Service. Order No. 738 at 4-10. The Commission concluded that the alternative methods the commenters suggested did not "offer a demonstrable improvement over the current method." *Id*. at 1. It decided to retain the elasticity-based accepted analytical principle for evaluating the financial effects of price incentives to increase mail volume or to shift mail volume between products. *See id*. at 16 (Ordering Paragraph No. 2).

In future ACRs, the Postal Service is directed to use the elasticity-based accepted analytical principle when estimating volume changes resulting from its pricing incentive programs unless the Commission accepts an alternative analytical principle. See 39 C.F.R. §§ 3050.10 and 3050.11.[91]

2. PHI NSA

The Postal Service implemented the PHI NSA on July 1, 2014[92]; it was in effect during the last quarter of FY 2014 (July 2014 through September 2014).[93] PHI sent enough mail pieces to qualify for approximately $175,000 in discounts. However, the Postal Service asserts that it could not calculate the net contribution from the PHI NSA on a contract year basis because a full contract year has not been completed. FY 2014 ACR at 38. Nevertheless, using the elasticity-based accepted analytical principle, the Postal Service estimates that the first quarter of the PHI NSA resulted in a net increase in contribution of $281,025.[94] It concludes that the PHI NSA complies with 39 U.S.C. § 3622(c)(10)(A) and the Commission's rules.[95]

Two parties commented on the PHI NSA. PHI identifies an error in the calculations underlying the Postal Service's initial estimate of the NSA's financial impact during the first quarter of FY 2014. PHI Comments at 2. Valpak urges the Commission to closely monitor

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[89] *See* Docket No. ACR2007, Annual Compliance Determination, March 27, 2008, at 127 (FY 2007 ACD).

[90] Docket No. RM2010-9, Notice of Proposed Rulemaking Concerning Methods to Estimate Volume Changes Caused by Pricing Incentive Programs, June 8, 2010 (Order No. 469).

[91] The Postal Service must also apply accepted analytical principles when it submits a request to add an NSA to the Market Dominant product list. 39 C.F.R. § 3010.42(f).

[92] Docket Nos. MC2014-21 and R2014-6, Notice of the United States Postal Service of Implementation Date for PHI Acquisitions, Inc. Negotiated Service Agreement, July 30, 2014, at 1.

[93] Implementation occurred pursuant to Docket Nos. MC2014-21 and R2014-6, Order Adding PHI Acquisitions, Inc. Negotiated Service Agreement to the Market Dominant Product List, June 19, 2014 (Order No. 2097).

[94] Library Reference USPS-FY14-30, revised February 20, 2015. The Postal Service initially miscalculated its estimate of the impact of the PHI NSA during the first quarter of FY 2014, stating that it had a net loss of $128,090 in contribution. January 23, 2015, Response to CHIR No. 2, question 4. The Postal Service acknowledged the error and revised its estimate accordingly. Response to CHIR No. 8. These revisions changed the initial $128,090 estimate of a net loss in contribution to a $281,025 net increase in contribution. Incorporating the updated elasticity provided in the attachment to the January, 20, 2015 letter from Daniel Foucheaux, Jr., produces the estimate of $263 thousand shown in Table III-11.

[95] Notice of the United States Postal Service of Filing of Revised Annual Compliance Report Page – Errata, January 23, 2015 (FY 2014 ACR Revised Page 38).

the PHI NSA and consider in this and subsequent ACR dockets whether it is profitable and lawful and whether it should remain in effect.[96]

The Commission is encouraged by the early positive results of the PHI NSA. By incentivizing new volumes that generate more contribution than the discounts awarded, the agreement may achieve the goal of improving the net financial position of the Postal Service. The Commission will continue to monitor this NSA.

3. Valassis NSA

The Commission approved the Valassis NSA on August 23, 2012.[97] It requires Valassis to begin sending Contract Pieces (*i.e.*, mail pieces eligible for contract prices) within 90 days after the effective date.[98] If it does not, it must mail at least 1 million Contract Pieces during the ensuing 12-month period. *Id.* If mail volume does not reach this threshold during that period, Valassis agrees to pay the Postal Service a $100,000 "transaction fee." *Id.*

Valassis did not meet the 1 million threshold because it did not send any Contract Pieces under its NSA during FY 2013 and FY 2014.[99] The Postal Service states that operations related to the Valassis NSA began during May 2013 in Atlanta, Georgia; Phoenix, Arizona; and Washington, DC. Response to CHIR No. 10, question 1.b. Valassis ceased NSA-related operations in Atlanta in August 2013 and in Phoenix and Washington, DC in December 2013. *Id.* The Valassis NSA is currently not operating in any market and there are no plans to initiate mailing Contract Pieces in 2015. *Id.*

The Postal Service has deferred collecting the $100,000 transaction fee "as it considers and evaluates its business options." *Id.* question 2.b. It did not amend the Valassis NSA to reflect its deferral of the transaction fee. *Id.* question 2.c.

Despite entering three markets and sending a small volume of NSA-related mail in FY 2013, it appears that Valassis was unable to achieve the density necessary to qualify for contract prices.[100] Because Valassis did not send any Contract Pieces in FY 2014, the NSA did not improve or harm the net financial position of the Postal Service.

The Commission is concerned that the Postal Service has not collected the $100,000 transaction fee (sometimes referred to as a "penalty" in the original docket). In proposing

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[96] Valpak Initial Comments at VI-4-5. Valpak's comments were based on the Postal Service's initial estimate of the PHI NSA's financial impact. Valpak's concerns are addressed in part by the revision to the initial estimate. *See* n.94, *supra*.

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

[98] Docket Nos. MC2012-14 and R2012-8, Notice of the United States Postal Service of Filing of Contract and Supporting Data and Request to Add Valassis Direct Mail, Inc. Negotiated Service Agreement to the Market Dominant Product List, April 30, 2012, Attachment B, at 3 (Valassis NSA Notice).

[99] Docket No. ACR2013, Responses of the United States Postal Service to Questions 1-20 of Chairman's Information Request No. 4, February 6, 2014, question 14 (FY 2013 ACR, Response to CHIR No. 4); Responses of the United States Postal Service to Questions 1-2 of Chairman's Information Request No. 10, February 27, 2015, question 1.a. (Response to CHIR No. 10).

[100] To qualify for contract prices, at least 85 percent of the total volume of Contract Pieces must be Standard Mail Saturation Flats entered at DDU. *See id.* question 2.b. n.5.

the Valassis NSA, the Postal Service stated that this provision would ensure that if Valassis did not meet the specified minimum volume, "the expected value of the agreement would still be positive, because of the penalty Valassis must pay[.]" Valassis NSA Notice at 7. When it approved the Valassis NSA, the Commission noted that the penalty provision reduced the risk of the agreement.[101]

Other NSAs—including all of those active in FY 2014—enable for the Postal Service to collect similar fees if anticipated volumes do not materialize. The Commission has found that these fees can be an integral part of NSAs.[102] In one case, the Public Representative argues that the ability of the Postal Service and its NSA partner to agree on changes to penalties "could become an all-purpose tool for evading regulatory scrutiny." *Id.* In that instance, the Commission responded by requiring the Postal Service to file additional information on the penalty and changes to it. *Id.* If the Postal Service fails to enforce these types of provisions, it could alter the perception of prospective NSA partners as to the consequences of risk-balancing provisions and potentially undermine the strength of its bargaining position.

The Postal Service failed to comply with the requirement that it notify the Commission within 30 days of when the Valassis NSA became operational in a market. *See* Order No. 1448 at 42. Furthermore, the Postal Service did not report this information in its FY 2013 or FY 2014 ACR. The ability of the Commission to perform its regulatory oversight duties depends on Postal Service compliance with reporting requirements. *Accordingly, the Postal Service shall report the information required by Order No. 1448 to be filed within 60 days of the end of each contract year. That information includes, but is not limited to, information regarding the payment of the $100,000 transaction fee/penalty. Order No. 1448 at 41.*

4. Discover Financial Services NSA

The Commission approved the Discover NSA on March 15, 2011. Order No. 694 at 24. When requesting approval, the Postal Service stated the "objective of this multi-class market dominant agreement is to maintain the total contribution the Postal Service receives from [Discover] First Class and Standard postage, and to provide an incentive for net contribution to grow beyond that."[103] Pursuant to the agreement, Discover receives rebates on "qualifying mail"[104] if its total revenue exceeds the agreed-upon revenue threshold.[105] In Contract Year 3, that threshold was $288.9 million, which Discover exceeded by $15.2 million. The NSA provides Discover with a rebate of a portion of the

[101] Order No. 1448 at 4.

[102] *See, e.g.,* Docket Nos. MC2011-19 and R2011-3, Order Adding Discover Financial Services 1 Negotiated Service Agreement to the Market Dominant Product List, March 15, 2011, at 17 (Order No. 694).

[103] Docket Nos. MC2011-19 and R2011-3, Notice of the United States Postal Service of Filing of Contract and Supporting Data and Request to Add Discover Financial Services Negotiated Service Agreement to the Market Dominant Product List, January 14, 2011, at 2 (Discover Notice).

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

[105] For Contract Year 3, the revenue threshold is equal to 120 percent of Discover's revenue during the baseline period (February 2010 through January 2011), plus an adjustment to account for the lower contribution of Standard Mail, based on changes in Discover's First-Class revenue since the baseline period.

generally applicable Market Dominant price increases during the contract for eligible volume (75 percent of the price increase for First-Class Mail and 37.5 percent of the price increase for Standard Mail).

a. Postal Service Calculation of Net Financial Benefit

In the Discover Notice, the Postal Service used its preferred net value estimation methodology to estimate that the Discover NSA would generate an increase of $2 to $15 million in contribution over the agreement's 3-year span. Discover Notice at 5. In the *Data Collection Report* for Contract Year 3, the Postal Service estimated that the Discover NSA resulted in a net contribution increase of between $16 million and $24 million based on its preferred net value estimation methodology.[106] It calculated net contribution by comparing actual Contract Year 3 results with projected volumes as forecast by the Postal Service prior to implementation of the Discover NSA. Table III-12 details the Postal Service's estimate of net contribution.

Table III-12
Postal Service Estimate of Net Contribution
($ Thousands, Except Unit Contribution)

	Year 3 Before Rates Volume (Projected)	Year 3 After Rates Volume (Actual)	Incremental Volume	Unit Contrib.	Total Contribution	Earned Rebate	Net Postal Service Value
	[1]	[2]	[3]	[6]	[7]	[8]	[9]
First-Class Mail	163,851	208,325	44,473	$0.254	$11,313	$7,292	
(Low Volume Estimate) Standard Mail	761,484	1,046,187	284,704	$0.110	$31,229	$11,246	
Total	**925,335**	**1,254,512**			**$42,543**	**$18,538**	**$24,005**
(High Volume Estimate) Standard Mail	834,213	1,046,187	211,974	$0.110	$23,252	$11,246	
Total	**998,064**	**1,254,512**			**$34,565**	**$18,538**	**$16,027**

Source: Docket No. R2011-3 Data Collection Report for Year 3 of Discover Financial Services, Inc.'s Negotiated Service Agreement, October 16, 2014.

The Postal Service's net value estimation methodology assumes that all volume greater than the projected Contract Year 3 volume is due to the rebate. For First-Class Mail, this amounted to 44.5 million pieces. The unit contribution of Discover's First-Class letters is,

[106] Docket Nos. R2011-3 and MC2011-19, Data Collection Report for Year 3 of Discover Financial Services, Inc.'s Negotiated Service Agreement, October 16, 2014. The Commission views this as the best representation of the financial impact using the Postal Service's preferred method. The ACR reports the estimated impact to be between $18.2 million and $23.1 million. FY 2014 ACR at 38, revised January 23, 2015. The FY 2014 ACR identifies the source of these figures as Library Reference USPS–FY14–30. *Id.* at n.15. However, the referenced spreadsheets show different values for the estimated impact ($18 million to $22.9 million), and also erroneously use the before-rates volume forecast for Contract Year 2 instead of those for Contract Year 3. (A revised version of Library Reference USPS–FY14–30 filed on February 20, 2015, does not correct this error.) While there are minor differences in the actual Contract Year 3 volumes reported in the Data Collection Report and those in the library reference, the Data Collection Report uses the before-rates volumes forecast corresponding to the correct contract year.

on average, 25.4 cents per piece. Thus, using the net value estimation methodology, the total contribution from the 44.5 million pieces was $11.3 million. The First-Class rebate was $7.3 million. The Postal Service estimates the net value after the First-Class rebate to be $4 million.

For Standard Mail, the Postal Service develops two alternative assumptions: Standard Mail–Low and Standard Mail–High. The Postal Service estimates that between 212 million and 285 million pieces of Standard Mail are due to the rebate. The unit contribution of Discover's Standard Mail letters is, on average, 11 cents per piece. Thus, using net value estimation methodology, the 212 to 285 million incremental pieces had a contribution of $23.3 million to $31.2 million. The Standard Mail rebate was $18.5 million. The Postal Service estimates the net value after the Standard Mail rebate to be $12 million to $20 million.

Applying its preferred net value estimation methodology, the Postal Service combines its net value calculations for First-Class and Standard Mail and estimates that the Discover NSA increased net contribution by $16 million to $24 million in Contract Year 3. However, using the elasticity-based accepted analytical principle, the Postal Service estimates that effect of the Discover NSA on the Postal Service's net financial position during Contract Year 3 is negative $14.2 million. FY 2014 ACR Revised Page 38.

b. Comments

One commenter, Valpak, addresses the Discover NSA. Valpak criticizes the Postal Service's reliance on its preferred net value estimation methodology as the basis for its assertion that the Discover NSA complied with the requirements of 39 U.S.C. § 3622(c)(10), and for "defying the authority of the Commission to approve costing methodologies." Valpak Comments at VI-2. Valpak points out that using the current accepted analytical principle, the Discover NSA resulted in a net loss of contribution of about $14 million in Contract Year 3 and concludes that the NSA violated section 3622(c)(10)(A). *Id*. Because of this, Valpak urges the Commission to find that the statute has been violated and to ask the Postal Service to explain how it would propose to remedy the $25 million in cumulative losses from the agreement. *Id.* at VI-4.

Overall, Valpak concludes that the Postal Service's Market Dominant NSAs have generated losses totaling nearly $50 million since the enactment of PAEA, and that the program has proven to be a failure. *Id*. at VI-5.

In its reply comments, the Postal Service argues that Valpak's criticisms are unwarranted. USPS Reply Comments at 9. Noting the "strong" cost coverage of First-Class Mail and the increasing cost coverage of Standard Mail, the Postal Service asserts that Market Dominant NSAs (including the Discover NSA) contributed to those results. *Id.* at 10. The Postal Service also cites the statement of Harit Talwar in Docket No. R2015-2, which credits the Discover NSA with boosting the amount that Discover has spent on postage in recent years, in support of its conclusion that the NSA improved the Postal Service's financial position. *Id.*

c. Commission Analysis

The Commission uses the elasticity-based accepted analytical principle to develop its estimates of the Discover NSA's net financial impact on the Postal Service's finances. The purpose is to estimate mailer response to a lower price using quantitative inputs. The accepted analytical principle incorporates the Contract Year 3 rebated volume, the marginal rebate, and the Standard Regular and First-Class workshared subclass own-price elasticities.[107] The Commission recognizes that the elasticity of individual mailers may differ from that of the subclass as a whole; however, the accepted analytical principle uses subclass elasticities because they are the only elasticity estimates produced by the Postal Service at this time.

In Contract Year 3, 203 million First-Class Mail pieces qualified for the marginal rebate of 3.6 cents per piece.[108] Using the 2014 First-Class workshared subclass elasticity of -0.305, 6.1 million pieces were incentivized by the rebate. Therefore, the Postal Service gained $1.5 million in contribution from these pieces.

In Contract Year 3, 1.032 billion Standard Mail pieces qualified for a 1.1 cent rebate. Using the 2014 Standard Regular elasticity of -0.482, the rebate incentivized 25.5 million pieces. Thus, the Postal Service gained $2.8 million in contribution from these pieces. Using the accepted analytical principle, the estimated increase in contribution from incentivized volume in Contract Year 3 of the Discover NSA is about $4.4 million. However, because the Postal Service paid rebates of $7.3 million for First-Class Mail volumes and $11.2 million for Standard Mail volumes, the estimated net benefit to the Postal Service of the Discover NSA in Contract Year 3 was negative $14,178,974.[109]

The Postal Service estimates that 44.5 million First-Class Mail pieces were incentivized by the rebate. Discover would need to have an elasticity of -2.45 to be incentivized to mail 44.5 million pieces by a marginal rebate of 3.6 cents. This is roughly 8 times the own-price elasticity of workshared First-Class Mail as a whole. The Postal Service estimates that the rebate incentivized more than 211 million Standard Mail pieces. Discover would need an elasticity of -4.42 to be incentivized to mail 211 million pieces by a marginal rebate of 1.1 cents, roughly 9 times the own-price elasticity of Commercial Standard Regular Mail as a whole.

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[107] The Postal Service's estimates of elasticity reflect subclasses, rather than products, that were used prior to the PAEA. Standard Regular includes the following commercial Standard Mail products: Letters, Flats, and Not Flat-Machinables/Parcels. Enhanced Carrier Route includes the following commercial products: Carrier Route, High Density and Saturation Letters, and High Density and Saturation Flats/Parcels. The accepted methodology was developed in Docket No. MC2004-3. The 2014 Standard Mail Regular elasticity is -0.482 and the First-Class workshared Letters, Flats, and Cards elasticity is -0.305, as provided in the attachment to the January 20, 2015 letter from Daniel Foucheaux Jr. The Postal Service provides its estimates of price elasticity pursuant to the Commission's Periodic Reporting Rules.

[108] The per-piece discounts for Contract Year 3 are substantially larger than in prior contract years. The discounts are determined by comparing the rates Discover paid at the end of each contract year with those paid before the implementation of the NSA. The implementation of the exigent price increases with less than 3 months remaining in Contract Year 3 resulted in relatively large per-piece discounts awarded to all of Discover's Contract Year 3 volume, including the volume it sent at lower rates before the exigent increase was implemented.

[109] The formula for estimating the incremental volume incentivized by a rebate is [Eligible Volume x (1-(Revenue Per Piece/(Revenue Per Piece-Marginal Rebate)) $^{\text{Own-Price Elasticity}}$]. The incentivized volume is multiplied by the contribution per piece of the incentivized volume to calculate the increase in contribution due to the incentivized volume. These calculations are presented in PRC–LR–ACR2014/8.

Section 3622(c)(10) of Title 39 of the U.S.C. requires that Market Dominant NSAs improve the net financial position of the Postal Service or improve operational performance while not causing unreasonable harm to the marketplace. The Discover NSA, using the accepted analytical principle, is estimated to have had a negative effect on the net financial position of the Postal Service in FY 2014. This does not mean that revenues did not cover attributable costs for these mail pieces; rather, the aggregate contribution was reduced from what it would have been absent the agreement.

The Postal Service's estimates of the Discover NSA's net benefits are based on qualitative rather than quantitative factors.[110] When approving the Discover NSA, the Commission expressed reservations about the qualitative methods the Postal Service used to estimate what Discover's net contribution would be absent the NSA. Order No. 694 at 13. It further noted, "[i]t is incumbent upon the Postal Service to develop a quantitative approach that incorporates the factors it is using to estimate volumes." *Id.* at 14. Using the elasticity-based accepted analytical principle, the Commission concluded that the Discover NSA was unlikely to improve the Postal Service's net financial position. *Id.*

The Commission also evaluated the agreement using an analysis presented by the Public Representative. Although the Commission did not endorse that method, it encouraged the Postal Service to explore that approach when analyzing similar agreements. *Id.* at 14-15. Recognizing that "[t]he context of the Postal Service's proposal is important," the Commission authorized the Discover NSA to proceed, stating, "allowing this negotiated service agreement to proceed will allow management to enhance its knowledge of potential tools to slow the overall declining trend for First-Class Mail volume." *Id.* at 15.

In the FY 2013 ACD, the Commission found that the Discover NSA resulted in a net loss of almost $11.2 million for the Postal Service during the first two contract years. FY 2013 ACD at 62, Table III-5. It directed the Postal Service to provide in its FY 2014 ACR "a detailed analysis of the lessons learned from the [Discover] NSA." *Id*. at 68. The Postal Service did not do so. However, in response to an information request, it stated that it learned that the NSA achieved its goals of maintaining Discover's contribution from First-Class Mail and Standard Mail, gaining a net increase in contribution of nearly $71 million over 3 years.[111]

The Postal Service also stated that its experience with this NSA has "deepened its understanding that First-Class Mail is highly affected by customer behavior in the acceptance of Electronic Statements from financial entities." It also concluded that future NSAs should provide overall net increases in contribution for all sub-products of a customer's mail volume. *Id.*

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

[111] January 23, 2015, Response to CHIR No. 2, question 19.

These conclusions are based on the Postal Service's evaluation of Discover's volumes compared with the forecast developed prior to implementation. The Postal Service's response stated that it was "currently evaluating alternative Net Value methodologies." *Id.* However, the Postal Service did not elaborate on the nature of these methodologies or when it anticipated proposing one for acceptance by the Commission.

As discussed above, the Postal Service is required to use the elasticity-based accepted analytical principle when estimating volume changes resulting from its pricing incentive programs unless the Commission accepts an alternative analytical principle. See 39 C.F.R. §§ 3050.10 and 3050.11.

In approving the Discover NSA, the Commission anticipated that the Postal Service would use the experience as an opportunity to observe and attempt to measure the specific factors affecting Discover's mailing behavior. The Postal Service could then use these data to develop and refine new potential methods for evaluating the financial impact of volume discounts based on quantitative inputs.

Based on the Postal Service's statements, it has not availed itself of this opportunity. Instead, it compares volume forecasts it developed nearly 5 years ago to the volumes actually sent by Discover and, with no apparent effort to analyze the effects of changed circumstances or other information, concludes that the entire difference is due to the discounts. The Postal Service's statement that it has "deepened its understanding that First-Class Mail is highly affected by customer acceptance of Electronic Statements from financial entities" seems to suggest that First-Class Mail is less likely to respond significantly to volume-based price incentives. It is unclear how this leads the Postal Service to conclude that future NSAs should provide incentives to increase overall net contribution without regard to "any sub-product of a customer's mail volume." January 23, 2015, Response to CHIR No. 2, question 19. In fact, one could conclude the opposite. The Postal Service's description of its efforts to develop a net value method with quantitative inputs does not suggest any progress or substantial effort toward this goal.

The Commission finds that the Discover NSA did not comply with 39 U.S.C. § 3622(c)(10) for the contract year that ended during FY 2014. The agreement implemented by the Postal Service was designed to pay rebates for all of Discover's qualifying volume, but the rebate was greater than the contribution incentivized by the agreement. The Discover NSA completed its third and final contract year on March 31, 2014; therefore no further action is necessary at this time.

D. Nonpostal Services

In FY 2014, Nonpostal Services generated $68 million in revenue and incurred $13 million in expenses, which resulted in a net income of $55 million. This is a 31 percent increase compared with FY 2013.

E. Other Issues

1. Metered Letter Prices

Several commenters address the price differential between Stamped and Metered Letters and the Metered Letters price in general. Pitney Bowes Inc. (Pitney Bowes), the National Postal Policy Council (NPPC), the National Association of Presort Mailers (NAPM), and Stamps.com asserted that the introduction of a separate price for Metered Letters has been a success. Pitney Bowes Comments at 4-5; NPPC Reply Comments at 3-13; NAPM Reply Comments at 2-3; Stamps.com Comments at 2-4. They support the differential between Stamped and Metered Letters and would support increasing the differential in the future. *Id.*

In contrast, APWU and the Greeting Card Association (GCA) questioned the legality of the differential between Stamped and Metered Letters. APWU Comments at 8-11; GCA comments at 2. They argue that the lower price for Metered Letters may simply lower the postage bill for businesses that already meter all Single-Piece Letter Mail they send. GCA Comments at 3; APWU Comments at 8-11. Consequently, GCA contends that the price differential between Stamped and Metered Letters may not conform with 39 U.S.C. §§ 3622(b)(1), 3622(b)(5), and 3622(b)(8). Likewise, APWU asserts that the differential violates 39 U.S.C. § 3622(b)(8) and suggests that the differential may also violate the 39 U.S.C. § 403(c) nondiscrimination principle. APWU Comments at 8-11. APWU notes that the Postal Service relied on the "experience of foreign posts" to justify the introduction of the Metered Letters price, ignoring the fact that foreign posts are not subject to 39 U.S.C. § 403(c) and may benefit from unequal treatment of its customers. *Id.* at 9. It urges the Commission to "revisit the legitimacy of the metered-mail discount." *Id.* at 2.

The Commission has not determined that a workshare relationship exists between Stamped and Metered Letters. To conclude that the Postal Service violates 39 U.S.C. § 403(c), the Commission must find that the price discrimination between Stamped and Metered Letters is either "undue or unreasonable." The Commission approved the establishment of the Metered Letters price in Docket No. R2013-10, based on a rational explanation presented by the Postal Service that supported pricing Stamped and Metered Letters differently. The same reasons justify its continuation. Furthermore, the Commission finds that the price differential between Stamped and Metered Letters is an appropriate exercise of the Postal Service's pricing flexibility.

2. First-Class Mail Product Cost Coverage Disparity

Pitney Bowes, NPPC, and NAPM have expressed concern about the high cost coverage of First-Class Presorted Letters/Postcards, contending that its relative cost coverage and unit contribution compared with Single-Piece Letters/Postcards is too high. Pitney Bowes Comments at 1-2; NPPC Comments at 2-8; NAPM Reply Comments at 1-2. NAPM argues that the above-average increases imposed on Presort Letters represent a missed opportunity for the Postal Service to encourage the use of its most efficient and profitable letter product. NAPM Reply Comments at 2. Pitney Bowes suggests that the Postal Service should rebalance the cost coverage and unit contributions among First-Class Mail products, lowering prices on Presort Letters. Pitney Bowes Comments at 1-2. NPPC contends that the Postal Service's price increases for Presorted Letters/Postcards may violate 39 U.S.C 3622(b)(1), (4), (5) and (8).

As the Commission noted in response to similar concerns expressed in the FY 2012 ACD and FY 2013 ACD, one objective of the PAEA was to allow the Postal Service pricing flexibility, subject to an inflation-based cap on price changes. See FY 2012 ACD at 82; FY 2013 ACD at 70. That flexibility can be used to apply non-uniform price adjustments within a class. Id.; see 39 U.S.C. § 3622(b)(8). The Commission continues to encourage the Postal Service to balance its own needs with those of its customers.

3. Discount for Automation 5-Digit Letters

Pitney Bowes, NPPC, and NAPM contend that the passthrough of avoided costs for Automation 5-Digit Letters penalizes users because it was too low. Pitney Bowes Comments at 3-4; NPPC Comments at 7; NAPM Reply Comments at 2. They argue that the Postal Service is sending inefficient price signals. *Id.* They contended the Postal Service should set workshare discounts as close as practicable to 100 percent of the costs avoided. *Id.*

The worksharing requirements of Title 39 impose a ceiling but not a floor on passthroughs. See 39 U.S.C. § 3622(e)(2). The Commission notes that passthroughs below 100 percent send inefficient price signals to mailers. Therefore, it encourages the Postal Service to adjust discounts to bring passthroughs closer to 100 percent. The Commission, however, recognizes that the PAEA gives the Postal Service pricing flexibility and encourages it to balance its own needs with those of its customers.

4. Cost Reduction Issues

PostCom believes that the Postal Service's cost reduction efforts have been counterproductive. PostCom Comments at 2. It asserts that instead of reducing costs, these initiatives have shifted mail processing costs to mailers and created higher costs for both mailers and the Postal Service. *Id.* PostCom also explains that the FSS, Load Leveling, and Network Rationalization initiatives have failed to yield savings in processing and delivery costs. *Id.* at 2-3. PostCom suggests that the Commission direct the Postal Service to, in future ACRs, provide top-level workpapers containing attributable costs associated with each rate category and separated by activity. *Id.* at 5.

The Commission agrees that the Postal Service must do a better job of quantifying the savings from its cost reduction initiatives. However, at this time, the Commission does not believe it necessary to direct the Postal Service to provide top-level workpapers showing attributable costs for each rate category and separated by activity. This information is available in the workpapers that accompany the ACR. Nevertheless, the Commission suggests that the Postal Service, in future ACRs, clearly identify where this information can be found.

5. Standard Mail Automation Letters

Pitney Bowes argues that the Postal Service sends inefficient price signals with its Standard Mail Automation Letters rate design. Pitney Bowes Comments at 3. It points out that the Automation AADC Letters passthrough is 137.5 percent, while the Automation 5-Digit Letters passthrough is 81.8 percent, and maintains that the Postal Service should set workshare discounts as close as practicable to 100 percent of the avoided costs. *ld.* It asserts that this approach promotes efficiency, lowers the total combined costs for mailers, and encourages the retention and growth of its most finely presorted and profitable products. *ld.*

Although the Commission concurs that the Postal Service should set its workshare discounts at avoided costs, it is not unlawful to set discounts below avoided costs.

CHAPTER 4: COMPETITIVE PRODUCTS

A. Introduction

In this chapter, the Commission reviews Competitive products to determine whether any rates or fees in effect during FY 2014 were not in compliance with 39 U.S.C. § 3633, which:

- Prohibits subsidization of Competitive products by Market Dominant products: 39 U.S.C. § 3633(a)(1)
- Requires that each Competitive product cover its attributable costs: 39 U.S.C. § 3633(a)(2)
- Requires that, collectively, Competitive products cover an appropriate share of the Postal Service's institutional costs: 39 U.S.C. § 3633(a)(3)

The principal FY 2014 findings for Competitive products are:

- Revenues, as a whole, exceeded incremental costs. Thus, Market Dominant products did not subsidize Competitive products during FY 2014, satisfying 39 U.S.C. § 3633(a)(1).
- Revenues for two products did not cover attributable costs and therefore did not comply with 39 U.S.C. § 3633(a)(2): International Money Transfer Service—Outbound and International Money Transfer Service—Inbound. The Commission orders the Postal Service to take corrective action.
- Collectively, Competitive products satisfied the Commission's 5.5 percent minimum contribution regulatory requirement. *See* 39 C.F.R. § 3015.7(c). As a result, Competitive products complied with 39 U.S.C. § 3633(a)(3) during FY 2014.

B. Cross-Subsidy Provision: 39 U.S.C. § 3633(a)(1)

In Order No. 399, the Commission approved the Postal Service's hybrid incremental cost methodology.[112] Under this methodology, the Postal Service aggregates three cost categories: incremental costs for Competitive domestic products, attributable costs for international Competitive products,[113] and Competitive group specific costs.

[112] Docket No. RM2010-4, Order Accepting Analytical Principles Used in Periodic Reporting (Proposals Twenty-Two through Twenty-Five), January 27, 2010, at 2-5 (Order No. 399).

[113] Order No. 399 established that international Competitive mail would use attributable costs instead of incremental costs, because the latter are not available for international products. *Id.* at 5.

According to the hybrid methodology, Competitive products had incremental costs of $11.2 billion[114] in FY 2014; the total revenues for Competitive products were $15.3 billion. *Id.* Accordingly, in FY 2014, revenues from Competitive products exceeded the hybrid incremental costs.[115] *Consequently, the Commission finds that revenues from Market Dominant products did not subsidize Competitive products, satisfying 39 U.S.C. § 3633(a)(1).*

C. Product Cost Coverage Provision: 39 U.S.C. § 3633(a)(2)

Section 3633(a)(2) of Title 39 of the U.S.C. requires the revenues for each Competitive product to cover attributable costs. Below, the Commission separately discusses the FY 2014 financial performance for five Competitive product groupings:

- Competitive domestic products with rates of general applicability
- Competitive domestic products consisting of NSAs[116]
- Competitive international products with rates of general applicability
- Competitive international products consisting of NSAs
- Competitive non-postal services

1. Competitive Domestic Products with Rates of General Applicability

In FY 2014, there were 12 Competitive domestic products with rates of general applicability: Priority Mail Express; Priority Mail; Parcel Select; Parcel Return Service; First-Class Package Service; Standard Post; Address Enhancement Services; Greeting Cards, Gift Cards, and Stationery; Competitive Ancillary Services; Premium Forwarding Service; Post Office Box Service; and Shipping and Mailing Supplies.

In the FY 2014 ACR, every Competitive domestic product within rates of general applicability covered its attributable costs and complied with the statutory requirements of 39 U.S.C. § 3633(a)(2). FY 2014 ACR at 47.

2. Competitive Domestic Products Consisting of Negotiated Service Agreements

As shown in Table IV-1, in FY 2014, there were 136 Competitive domestic products consisting of NSAs.

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[114] *See* FY 2014 ACR at 46.

[115] The Public Representative also concludes that revenues from Competitive products exceed the FY 2014 hybrid incremental costs. PR Comments at 48-49.

[116] As discussed in Chapter 3, an NSA is a written contract between the Postal Service and a mailer, to be in effect for a defined period, which provides for customer-specific rates or fees and/or terms of service in accordance with the terms and conditions of the contract. *See* 39 C.F.R. § 3001.5(r).

Table IV-1
Competitive Domestic NSA Products in Effect During FY 2014

Competitive Domestic NSA Product Groupings	Number of Products[a]
First-Class Package Service Contracts	35
Parcel Return Service Contracts	4
Parcel Select & Parcel Return Service Contracts	2
Parcel Select Contracts	7
Priority Mail—Non-Published Rates[b]	1
Priority Mail & First-Class Package Service Contracts	1
Priority Mail Contracts	64
Priority Mail Express & Priority Mail Contracts	7
Priority Mail Express Contracts	11
Priority Mail Express, Priority Mail, & First-Class Package Service Contracts	4
Total	**136**

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

[b] The Priority Mail—NPR product allows the Postal Service to enter into Priority Mail NSAs without filing the agreements with the Commission for pre-implementation review

Source: Library Reference USPS–FY14–NP27.

Pursuant to 39 U.S.C. § 3633(a)(2), each Competitive domestic NSA product must cover its attributable costs. The Commission finds that each product for which the Postal Service filed contract-specific data covered its attributable costs and complied with these statutory requirements. The Commission was, however, unable to make a definitive finding on 31 of the 35 First-Class Package Service NSA products because the Postal Service did not file contract-specific data for them. Commission regulations require the Postal Service to file data that allows the Commission to evaluate each Competitive domestic NSA for compliance with 39 U.S.C. § 3633. *See* 39 C.F.R. § 3050.21(g)(2). However, the Postal Service did not provide total volume, revenue, and cost data for 58 products that were in effect during FY 2014.[117]

The Postal Service notes that 31 of the 35 First-Class Package Service contracts in effect during FY 2014 paid published, not discounted, prices and that the sole purpose of the contracts was to allow partners to use the PC Postage payment method during a time when it was not authorized for First-Class Package Service rates. *Id.* The Postal Service further explains that as of January 27, 2013, PC Postage became an authorized payment method for First-Class Package Service and, therefore, these types of First-Class Package Service contracts are no longer required. *ld.*

[117] In Response to CHIR No. 9, question 1, the Postal Service discusses 27 additional non-First-Class Package Service NSA products for which it did not provide financial data. Response of the United States Postal Service to Question 1 of Chairman’s Information Request No. 9, February 24, 2015 (Response to CHIR No. 9). It notes that 24 of these products had no mail pieces shipped under the respective contracts in FY 2014. It further notes that the revenue, volume, weight, and attributable costs data for contracts of the other three products were included in another contract with the same customer. Consequently, for those three products, the Postal Service provided the financial data with the corresponding contract with the same mailer that was in effect in FY 2014.

For these reasons, the Postal Service did not track the 31 First-Class Package Service NSA products. *Id.* Because the mail was entered at published rates, data entered by mailers for these products are included with all other First-Class Package Service data. *Id.*

The Commission recognizes the unique status of these First-Class Package Service NSA products and accepts the Postal Service's rationale for reporting their financial data with the First-Class Package Service product in this limited instance. However, the Commission is required to review each NSA product to determine compliance with 39 U.S.C. § 3633(a)(2). Therefore, for those Competitive domestic NSAs that are not active or are paying published rates, the Postal Service should file a notice of termination to remove the agreement from the Competitive product list.[118] *Furthermore, the Commission directs the Postal Service to identify each NSA product that had no mail pieces shipped under the respective contracts.*

Because the Postal Service did not file contract-specific data for these 31 First-Class Package Service NSA products, the Commission cannot make a definitive finding pursuant to 39 U.S.C. § 3633(a)(2). However, because each of the underlying contracts paid published prices that were found to satisfy the statutory requirements in FY 2014, it is likely that each product also satisfied the requirements in FY 2014.

The Postal Service filed a motion for late acceptance of its notice of filing for two Priority Mail—Non-Published Rates customer agreements on December 22, 2014,[119] with effective dates of June 1 and July 28, 2014.[120] These notices were not filed in a timely manner. The Commission directs the Postal Service to file future notices within a reasonable time of the contract's effective date. Reasonableness requires consideration of all relevant factors. It is incumbent upon the Postal Service to identify and address those relevant factors in order to establish that its request for late acceptance is being made within a reasonable time.

3. Competitive International Products with Rates of General Applicability

Ten Competitive international mail products feature rates and fees of general applicability:[121]

- Outbound International Expedited Services
- Outbound Priority Mail International
- Inbound Air Parcel Post (at UPU rates)

[118] *See, e.g.*, Docket No. CP2014-29, Notice of the United States Postal Service of Termination of Global Reseller Expedited Package Contracts 1 Negotiated Service Agreement, September 30, 2014.

[119] Docket No. CP2011-51, Motion for Late Acceptance of Customer Contract Filing Notice for Priority Mail—Non-Published Rates Serial Number Ending: 0008-0009, December 22, 2014.

[120] Docket No. CP2011-51, Customer Contract Filing Notice for Priority Mail—Non-Published Rates Serial Number Ending: 0008 and 0009, December 22, 2014, at 2.

[121] Prices of general applicability in effect during FY 2014 for Competitive international mail products were established pursuant to Docket No. CP2014-5, Order Approving Changes in Rates of General Applicability for Competitive Products, December 12, 2013 (effective January 26, 2014) (Order No. 1903); Docket No. CP2013-3, Order Approving Changes in Rates of General Applicability for Competitive Products, November 8, 2012 (effective January 27, 2013) (Order No. 1536).

- Outbound Single-Piece First-Class Package International Service
- International Surface Airlift
- International Priority Airmail
- International Direct Sacks—M-Bags
- International Money Transfer Service (IMTS)—Outbound
- IMTS—Inbound
- International Ancillary Services[122]

The Commission concludes that all but the IMTS—Outbound and IMTS—Inbound products satisfy 39 U.S.C. § 3633(a)(2).[123]

The Postal Service separately reports financial results for the IMTS—Outbound and IMTS—Inbound products. The FY 2014 revenue for IMTS—Outbound was less than its attributable costs. In response to an information request, the Postal Service offers no explanation for the cause(s) of the FY 2014 loss, but observes that the product "has a long history of challenges associated with determining [its] attributable costs with confidence." January 16, 2015, Response to CHIR No. 1, question 4. In this regard, the Postal Service reports that only five In-Office Cost System (IOCS) tallies were available to estimate IMTS—Outbound costs,[124] which resulted in a Coefficient of Variation of 44 percent. *Id.,* question 6.a.

In FY 2014, the revenue for IMTS—Inbound product did not exceed attributable costs. The Postal Service explains that attributable costs for IMTS—Inbound were based on only one IOCS tally. Moreover, that tally was inadvertently excluded from the calculation of attributable costs initially included in its FY 2014 International Cost and Revenue Analysis (ICRA) report.[125] As a result, all attributable costs for the IMTS—Outbound product were revised. *Id.*

The Public Representative observes that the Postal Service provided little information concerning the failure of the IMTS—Outbound product to cover costs. PR Comments at 50-51. The Public Representative therefore suggests that the Commission require the Postal Service to provide detailed data to permit a proper analysis of the IMTS—Outbound and IMTS—Inbound products. The Public Representative also requests that the Commission

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[122] The Competitive International Ancillary Services product consists of the following Special Services: International Certificate of Mailing, Outbound Competitive International Registered Mail, International Return Receipt, International Insurance, and Customs Clearance and Delivery Fee. *Mail Classification Schedule* § 2615, August 29, 2014.

[123] Unless stated otherwise, this section analyzes revenue and expenses for international mail products developed according to the "booked" accounting method. The use of booked revenue and expenses ensures that the Commission's financial analyses are consistent with the Postal Service's audited financial statements. The Postal Service also reports "imputed" revenue, presented in the FY 2014 ICRA. Imputed revenue differs from booked revenue, which is consistent with revenue reported in the Postal Service's financial statements and the *Revenue, Pieces, and Weight* report.

Federal Express asks the Commission to direct the Postal Service to issue a public version of the ICRA. FedEx Reply Comments at 4-5. This request is outside the scope of the Commission's ACD.

[124] The IOCS collects data on the proportion of time spent by an employee performing various functions on different mail products or services. These proportions of time are used to estimate the costs of such products or services (*e.g.*, the time city carriers spend in a delivery post office sorting mail). "Tally takers" collect the time data, so "tallies" are used as the source of the data.

[125] January 16, 2015, Response to CHIR No. 1, question 6.b.; *see also* Notice of the United States Postal Service of Revisions to USPS-FY14-NP2—Errata, February 5, 2015.

consider whether rate increases may be necessary to offset the current losses and bring the products into statutory compliance with 39 U.S.C. § 3633(a)(2). *Id.* at 51.

Both IMTS products are relatively small, as evidenced by the few IOCS tallies collected in FY 2014 and in previous fiscal years. Consequently, attributable costs based upon IOCS tallies for both IMTS products will continue to be unreliable or unavailable.

For FY 2014, the Commission finds that the IMTS—Outbound and IMTS—Inbound products do not comply with 39 U.S.C. § 3633(a)(2). The Commission directs the Postal Service to report within 90 days on the feasibility of developing attributable costs for both products based on alternatives to the IOCS methodology. In its report, the Postal Service should discuss the feasibility of conducting engineering studies or utilizing costs from other Special Services with similar functions, such as domestic Money Orders. In addition, the Commission considers a price increase for the IMTS—Outbound product to be one option the Postal Service may want to implement to reduce current losses.

4. Competitive International Products Consisting of NSAs

Competitive international mail also includes products with rates and fees not of general applicability that are established pursuant to one or more NSAs. These agreements often require a minimum volume and/or revenue commitment by mailers or foreign postal operators in exchange for reduced rates from the Postal Service.

In general, each international NSA is classified as a separate Competitive product.[126] The Commission must evaluate each international NSA for compliance with 39 U.S.C. § 3633(a)(2), which requires that the revenues for each product cover its attributable costs.

In some cases, international NSAs with similar cost or market characteristics may be grouped together under a single product. At the request of the Postal Service the Commission permitted the grouping of functionally equivalent NSAs to address administrative concerns involving product reporting and classification on the Competitive product list. Such functionally equivalent international NSAs are collectively evaluated as a product for compliance with 39 U.S.C. § 3633(a)(2). The Commission grouped functionally equivalent NSAs with the express understanding that each NSA within a product must cover its attributable costs.[127]

To that end, the Commission specifically requires that the revenue for each international NSA, grouped by product under one of the following organizational categories, cover its attributable costs: Inbound Express Mail Service (EMS), Inbound Direct Entry Contracts

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[126] Docket No. RM2007-1, Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products, October 29, 2007, ¶¶ 2177 and 3001 (Order No. 43).

[127] *See, e.g.*, Docket Nos. CP2011-34, CP2011-35, CP2011-36, CP2011-37, and CP2011-38, Order Approving Five Additional Global Expedited Package Services 3 Negotiated Service Agreements, December 1, 2010, at 5 (Order No. 601). *See also* Docket No. CP2012-3, Notice of United States Postal Service of Filing Functionally Equivalent Inbound Competitive Multi-Service Agreement with a Foreign Postal Operator, November 30, 2012, at 2.

with Customers, Inbound Direct Entry Contracts with Foreign Postal Administrations, and International Business Reply Service Competitive Contracts.[128] Similarly, Governors' Decisions for products established under the following categories authorize postal management to enter into NSAs, provided the negotiated prices will generate sufficient revenues to cover attributable costs: Inbound Air Parcel Post (at non-UPU rates) and Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1.[129] Thus, the Commission also evaluates each functionally equivalent NSA within a product separately for compliance with 39 U.S.C. § 3633(a)(2).

The Postal Service reports volume, revenue, and cost data on each Competitive international NSA. For FY 2014, it provides such data on 282 international NSAs, of which 262 include negotiated rates for outbound mail and 20 include negotiated rates for inbound mail. The financial results for Competitive outbound and inbound international products consisting of NSAs are discussed below.

a. Competitve Outbound International Products Consisting of NSAs

Competitive outbound international products with negotiated rates are classified on the Competitive product list. Table IV-2 shows the Competitive outbound international products for which the Postal Service reported FY 2014 financial results.[130]

Table IV-2
Competitive Outbound International Products by Category (FY 2014)[131]

Category	Name
Global Expedited Package Services (GEPS) Contracts	GEPS 3
Global Expedited Package Services—Non-Published Rates	GEPS—NPR 3 GEPS—NPR 4
Global Plus Contracts	Global Plus 1C Global Plus 2C
Global Reseller Expedited Package Contracts	Global Reseller Expedited Package Service (GREPS) 1 GREPS 2 GREPS 4

Source: Library Reference PRC–LR–ACR2014/NP2.

[128] *See Mail Classification Schedule* §§ 2515.6 (Inbound International Expedited Services), 2515.4 (Inbound Direct Entry Contracts with Customers), 2515.5 (Inbound Direct Entry Contracts with Foreign Postal Administrations), and 2515.3 (International Business Reply Service Competitive Contracts), August 29, 2014.

[129] *See* Docket Nos. MC2009-24 and CP2009-28, Request of the United States Postal Service to Add Royal Mail Inbound Air Parcel Post Agreement to the Competitive Products List and Notice of Filing (Under Seal) Contract and Enabling Governors' Decision, April 21, 2009; and Docket Nos. MC2010-34 and CP2010-95, Request of United States Postal Service to Add Inbound Competitive Multi-Service Agreements with Foreign Postal Operators to the Competitive Products List and Notice of Filing (Under Seal) of Enabling Governors' Decision and Negotiated Service Agreement, August 13, 2010.

[130] The Postal Service does not report FY 2014 financial results for the following Competitive outbound international products: Global Direct Contracts 1, Global Bulk Economy Contracts, GREPS 3, GEPS—NPR 2, and Priority Mail International Regional Rate Boxes—Non-Published Rates.

[131] This table presents the outbound international products by product category. In some cases, the product name is the same name as the product category.

For FY 2014, the Commission concludes that competitive outbound international products consisting of NSAs satisfy 39 U.S.C. § 3633(a)(2) because revenue exceeds attributable costs for each.

The Postal Service also reports financial results for each outbound international NSA within these products. For FY 2014, these results show that all 262 outbound international NSAs generated sufficient revenues to cover their attributable costs.

b. Competitive Inbound International Products Consisting of NSAs

As with Competitive outbound international products, Competitive inbound international products with negotiated rates are classified on the Competitive product list. Table IV-3 shows the Competitive inbound international products for which the Postal Service reported FY 2014 financial results.[132]

Table IV-3
Competitive Inbound International Products by Category (FY 2014)[133]

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

Source: Library Reference PRC–LR–ACR2014/NP2.

For FY 2014, the Postal Service reports that Inbound Air Parcel Post (at non-UPU rates) did not satisfy 39 U.S.C. § 3633(a)(2).

The Postal Service also reports financial results for each NSA within the Competitive inbound international products. Of the 20 Competitive inbound NSAs, 5 are included in the International Business Reply Service Competitive Contracts 3 product, 2 in the Inbound EMS 2 product, 1 in the Inbound Air Parcel Post (at non-UPU rates) product, and 12 in the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 product. With the exception of two NSAs within the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 product, negotiated rates for each of the remaining 18 NSAs generated sufficient revenue to cover their attributable costs in FY 2014.

[132] The Postal Service does not report FY 2014 financial results for four Competitive inbound international products: International Business Reply Service Competitive Contract 1, Inbound Direct Entry Contracts with Customers, Inbound Direct Entry Contracts with Foreign Postal Administrations, and Inbound Direct Entry Contacts with Foreign Postal Administrations 1.

[133] As with Competitive outbound international products, in some instances the Competitive inbound international product has the same name as the product category.

c. Inbound Air Parcel Post (at Non-UPU Rates)

For Inbound Air Parcel Post (at non-UPU rates), the Postal Service separately reports financial results for parcels from Royal Mail and collectively from several other European postal operators that are parties to the Agreement for the Delivery of Day-Certain Cross-Border Parcels (E-Parcel Group (EPG) Agreement). Inbound Air Parcels from Royal Mail are entered pursuant to the Royal Mail Group Inbound Air Parcel Post Agreement, which is classified as a product on the Competitive product list.[134] Bilateral agreements for the entry of inbound air parcels from postal operators in the EPG-member countries of Belgium, Denmark, Germany, Finland, Slovakia, Slovenia, Sweden, and Switzerland were executed prior to the PAEA.[135] Therefore, they are not included on the Competitive product list because the rates for inbound air parcels tendered by EPG-member countries have not changed. *Id.*

For FY 2014, the Postal Service reports that revenue for Inbound Air Parcel Post (at non-UPU rates) did not cover attributable costs. FY 2014 ACR at 47. Revenue from inbound air parcels entered pursuant to the bilateral agreement with Royal Mail exceeded costs. Therefore, the loss is fully attributable to the financial results for inbound air parcels from EPG-member countries.

Financial penalties for the late delivery of EPG parcels, as well as late transmission of delivery data and missing delivery information, explain a large part of the FY 2014 loss. January 23, 2015, Response to CHIR No. 1, question 5.c. In FY 2014, as in FY 2013, the Postal Service implemented an EPG continuous improvement plan to make operational improvements to decrease financial penalties and increase revenue. This plan improved quarterly on-time service performance and reduced penalties compared with FY 2013. However, financial penalties in FY 2014 were several times greater than the entire loss for inbound air parcels from EPG-member countries. The Postal Service explains that factors such as operational changes at International Service Centers, adjustments to the domestic network service standards, and the consolidation of military mail operations “impacted” financial penalties. *Id.,* question 5.b.

Moreover, the FY 2014 loss is considerably more than the FY 2013 loss. In the FY 2013 ACD, the Commission directed the Postal Service to pursue additional improvements in on-time service performance through implementation of the EPG continuous improvement plan to improve the financial results for Inbound Air Parcel Post (at non-UPU rates) during FY 2014. FY 2013 ACD at 91. The Commission also directed the Postal Service to negotiate bilateral NSAs for the entry of inbound air parcels with EPG-member countries to add such NSAs to the Competitive product list. *Id.*

In its response to this directive in the FY 2013 ACD, the Postal Service states that it gave serious consideration to the Commission’s observations. January 16, 2015, Response to

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[134] *See* Docket Nos. MC2009-24 and CP2009-28, Order Concerning Royal Mail Inbound Air Parcel Post Negotiated Service Agreement, May 29, 2009 (Order No. 218).

[135] Docket No. ACR2013, United States Postal Service FY 2013 Annual Compliance Report, December 27, 2013, at 49 (FY 2013 ACR).

CHIR No. 1, question 4. However, it asserts that the EPG agreement "resulted in a net financial benefit as favorable rates on outbound flows outweighed losses on inbound flows." *Id.* The Postal Service adds that it intends to pursue additional improvements in on-time service performance through the EPG continuous improvement plan, and to engage EPG-member countries during FY 2015 "in the process of examining alternatives to the existing agreements, . . . [although] there are no concrete developments that can be reported at this time." *Id.*

The Public Representative observes that from FY 2012 through FY 2014, the Inbound Air Parcel Post (at non-UPU rates) product failed to cover costs and did not comply with 39 U.S.C. §§ 407(a)(2) and 3633(a)(2). PR Comments at 51-52. Even though inbound air parcels entered pursuant to the Royal Mail agreement covered costs in FY 2014, she adds that Inbound Air Parcel Post (at non-UPU rates) as a whole was noncompliant because inbound air parcels from EPG-member countries failed to generate sufficient revenues to cover costs. *Id.*

The Public Representative, therefore, "reemphasizes [her] concern that domestic mailers are continuing, now for a fourth year in FY 2015, [to] subsidize a product that is competing with private industry." *Id.* at 52. She also advises "the Commission to direct the Postal Service to push forward more aggressively with regard to the Inbound Air Parcel Post (at non-UPU rates) product." *Id.*

In its reply comments, Federal Express Corporation (FedEx) favorably cites the Public Representative's comments, and asks the Commission to "look carefully at this NSA along with the underlying UPU rates going forward."[136]

As noted above, current rates applicable to inbound air parcels from EPG-member countries have not changed, and in FY 2014 revenues again failed to cover costs. Because current rates for inbound air parcels do not cover attributable costs, the rates are inconsistent with federal policy to "promote and encourage unrestricted and undistorted competition in the provision of international postal services and other international delivery services." 39 U.S.C. § 407(a)(2). The rates at issue distort competition.

Although the bilateral agreements with EPG-member countries precede enactment of the PAEA in 2006, the Commission considers this situation problematic. The Commission reiterates its view that the continued entry of inbound air parcels by EPG-member countries at rates that do not cover costs means that domestic mailers are subsidizing the entry of such parcels in competition with private companies engaged in international delivery services. The Postal Service's view that the net financial benefit derived from outbound air parcels outweighs the loss on inbound air parcels evidences its willingness to continue such subsidies and distort competition.

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[136] FedEx Reply Comments at 5-6. The Commission notes that for the Inbound Air Parcel Post (at UPU rates) product, the Postal Service is compensated for the delivery of such parcels at UPU Inward Land Rates. In FY 2014, Inward Land Rates generated revenues for the Inbound Air Parcel Post (at UPU rates) product that exceeded attributable costs. *See* Postal Service Library Reference USPS-FY14-NP2 (revised February 5, 2015), Excel file Reports (Booked).xls.

The Commission concludes that the entry of inbound air parcels post from EPG-member countries is inconsistent with 39 U.S.C § 407(a)(2). The Commission therefore recommends that the Postal Service pursue additional improvements in on-time service performance through implementation of the EPG continuous improvement plan to improve the financial results for Inbound Air Parcel Post (at non-UPU rates) during FY 2015. The Commission directs the Postal Service to negotiate compensatory rates within the EPG-Agreement or extricate itself from the Agreement.

d. Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1

The Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product consists of 12 bilateral NSAs with foreign postal operators for the entry of Inbound EMS, and inbound air and surface parcel post. For FY 2014, the Postal Service reports that revenues for two of these NSAs did not cover their attributable costs. The foreign postal operators with which these NSAs were concluded and the corresponding NSAs (identified by docket number) in effect during FY 2014 were with Royal PostNL (Docket No. CP2013-24) and Hongkong Post (Docket No. CP2013-22). The NSA with Royal PostNL is a 2-year agreement coterminous with CY 2013 and CY 2014. Therefore, the FY 2014 financial results are included within its 2-year term.

In response to an information request, the Postal Service explains that the financial model for the Royal PostNL NSA was developed in FY 2012 using cost data from the FY 2011 ICRA report, which was the most current ICRA available at the time. January 30, 2015, Response to CHIR No. 3, question 14. a. (*citing* Library Reference USPS-FY14-NP33). The Postal Service further explains that despite the use of inflation factor adjustments in the financial model to project costs for the duration of the agreement, actual costs increased by 26 percent compared with a projected cost increase of 11 percent between FY 2011 and FY 2014. *Id.* As a result, costs exceeded revenue during FY 2014. *Id.*

The Postal Service provides a similar explanation with respect to the Hongkong Post NSA. The financial model for this NSA was developed in December 2013, using cost data from the FY 2012 ICRA report, which was the most current ICRA available at the time. January 30, 2015, Response to CHIR No. 3, question 14. b. (*citing* Library Reference USPS-FY14-NP33). Inflation factor adjustments were also incorporated into the financial model to project costs for the duration of the agreement.

However, the Postal Service projected cost inflation of 8.7 percent while the actual costs for processing, delivery, and other costs increased 10 percent, 62 percent, and 31 percent, respectively, between FY 2012 and FY 2014. *Id.* The Postal Service adds that the extension of the Hongkong Post NSA’s termination date from December 31, 2013 to February 28, 2014, also contributed to the loss.

The Royal PostNL NSA expired on December 31, 2014. Prior to its expiration, the Commission approved a successor NSA in Docket No. CP2015-18. The Commission noted that the financial model for the successor NSA was developed in December 2014 using cost data from the FY 2013 ICRA report, the most current ICRA available at the time. The successor NSA became effective January 1, 2015, and has a 2-year term.

The Commission finds that the Royal PostNL NSA (Docket No. CP2013-24) did not satisfy 39 U.S.C. § 3633(a)(2). Moreover, the negotiated rates do not comply with 39 U.S.C. § 407(a) because such rates distort competition. For the successor NSA with Royal PostNL in Docket No. CP2015-18, the Commission directs the Postal Service to report within 90 days on the financial model's projected change in cost compared with the actual change in cost for mail processing, delivery, and other costs, and whether the successor NSA is expected to cover costs during FY 2015. The Postal Service shall provide financial workpapers to support any statements or analysis in its report.

The Commission observes that the term of the Hongkong Post NSA (Docket No. CP2013-22) spanned portions of FY 2013 (Quarters 2-4) and FY 2014 (Quarter 1, January, and February). During FY 2013, the Hongkong Post NSA covered costs, although it did not cover costs in FY 2014. Upon expiration of the NSA in FY 2014, the Commission approved a successor NSA in Docket No. CP2014-21. The successor NSA became effective March 1, 2014, and has a 1-year term.

Under these circumstances, no remedial action is required for the Hongkong Post NSA because it expired and the successor NSA covered costs in FY 2014.

5. Competitive Nonpostal Services

In FY 2014, Nonpostal Services[137] generated $68 million in revenue and incurred $13 million in expenses, which resulted in a net income of $55 million. This figure represents a 31 percent increase compared with FY 2013.

D. Appropriate Contribution Provision: 39 U.S.C. § 3633(a)(3)

Section 3633(a)(3) of Title 39 of the U.S.C. requires the Commission to ensure that all Competitive products collectively cover an appropriate share of the Postal Service's institutional costs. In implementing this section, the Commission determined that if Competitive products contribute at least 5.5 percent toward the Postal Service's total institutional costs, then, as a whole, they cover an appropriate share of the Postal Service's total institutional costs. *See* 39 C.F.R. § 3015.7(c).[138]

[137] The two Market Dominant products are Alliances with the Private Sector to Defray Cost of Key Postal Functions and Philatelic Sales. Docket No. MC2010-24, Order Approving Mail Classification Schedule Descriptions and Prices for Nonpostal Service Products, December 11, 2012, at 4 (Order 1575).

[138] In Order No. 1449, the Commission reaffirmed that the appropriate share of institutional costs to be borne by Competitive products is 5.5 percent, subject to future revision, if necessary. *See* Docket No. RM2012-3, Order Reviewing Competitive Products' Appropriate Share Contribution to Institutional Costs, August 23, 2012, at 24-25 (Order No. 1449).

In FY 2014, the Postal Service reports that total institutional costs were $34.2 billion.[139] Therefore, in order to comply with 39 U.S.C. § 3633(a)(3) for FY 2014, Competitive products must contribute at least $1.9 billion toward the Postal Service's institutional costs. In FY 2014, the total Competitive products contribution was $4.3 billion (12.9 percent),[140] which exceeds the minimum contribution requirement.[141]

Therefore, the Commission finds that Competitive products in FY 2014 satisfied 39 U.S.C. § 3633(a)(3) by covering an appropriate share of the Postal Service's institutional costs.

E. Issues Raised by Commenters

In its comments, United Parcel Service (UPS) raises two issues with Competitive products[142]: the cost attribution of the products and the attribution of institutional costs. UPS asserts that the Commission should require the Postal Service to provide additional information regarding the cost accounting for Competitive products in the current and future ACR proceeding. *Id.* at 2. Although UPS contends that the Commission should closely scrutinize these issues, it recognizes that the cost accounting issues need more thorough examination than is possible within the compressed time frame for comments. *Id.* at 14. Therefore, UPS "intends to submit a petition initiating a proceeding on these matters." *Id.* at 15. Each issue is discussed below.

1. The Attribution of Costs to Competitive Products

UPS asserts that the Postal Service failed to account for large expenditures and investments made in its Competitive products business. *Id.* at 1-2. It states that even with access to non-public data for its outside counsel and consultants, "it was not possible to determine how the Postal Service is accounting for these large expenditures, principally because the data does not contain all of the necessary information."[143] *Id.* UPS asserts that, despite a Congressional mandate in the PAEA, the "Postal Service has done little to improve its cost attribution." *Id.* at 4.

UPS states that the "ACR data and public reports confirm that the Postal Service is rapidly expanding investments in its [C]ompetitive products business and making related operational changes." *Id.* at 5. UPS cites examples such as investments in Delivery Scanning Systems, Passive Adaptive Scanning Systems, Mobile Delivery Devices, Sunday delivery of Competitive products, and "weekday package-specific delivery runs." *Id.* at 5-6. UPS contends that the data the Postal Service provided "does not clearly show how the Postal Service is accounting for these investments" due to both gaps in the data and the

[139] *See* Library Reference USPS–FY14–1.

[140] FY 2014 ACR at 47.

[141] The Public Representative also concludes that the Postal Service complied with 39 U.S.C. § 3633(a)(3) in FY 2014. *See* PR Comments at 53.

[142] Comments of United Parcel Service on Postal Service's FY2014 Annual Compliance Report, February 2, 2014 (UPS Comments).

[143] UPS filed a motion with the Commission requesting access to "a limited subset of non-public materials" for its outside consultants and counsel. United Parcel Service, Inc.'s Motion Requesting Access to Non-Public Materials Relevant to Compliance under Protective Conditions, January 9, 2015. The Commission issued an order granting the request for access on January 15, 2015. Order Granting Request for Access, January 15, 2015, at 2 (Order No. 2321).

complexity of the Postal Service's costing procedures. *Id.* at 7. UPS believes that "[w]ithout more transparency regarding these issues, neither the Commission nor the public can have confidence in any compliance determination regarding [C]ompetitive products." *Id.* at 8.

UPS encourages the Commission to require the Postal Service to provide additional information disclosing how it is accounting for costs attributed to Competitive products. *Id*. It sets forth specific disclosures that the Postal Service should provide relative to its accounting for investments, operational changes, and "increased time and attention Postal Service management is devoting to [C]ompetitive products." *Id.* at 9.

The Public Representative comments that although the "cross-subsidy test is satisfied and market dominant products did not subsidize [C]ompetitive products during FY 2014 … questions still remain concerning the accuracy of the methodology employed to calculate the total hybrid incremental costs." PR Comments at 49.

a. Federal Express Corporation Reply

In its reply comments, FedEx agrees with UPS that the Commission should re-evaluate the cost attribution process,[144] pointing to the Postal Service's recently announced intentions to make major investments aimed at supporting or expanding its Competitive products business. *Id.* FedEx claims that a "review of cost attribution procedures is long overdue." *Id.* at 3.

b. Postal Service Reply

The Postal Service contends that the issues raised by UPS are beyond the scope of the Commission's ACR review and that despite UPS assertions, the costing system is working as intended.[145] It asserts that the allegations regarding overall cost attribution are without merit and the costing methodologies applied by the Postal Service are approved by the Commission. *Id.* at 13. The Postal Service points out that it has made major efforts to improve cost attribution and cites to its efforts to improve city carrier cost attribution[146] and its recent success in decreasing institutional costs by more than $100 million.[147] Postal Service Reply Comments at 13-14.

The Postal Service counters UPS's assertion that costs for investments in new equipment are not properly distributed to Competitive products. *Id.* at 17. It cites the Delivery Scanning Systems and Passive Adaptive Scanning Systems as one example of how costs are being distributed to Competitive products, contrary to UPS's assertion. The Postal Service walks through the cost attribution of the resulting depreciation expenses to show how the majority of the attributable depreciation costs were distributed to Competitive products.

[144] Reply of Federal Express Corporation, February 18, 2015, at 2 (FedEx Reply Comments).

[145] Reply Comments of the United States Postal Service, February 18, 2015, at 1-2, 12-13 (Postal Service Reply Comments).

[146] Docket No. RM2015-7, Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Change in Analytical Principals (Proposal Thirteen), December 11, 2014.

[147] Docket No. RM2015-4, Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Eleven), November 4, 2014.

Id. at 16-17.[148] It concludes that UPS's concerns are not well-founded, stating that "the ACR docket is not the appropriate forum to attempt to resolve the concerns it has raised." *Id.* at 19.

c. Commission Analysis

The transparent and accurate costing of Competitive products is an issue of critical importance. The scope of the Commission's ACR review is limited to determining the Postal Service's compliance with rates and services in FY 2014. 39 U.S.C. § 3653(b). The issues raised by UPS relating to the costing methodology and attribution for Competitive products are more appropriately addressed in a separate proceeding. *See* UPS Comments at 15.

At this time, the issues raised in the comments do not warrant initiation of a proceeding to investigate the methodology the Postal Service uses to attribute total postal costs. The Commission agrees with the Postal Service that attributable costs related to investments in new equipment are properly distributed to Competitive products. *See* Postal Service Reply Comments at 16-19.

Although it is complicated to decipher the process of attributing equipment costs to products through the spreadsheets, the process of allocating the costs of equipment maintenance, labor, parts and supplies, and equipment depreciation has been in place since the first rate case before the Commission. *See* Docket No. R71-1, Opinion and Recommended Decision, June 5, 1972. The process and methodology by which the Postal Service attributes costs have been developed and revised through various Commission proceedings for more than 40 years. The Postal Service follows this process when equipment is purchased and develops an annual depreciation schedule. Total depreciation costs for a fiscal year are apportioned among the equipment types and a proportion factor is then developed for the CRA. A variability factor is applied to each of the different equipment categories to determine an applicable product distribution key. The same process is used to develop attributable costs for equipment maintenance, labor, and parts and supplies. Further, the Postal Service updates these spreadsheets annually to reflect any changes in the current equipment maintenance, labor, parts and supplies, depreciation costs, and new purchases as evidenced by the preface to Library Reference USPS–FY14–8.

The Commission examined and approved the current cost attribution methodology in Docket No. R2006-1 and subsequent rulemakings in which the Postal Service has proposed changes.[149] Although the Commission encourages parties to develop and propose new methodologies for attributing cost to products, such consideration is outside the scope of its ACR review.

2. Appropriate Share of Institutional Costs

UPS contends that without appropriate cost accounting practices "the Postal Service may be staking its future on investments that are economically irrational, with the

[148] The Postal Service also discusses the cost attribution for Mobile Delivery Devices and Sunday delivery. *Id.* at 17-19.

[149] *See, e.g.*, Docket No. RM2007-1 and Docket No. RM2010-4.

consequences of those decisions hidden for now but ultimately to be borne by the public." UPS Comments at 10. Although UPS recognizes that the appropriate valuation of the "appropriate share" percentage is beyond the scope of this proceeding, it asserts that the current 5.5 percent threshold set by the Commission is insufficient to counter the Postal Service's incentive to classify the majority of costs as institutional. *Id.* at 11, n.16. It encourages the Commission to require the Postal Service to evaluate whether fixed costs that vary with volume should be attributed, as opposed to being included in the institutional costs. *Id.* at 12.

The Public Representative comments that Competitive products met and exceeded the 5.5 percent appropriate share requirement of the Postal Service's total institutional costs. PR Comments at 52.

a. FedEx Reply

FedEx asserts that although the Public Representative found the appropriate share threshold was met and exceeded, there is no guarantee it will continue to be met given the rapid changes in the marketplace. FedEx Reply Comments at 2. FedEx agrees with UPS that the Commission should re-evaluate the appropriate share level for Competitive products. *Id*.

b. Postal Service Reply

The Postal Service asserts that the Commission approved the costing methodologies applied to classify costs as attributable or institutional. Postal Service Reply Comments at 13. Therefore, it is not the Postal Service alone that is deciding what costs to classify as institutional. *Id.* In addition, the Postal Service contends that the ACR docket is not the appropriate forum to attempt to resolve UPS' concerns. *Id.* at 19.

c. Commission Analysis

In FY 2014, Competitive products contributed $4.3 billion (12.9 percent) to institutional costs. As noted by the Public Representative, this was well above the 5.5 percent minimum requirement. *See* PR Comments at 53. The Commission finds that Competitive products satisfied 39 U.S.C. § 3633(a)(3).

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

UPS acknowledges that the issue is outside the scope of this proceeding. *See* UPS Comments at 15. The Commission is required by law to re-examine the appropriate share requirement again no later than 2017. 39 U.S.C. § 3633(b).

CHAPTER 5: SERVICE PERFORMANCE

A. Service Performance Results by Class

1. Introduction

Section 3652 (a)(2)(B)(i) of Title 39 of the U.S.C. requires the Postal Service to report on each Market Dominant product's "level of service (described in terms of speed of delivery and reliability)." Speed of delivery is evaluated based on the mail piece reaching its destination within a given service standard; reliability refers to consistency of delivery. The Commission compares the information in the Postal Service's ACR against targets established by the Postal Service to evaluate annual service performance for each Market Dominant product.[150]

On July 1, 2012, the Postal Service changed its business rules related to its service standards.[151] For example, for First-Class Mail, the change in service standards decreased the volume of overnight mail and increased the volume of 2-Day and 3-5-Day mail.[152]

The products listed in Table V-1 met or exceeded their annual service performance target for FY 2014. Those shown in Table V-2 fell below their target for FY 2014.

Table V-1
Products that Met Annual Service Performance Targets, FY 2014

Class	Product
First-Class Mail	Presorted Letters/Postcards (Overnight and 2-Day)
Standard Mail	High Density and Saturation Letters
Package Services	• Bound Printed Matter Parcels • Media Mail/Library Mail
Special Services	• Ancillary Services • International Ancillary Services • Money Orders • Post Office Box Service • Stamp Fulfillment Service

[150] On an annual basis, the Commission compares a product's on-time delivery with delivery targets established by the Postal Service. For Special Services, the Commission evaluates performance data from metrics developed by the Postal Service applicable to each product.

[151] Revised Service Standards for Market-Dominant Mail Products; Designation of Implementation Date, 79 Fed. Reg. 44,700-44,701 (August 1, 2014).

[152] *See* FY 2013 ACD at 99-100.

Table V-2
Products that Failed to Meet Annual Service Performance Targets, FY 2014

Class	Product
First-Class Mail	• Single-Piece Letters/Postcards (Overnight; 2-Day; 3-5-Day) • Presort Letters/Postcards (3-5-Day) • Inbound Letter Post • Outbound Single-Piece First-Class Mail International Letters
Standard Mail	• High Density and Saturation Flats/Parcels • Carrier Route • Letters • Flats
Periodicals	• In-County • Outside-County
Package Services	• Bound Printed Matter Flats • Inbound International Surface Parcel Post (at UPU rates)
Special Services	• Address List Services

According to the Postal Service, severe winter storms during the first and second quarters of FY 2014 had a significant impact on performance results for many service standards and products.[153] The Postal Service's claim that severe weather had an adverse effect on service performance results is, on its face, reasonable. However, it is unclear if weather alone was responsible for the continuing failure of some products, such as BPM Flats and many Standard Mail products, to meet intended annual targets.

Within Standard Mail, High Density and Saturation Letters exceeded service performance targets for the second consecutive year. Within Package Services, BPM Parcels and Media Mail/Library Mail exceeded targets for the third consecutive year.

2. Participant Comments and Concerns on Service Performance

In FY 2014, four participants offered comments on service standards or service performance results for Market Dominant products: NPPC, NTU, APWU, and the Public Representative.

NPPC suggests that the Commission "should consider adjusting the price cap [with respect to First-Class Mail] to offset the costs of service reductions as well as costs that the Postal Service has shifted onto customers."[154] NPPC argues that the Postal Service reduced service

[153] *See* Library Reference USPS–FY14–29 at 8. *See also* Responses of the United States Postal Service to Questions 7, 9, 11, and 14 of Chairman's Information Request No. 2, January 29, 2015, questions 11. a. and 14. a. (January 29, 2015, Response to CHIR No. 2).

[154] Docket No. ACR2014, Comments of the National Postal Policy Council, February 2, 2015, at 11 (NPPC Comments).

as a consequence of the Network Rationalization plan and that, "the reduction in service standards has forced Presort mailers with a business-driven need to achieve overnight delivery to incur substantial costs in reconfiguring their mailing operations to achieve earlier entry times demanded by the Network Rationalization process." *Id.* at 11-12. NPPC concludes that mailers incur higher preparation costs from reconfiguring their mailing operations. *Id*. NPPC also argues that the Postal Service has increased costs to mailers by changing entry regulations or amending mailing software. *Id*. It claims that this type of cost shifting takes the form of "mandates" that mailers must meet to maintain eligibility for workshare rates. *Id*. For example, NPPC highlights the conversion to Full-Service Intelligent Mail barcode (IMb) to illustrate mandated changes that result in additional costs to mailers. *Id.* at 13. NPPC concludes that the Commission should consider whether the cumulative effects of the Postal Service's operational adjustments provide reason to reduce the price cap applicable to affected products. *Id.* at 14.

NTU states that the Postal Service is "witnessing an unfavorable trend as delivery times are expected to become slower—increasing from 1.8 days to 2.1 days on average."[155] NTU also mentions that customer satisfaction is declining. *Id*.

APWU expresses general concern over what it views as the disproportionate effect of service reductions on rural communities.[156] It asserts that the Commission "should require the Postal Service to document the extent to which rural customers have been disproportionately affected by changing mail process and service patterns." *Id*. It calculates that of the facilities affected by Phase I of the Network Rationalization plan consolidations, 61.1 percent are in smaller, more rural "urban clusters." *Id.* at 6. Specifically, APWU suggests that the Commission order an independent study to determine whether the benefits found in a 2011 study of rural mail services[157] have survived changes in service related to mail-processing consolidation. *Id.* at 3. It also states that the Commission has a responsibility to determine whether the Postal Service serves urban businesses more faithfully than rural America. *Id.* at 7.

The Public Representative reports that the Postal Service showed no progress in service performance results for products the Commission requested or directed it to improve.[158] In general, the Public Representative concludes that there was a consistent failure in FY 2014 to meet product delivery category service performance targets, especially in the first and second quarters. *Id*.

For First-Class Mail, the Public Representative highlights that Presorted Letters/Postcard Overnight and 2-Day service standards were the only domestic delivery categories to meet the FY 2014 service performance targets. *Id*. at 6. She agrees with the Postal Service's

[155] Docket No. ACR2014, Comments of Pete Sepp, President National Taxpayers Union, February 2, 2015, at 2 (NTU Comments).

[156] Docket No. ACR2014, Initial Comments of American Postal Workers Union, AFL-CIO, February 2, 2015, at 1 (APWU Comments).

[157] Consulting Group, Inc., *Report on Measuring the Benefits of Rural Postal Service*, August 2011; *http://www.prc.gov/sites/default/files/archived/Rural_Service_Report.pdf.*

[158] Public Representative Comments, February 2, 2015, at 3 (PR Comments).

explanation that several storms adversely affected First-Class Mail with service standards longer than 2 days, indicating that Quarters 1 and 2 sustained much lower service performance results for First-Class Mail Flats and Parcels. *Id.* at 8. However, she points to only slight improvements in Quarters 3 and 4 for First-Class Mail Flats. *Id*. The Public Representative finds that for all First-Class Mail products, the Postal Service does not set forth any new management plans intended to increase on-time delivery performance. *Id.* at 12. Finally, the Public Representative assesses that the discrepancy between targets and actual performance suggest that the targets are misleading to mailers. *Id*. As a result, she concludes that the targets should be reduced if there is not significant improvement to Postal Service operating systems for which performance regularly falls 10 to 15 percent below target. *Id.* at 13.

For Standard Mail, the Public Representative noted general annual service performance improvement, but highlights the Postal Service's continued inability to meet or exceed targets. *Id.* at 14. As with First-Class Mail, she criticizes the Postal Service's actions to increase service performance. *Id*. Specifically, she asserts that diagnostic tools and timely start-the-clock scans, which the Postal Service considers to be a strategy that will increase service performance results, have not been successful. *Id*.

The Public Representative also discusses the Commission's directive to enhance Full-Service mailer participation in Package Services. *Id.* at 16. She states that the Postal Service fails to meet this directive; therefore, she encourages the Commission to ask what steps have been taken pursuant to its FY 2013 ACD directive to improve service performance of Package Services, particularly BPM Flats. *Id*. Finally, the Public Representative theorizes that the "dichotomy of [the iMAPS (Intelligent Mail Accuracy and Performance System) and PTS (Product Tracking System)] measurement systems [which measure Bound Printed Matter Flats and Media Mail/Library Mail] may account for part of the large discrepancy in service performance results between these [two] products." *Id.* at 18.

The Commission generally agrees with the Public Representative's comments regarding First-Class Mail, Standard Mail, and Periodicals. For example, the Commission notes that some mail products are not making sufficient strides toward reaching annual service performance targets. The Commission views a lack of Full-Service IMb participation and relatively low service performance results as the primary causes of the large discrepancy in service performance between BPM Flats and Media Mail/Library Mail.

3. Measurement Systems

The Postal Service uses a variety of measurement systems to measure service performance for Market Dominant products. Table V-3 identifies each system used to measure those products reported in the Postal Service's *Annual Service Performance Report*. In Table V-3 and the discussion that follows, *EXFC* stands for "External First-Class Measurement," *iMAPS* stands for "Intelligent Mail Accuracy and Performance System," *IMMS* stands for "International Mail Measurement System," *PTS* stands for "Product Tracking System," and *SASP* stands for "Seamless Acceptance and Service Performance."

Table V-3
Service Performance Measurement Systems

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

Source: Docket No. PI2008-1, Service Performance Measurement, November 2007, at 6.

a. External First-Class Measurement System (EXFC)

EXFC is a sampling system managed by an independent contractor. Delivery performance is measured from the street collection box to the delivery mailbox. FY 2009 ACD at 49. When evaluating delivery performance, test mailers record the time they place First-Class Mail in the collection box. The pieces are deposited before the last collection time for the collection box. Those test mail pieces are sent to a nationwide panel of receivers who record when each was delivered to their mailbox. Actual transit time is then compared against First-Class Mail service standards. EXFC provides quarterly service performance measurement scores at the area and district levels.

b. Intelligent Mail Accuracy and Performance Systems (IMAPS)

iMAPS provides an end-to-end service performance measurement by using documented mail arrival time at a designated postal facility to start a measurement clock and an IMb scan by an external, third-party reporter to stop the clock. The measurement involves two distinct steps. The Postal Service obtains processing times based on IMb scans reported through the SASP system. Throughout FY 2014, SASP captured data from all Full-Service Intelligent Mail.[159] This is combined with a “last mile” factor that is developed through scans by third-party reporters upon receipt of the mail. Service performance is measured by comparing the overall transit time to the service standards to determine the percentage of mail delivered on time.

c. Product Tracking System (PTS)

For use with Parcels, PTS is an internal measurement system that measures transit time from the time of mailing until the time of delivery. Measurements are based on Delivery Confirmation scans. Actual transit time is compared against service standards for the Market Dominant Parcel products.

[159] Library Reference USPS–FY14–29 at 2.

d. Seamless Acceptance and Service Performance (SASP)

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

e. International Mail Measurement System (IMMS)

Based on a system similar to EXFC, IMMS measures the domestic leg of transit time for international mail. It measures the time between the domestic collection point and the outbound international service center for outbound letters, and between the inbound international service center and the domestic delivery point for inbound letters.

f. Intelligent Mail Barcode (IMb)

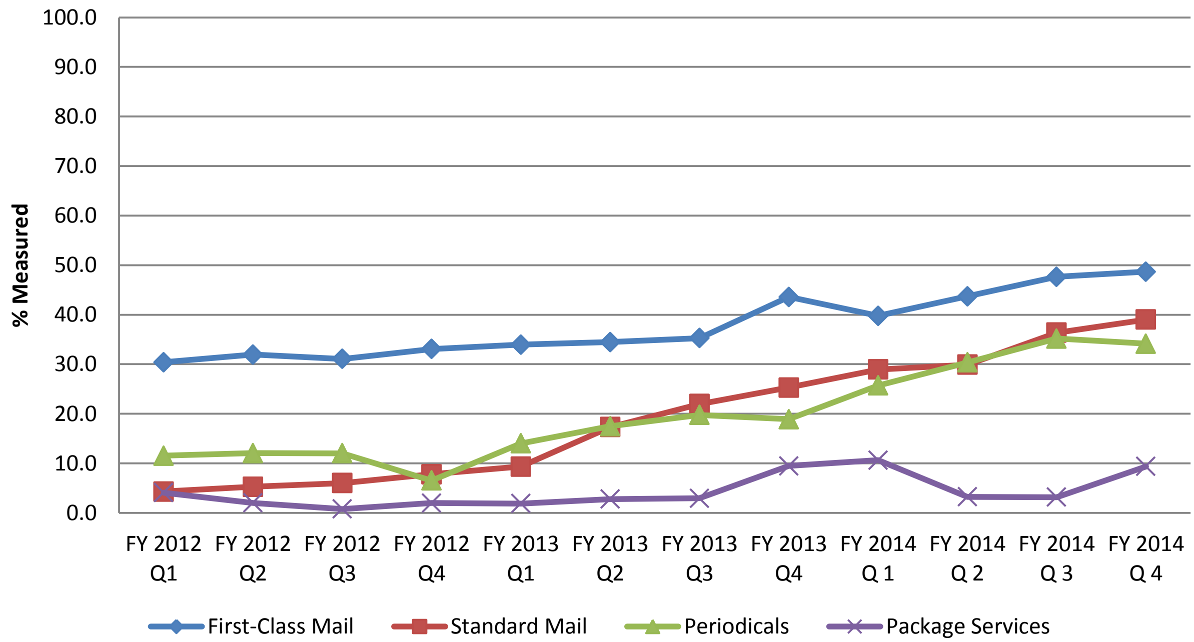
In Quarter 3 of FY 2011, the Postal Service began using IMb to measure Standard Mail, Periodicals, BPM Flats, and some First-Class Mail products. Mailers had since been encouraged to participate in the Full-Service option of IMb, in part because it provides data necessary to measure service performance.[160] FY 2011 ACD at 63. The Full-Service feature allows the mailer to identify unique mail pieces throughout the mailstream and receive start-the-clock notifications, discounts, and automated address corrections. *Id.*

In FY 2013, the Postal Service acknowledged that measurable volumes for First-Class Mail Flats, BPM Flats, Standard Mail products, and DDU Entry Periodicals have been low since the onset of IMb measurement. FY 2013 ACD at 103.

Since FY 2011, the number and proportion of mail pieces measured by IMb has generally increased. Figure V-1 illustrates this trend, showing that the percent of presort First-Class Mail, Standard Mail, Periodicals, and BPM Flats volume measured by IMb has generally increased each quarter since 2011. However, as seen in Figure V-1, the majority of mail volume is not in measurement. The Package Services volume measured by IMb decreased slightly in FY 2014.

[160] Mailers are required to prepare mail with IMbs and submit electronic mailing information listing IMbs used. Mail is verified to ensure it meets mail preparation criteria. Mail that does not meet mail prep standards is excluded from service performance measurement. *See* Docket No. PI2008-1, Order No. 140, Order Concerning Proposals for Internal Service Standards Measurement Systems, November 25, 2008, at 11.

Figure V-1
Percentage of Mail Measured by Full-Service IMb



In FY 2014, the volume of mail measured by IMb and categorized as Mixed Product Letters and Flats continued to decline.[161] The Postal Service states that only "1.4 percent of measureable Standard letters and 0.1 percent of Full-Service Intelligent Mail flats fell into a Mixed Product category."[162] The Postal Service attributes this decline to the discontinued use of the range-record format.[163] Previously, the range-record format did not require mailers to specify the rate categories and piece counts for their mailings. The Postal Service explains that when this information is missing for Standard Mail products, the associated pieces are mapped to the generic Mixed Letter or Mixed Flats product group. *Id.* Currently, the piece-detail record format that the Postal Service uses requires rate category information, thereby eliminating the automatic mapping of pieces with missing information to a Mixed Product category. *Id*. Figures V-2 and V-3 show the decline in volume of Mixed Flats and Mixed Letters since 2012.

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[161] The Postal Service included in its measurement Standard Mail pieces for which mailers did not supply enough information to identify the product. It categorized this mail as either Standard Mail Mixed Product Letters or Standard Mail Mixed Product Flats. *See* FY 2012 ACD at 54. *See also* Library Reference USPS–FY14–29 at 12.

[162] Library Reference USPS–FY14–29 at 12.

[163] Responses of the United States Postal Service to Questions 1-6, 8, 10, 12-13 and 15-22 of Chairman's Information Request No. 2, January 23, 2015, question 13 (January 23, 2015, Response to CHIR No. 2).

Figure V-2
Mixed Flat Volume

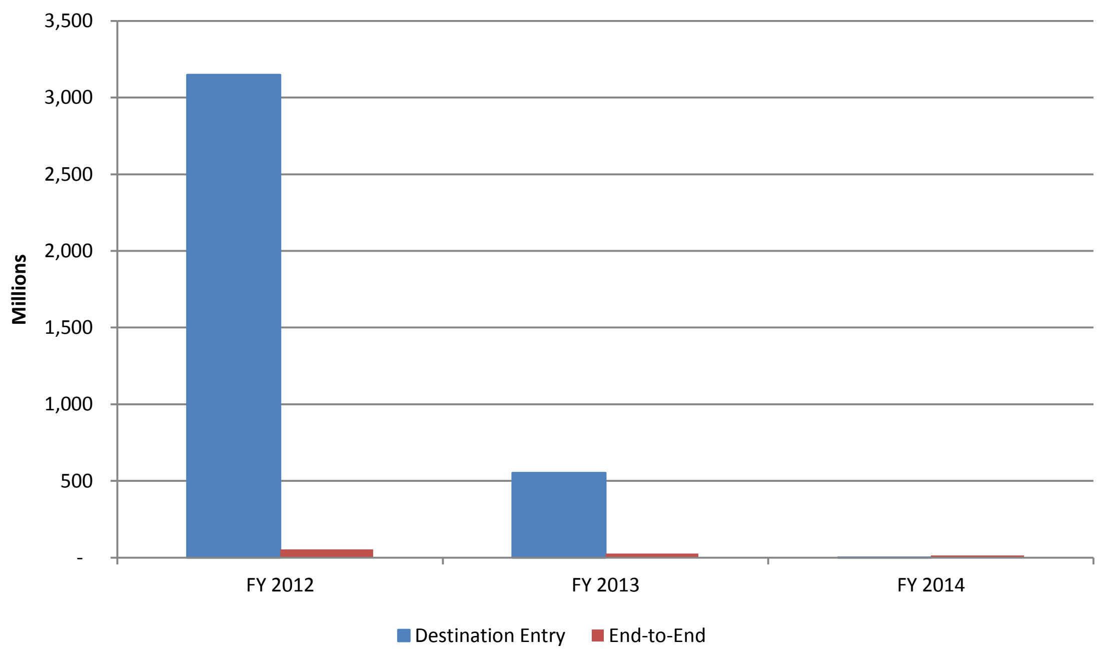
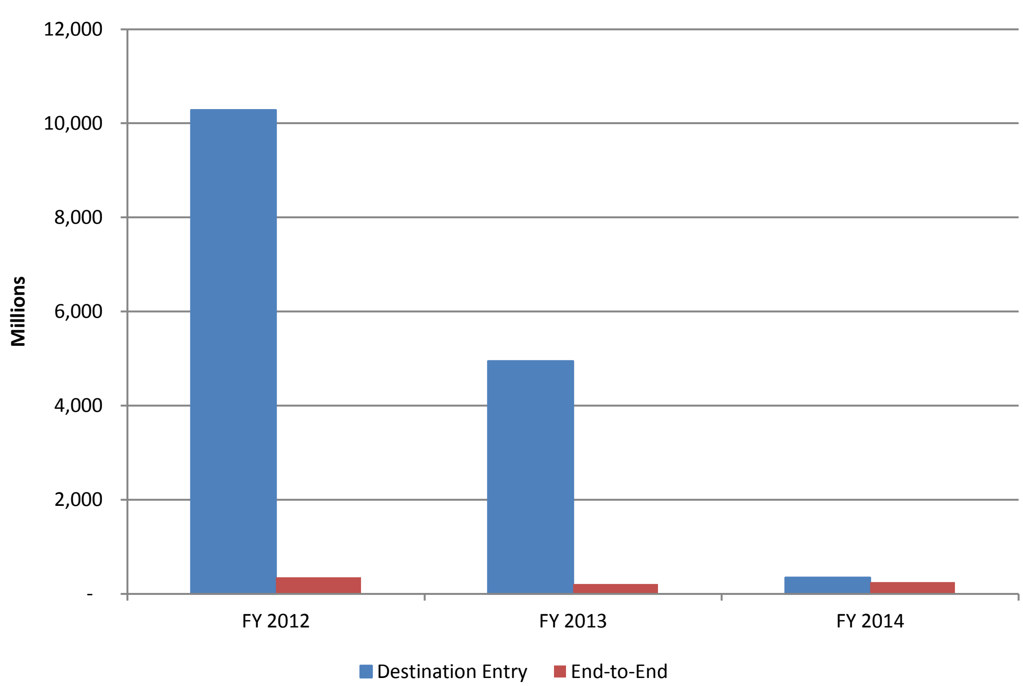


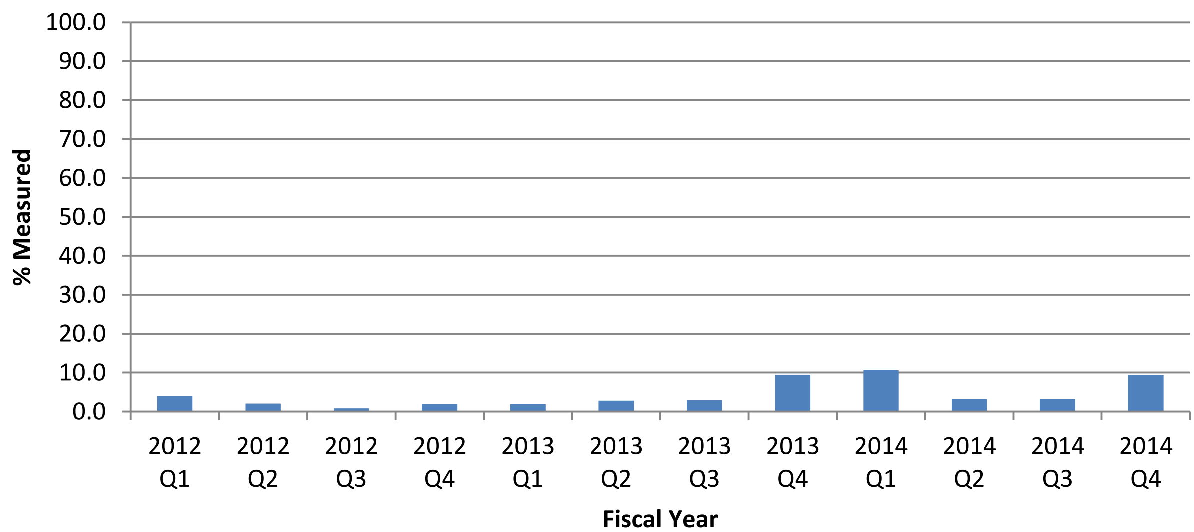
Figure V-3
Mixed Letter Volume



The decrease in volume for Mixed Product categories compared with the increase in volume of other measured Standard Mail pieces suggests that more specific Standard Mail products are measured for service performance.

As previously noted, measurement of BPM Flats have been low since the onset of IMb measurement. This trend has continued in FY 2014. Figure V-4 shows that the proportion of measureable BPM Flats has never reached 15 percent.

Figure V-4
Measured BPM Flats



The Postal Service states that the number of mailers using Full-Service IMb is the main reason the volume of measureable BPM Flats fluctuates. February 18, 2015, Response to CHIR No. 6, question 4. It also acknowledges that one reason for the volume variability and low levels of measureable volume is that one mailer accounts for 70 percent of BPM mail pieces. *Id.* The Postal Service explains that a single mailer can easily influence the total number of mail pieces in measurement, and that volumes will vary widely as a result of having one large BPM Flats mailer. *Id.*

4. Service Performance Results by Class

a. First-Class Mail

Service performance for most First-Class Mail products and corresponding service categories, especially the 3-5-Day service standard, failed to meet or exceed annual targets. The Postal Service states that these results are primarily due to adverse effects of large winter storms occurring in the first and second quarters of FY 2014. As Table V-4 shows, service performance results for First-Class Mail Flats, Parcels, Outbound Single-Piece First-Class Mail International, and Inbound Letter Post again failed to reach their on-time delivery performance targets.

Table V-4
Service Performance Results for First-Class Mail[a]

Product	FY 2014		FY 2013		FY 2012		FY 2011	
	Target	% On-Time	Target	% On-Time	Target	% On-Time	Target	% On-Time
Single-Piece Letters/Postcards								
Overnight	96.80	96.7	96.70	96.8	96.65	97.0	96.65	96.7
2-Day	96.50	95.7	95.10	96.0	94.15	95.6	94.15	94.2
3-5-Day	95.25	88.6	95.00	92.5	92.85	93.2	92.95	91.9
Presorted Letters/Postcards								
Overnight	96.80	97.2	96.70	97.3	96.65	96.9	96.65	90.8
2-Day	96.50	96.6	95.10	97.2	94.15	95.9	94.15	89.2
3-5-Day	95.25	92.5	95.00	95.4	92.85	95.4	92.85	90.7
Flats								
Overnight	96.80	84.9	96.70	86.6	96.65	89.8	96.65	90.3
2-Day	96.50	82.5	95.10	84.4	94.15	85.0	94.15	84.0
3-5-Day	95.25	72.6	95.00	77.6	92.85	80.0	92.85	80.0
Parcels								
Overnight	96.80	88.4	96.70	89.8	96.65	89.8	96.65	90.3
2-Day	96.50	86.8	95.10	89.1	94.15	85.8	94.15	83.2
3-5-Day	95.25	83.8	95.00	88.8	92.85	88.4	92.85	86.6
Outbound Single-Piece First-Class Mail International								
Overnight		93.0	-	94.3		95.0		96.1
2-Day		93.2	-	92.7		92.9		92.5
3-5-Day		85.7	-	87.5		90.7		91.1
Combined	94.00	87.8	94.00	88.9	94.00	91.5	94.00	91.9
Inbound Letter Post								
Overnight		91.8	-	92.3		94.1		93.4
2-Day		89.4	-	90.7		91.5		88.6
3-5-Day		82.9	-	86.5		89.2		87.6
Combined	94.00	85.2	94.00	88.0	94.00	90.5	94.00	91.9

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

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

(1) Single-Piece Letters/Postcards

The Postal Service did not meet its service performance targets in FY 2014. This is one of the few times since passage of the PAEA that Single-Piece Letters/Postcards service performance did not meet its targets. Service performance for the Overnight service standard decreased only 0.1 percent since FY 2013, yet did not meet this year's increased on-time service performance target of 96.8 percent. Service performance results for the 2-Day service standard also decreased slightly (0.3 percent) compared with FY 2013. Service performance scores for the 3-5-Day service standard fell below 90 percent on-time delivery for the first time since FY 2011.

The Postal Service explains that mail with a 3-5-Day service standard utilizes the air transportation network, which is most susceptible to severe weather.[164] As a result of the severe storms in Quarters 1 and 2, the Postal Service diverted First-Class Mail with service standards longer than 2 days to available surface transportation. *Id.* In FY 2014, the Postal Service claims that surface transportation was significantly affected by severe weather. *Id.* Tables V-5 and V-6 show these winter storms, their dates, and the affected regions and corresponding Postal Service areas.

Table V-5
Quarter 1 Storms

Storm	Begin	End	States/Regions Affected	Service Area Affected
Atlas	10/3/2013	10/5/2013	Northern Rockies, Northern High Plains	Western
Boreas	11/22/2013	11/27/2013	California, Maine, Southern Appalachians, New England, New York	Northeast, Pacific, Western
Cleon	12/1/2013	12/7/2013	Mountain West, Upper Midwest, Texas, Oklahoma, Northeast, Mississippi Valley	Southern , Western
Dion	12/5/2013	12/11/2013	Oregon, Mountain West, Midwest, Mid-Atlantic, Northeast	Capital Metro, Northeast, Western
Electra	12/11/2013	12/14/2013	New York, New England	Northeast
Falco	12/16/2013	12/18/2013	Northeast	Northeast
Gemini	12/19/2013	12/23/2013	Michigan, New York, Northeast	Great Lakes, Northeast
Hercules	12/31/2013	1/3/2014	Midwest, New England	Great Lakes, Northeast

[164] Library Reference USPS–FY14–29 at 8.

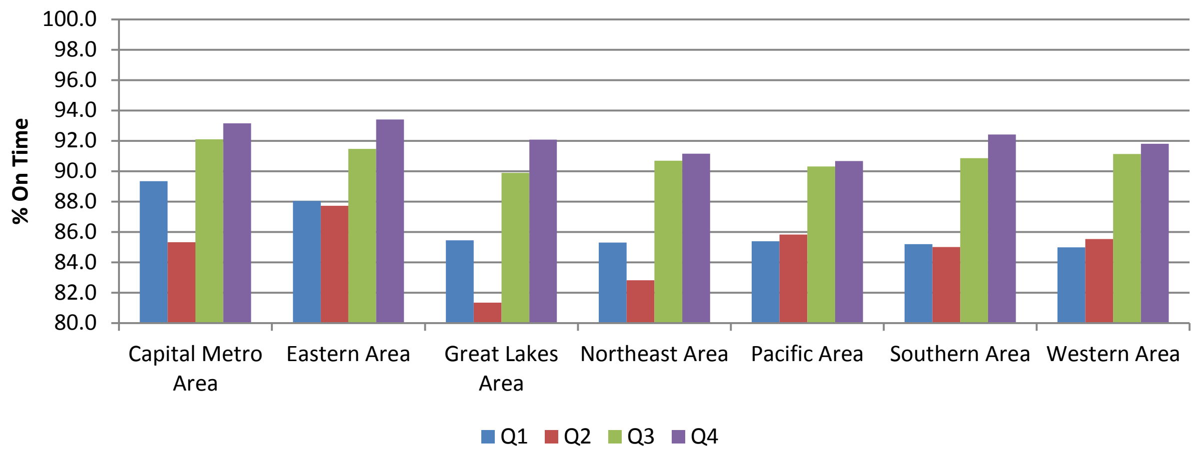
Table V-6
Quarter 2 Storms

Storm	Begin	End	States/Regions Affected	Service Area Affected
Ion	1/3/2014	1/6/2014	Midwest, Michigan, Indiana, Chicago	Great Lakes
Janus	1/20/2014	1/22/2014	Ohio Valley, Appalachians, New York, Mid-Atlantic	Eastern, Northeast, Capital Metro
Kronos	1/23/2014	1/24/2014	Texas, Louisiana, Mississippi	Southern
Leon	1/27/2014	1/29/2014	South, Mid-Atlantic, Atlanta, Birmingham	Southern
Maximus	1/29/2014	2/3/2014	California, Idaho, Wyoming, Montana, Utah, Colorado, Great Lakes, Texas, Oklahoma, Ohio Valley, Appalachians	Eastern, Southern, Western
Nika	1/31/2014	2/5/2014	Arkansas, Pennsylvania, New Jersey, Maryland	Eastern, Capital Metro, Southern
Orion	2/6/2014	2/10/2014	Pacific Northwest, Oregon, Idaho Louisiana, Oklahoma, Texas, Kentucky	Pacific, Southern
Pax	2/9/2014	2/14/2014	Southern, Mid-Atlantic, Northeast, Georgia, South Carolina	Capital Metro, Northeast, Southern
Quintus	2/14/2014	2/16/2014	Northeast	Northeast
Rex	2/16/2014	2/19/2014	Maine, New Hampshire, Massachusetts, Rhode island, Connecticut, Vermont, New York Pennsylvania, New Jersey, Delaware, Ohio, Mid-Atlantic, Michigan, Indiana, Illinois, Wisconsin, Minnesota, Iowa, Missouri, Nebraska, S. Dakota, N. Dakota	Northeast Great Lakes, Eastern, Capital Metro
Seneca	2/19/2014	2/21/2014	Nebraska, Iowa, Minnesota, Wisconsin, Michigan	Great Lakes Western
Titan	2/27/2014	3/3/2014	West, Rockies, Mid-Atlantic, Arkansas, Delaware, Illinois, Indiana, Kentucky, Missouri, Ohio Oklahoma, Tennessee, Texas, Virginia, West Virginia, Texas	Western, Southern
Ulysses	3/5/2014	3/6/2014	North Carolina	Capital Metro
Vulcan	3/9/2014	3/13/2014	Midwest, Great Lakes, Northeast	Great Lakes, Northeast
Wiley	3/16/2014	3/18/2014	Missouri, Mid-Atlantic	Capital Metro
Xenia	3/30/2014	4/1/2014	North Dakota, Wyoming	Western

Source: *http://www.weather.com/storms/winter/news/winter-storms-2013-2014-recap-20140418?pageno=2#/26.* These are not official names assigned by the National Weather Service. They are popular names given by the Weather Channel, a cable and satellite channel company.

For the 3-5-Day service standard, there was a noticeable difference between service performance in Quarters 1 and 2 and in Quarters 3 and 4. Figure V-5 compares service performance results across areas and quarters. The lower service performance results occurred when there was severe weather. For example, the Capital Metro and Eastern areas were not inordinately affected in Quarter 1, which correlates to relatively higher service performance during that time. The Great Lakes and Northeast areas experienced nine storms in Quarter 2, which correlates to very low performance scores.

Figure V-5
Single-Piece Letters/Postcards 3-5-Day

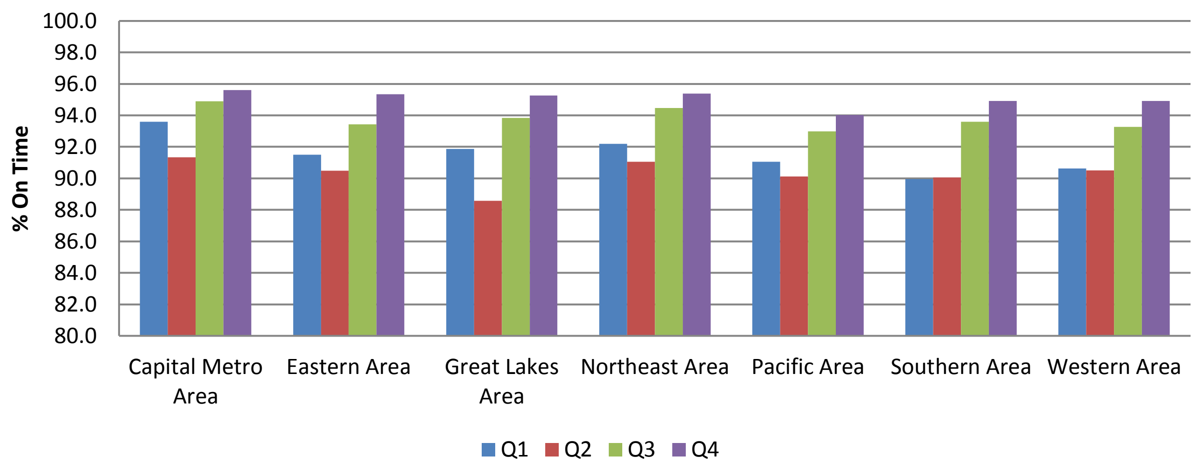


(2) Presorted Letters/Postcards

Service performance results for Presorted Letters/Postcards exceeded annual service performance targets for its Overnight and 2-Day service standard categories in FY 2014. In FY 2013, Network Rationalization caused a noticeable shift in volume between the Overnight, 2-Day, and 3-5-Day service standard categories. FY 2013 ACD at 105. As a result, significantly more of the measurable volume fell within the 3-5-Day category. *Id.*

The Postal Service notes that winter weather also had an adverse effect on Presorted Letters/Postcards 3-5-Day service performance results. According to Figure V-6, service performance for the Great Lakes area suffered in Quarter 2, similar to the lower service performance results for Single-Piece Letters/Postcards.

Figure V-6
Presort Letters/Postcards 3-5-Day



(3) Flats

Service performance for First-Class Mail Flats continues to miss its annual on-time delivery performance targets. It has not met annual targets for 4 consecutive years. First-Class Mail Flats include Single-Piece and Presorted Flats. The Postal Service measures Single-Piece Flats through the EXFC system; the service performance results for Single-Piece Flats is used as a proxy for Presorted Flats.[165] The proxy is used because there is insufficient Full-Service IMb data available to make reliable service performance estimates.[166]

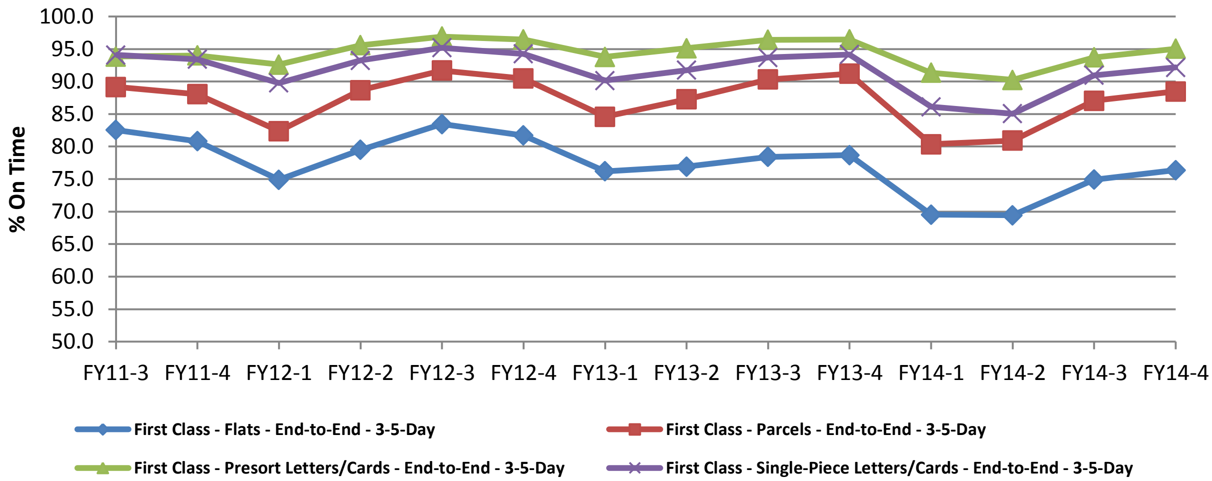
Service performance for Flats has routinely missed its annual target. The Postal Service attributes FY 2013 and FY 2014 service performance results to extreme weather.[167] As seen in Figure V-7, service performance results for End-to-End Flats with a 3-5-Day service standard have been lower than results for other domestic First-Class Mail products for more than 10 consecutive quarters.

[165] FY 2013 ACD at 106. Library Reference USPS–FY14–29 at 2. *See also* Docket No. PI2008-1, Second Notice of Request for Comments on Service Performance Measurement Systems for Market Dominant Products, June 18, 2008.

[166] FY 2013 ACD at 106. Library Reference USPS–FY14–29 at 2. The Postal Service states that 68 percent of First-Class Mail Flats were mailed at Single-Piece rates.

[167] January 29, 2015, Response to CHIR No. 2, question 11. *See also* FY 2013 ACD at 106.

Figure V-7
First-Class Mail Product Comparison

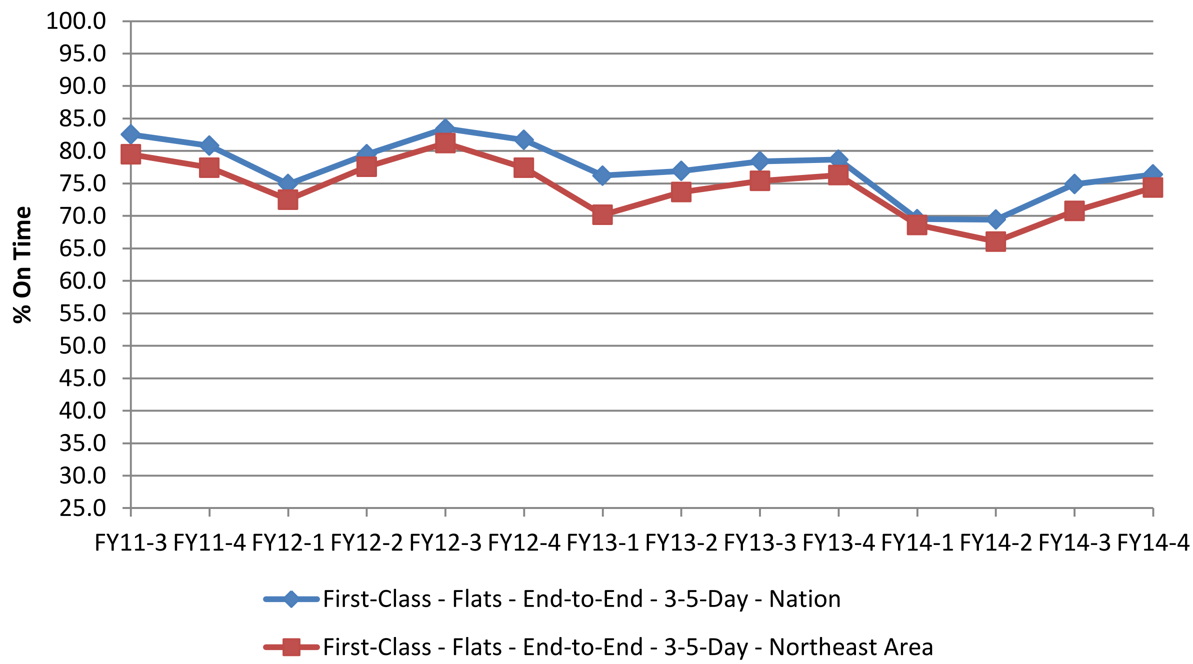


In FY 2013 and FY 2014, the Commission found that the service performance results for the Northeast area were consistently lower, especially for the 3-5-Day service standard. These low scores are one of the reasons the national scores are below target. FY 2013 ACD at 106. Service performance scores for the seven districts shown in Table V-7 ranked among the 20 districts with the lowest service performance since FY 2012. Four of these districts are in the Northeast area, which consistently has low service performance results. Figure V-8 shows the reported scores for the Northeast area and the national average.

Table V-7
Districts with Low Service Performance, FY 2012–FY 2014

District	FY 2012	FY 2013	FY 2014
Caribbean	68.33	66.66	66.37
Westchester	71.72	69.13	64.42
South Florida	72.60	66.20	58.14
Long Island	73.04	72.21	69.68
Greater Boston	75.89	72.16	70.46
Connecticut Valley	77.25	72.14	65.53
Triboro	78.50	75.55	70.41

Figure V-8
First-Class Mail Flats Regional Comparison



In response to such poor service performance results, the Postal Service maintains that its use of root cause diagnostic tools and other improvement projects will allow operating managers to improve processing and transportation flows, which will improve service performance. January 29, 2015, Response to CHIR No. 2, question 11. Overall, it appears this strategy has not been effective for Flats.

(4) Parcels

Service performance for Parcels did not meet the annual service performance targets in FY 2014 or FY 2013. In FY 2014, large districts such as Chicago reported very low service performance results each quarter. For each service standard, the Chicago district had among the lowest performance of any district, and has consistently had low performance results since the fourth quarter of FY 2012. The Postal Service explains that mail prioritization was one factor that caused low service performance scores in the Chicago District.[168] Processing and transportation delays caused the Postal Service to prioritize other mail classes and products over Chicago District Parcels in order to meet service standards for that mail. *Id.* Mail flow reconfiguration, transitional effects due to staffing shifts, operational window changes, and equipment relocations were other factors that caused reduced service performance scores. *Id.* The Postal Service, in response, has changed transportation operations to allow earlier arrival profiles, and increased staffing at the network distribution center (NDC). *Id.*

[168] March 4, 2015, Response to CHIR No. 6, question 3.

Figure V-9 compares national service standards for Parcels, and Figure V-10 illustrates the Chicago district's service performance versus the Great Lakes area and national results.

Figure V-9
Parcels – Nationwide Service Standard Comparison

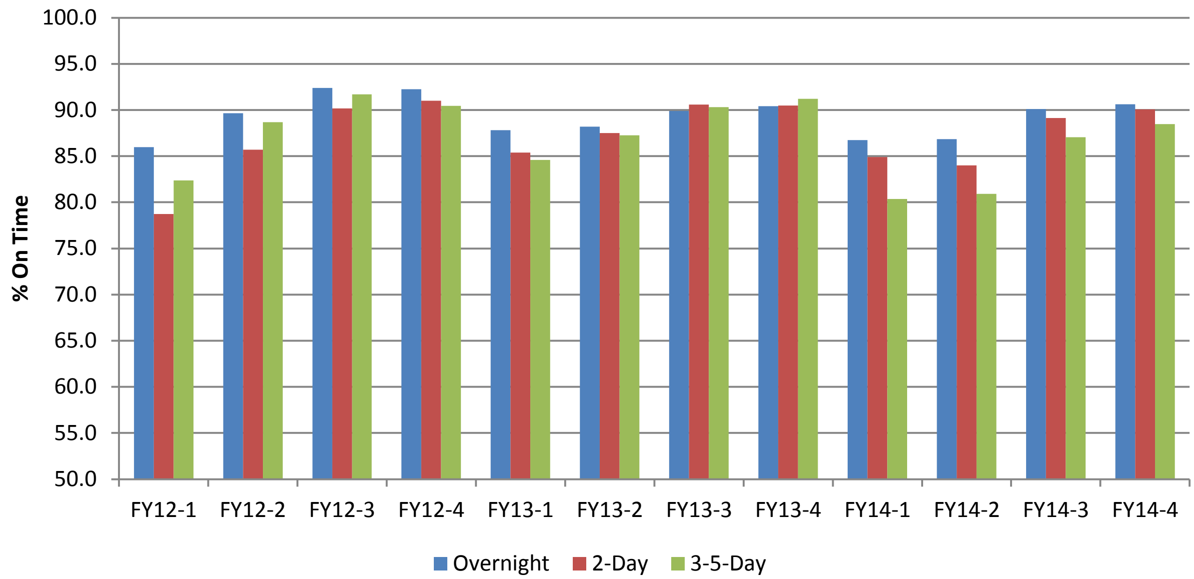
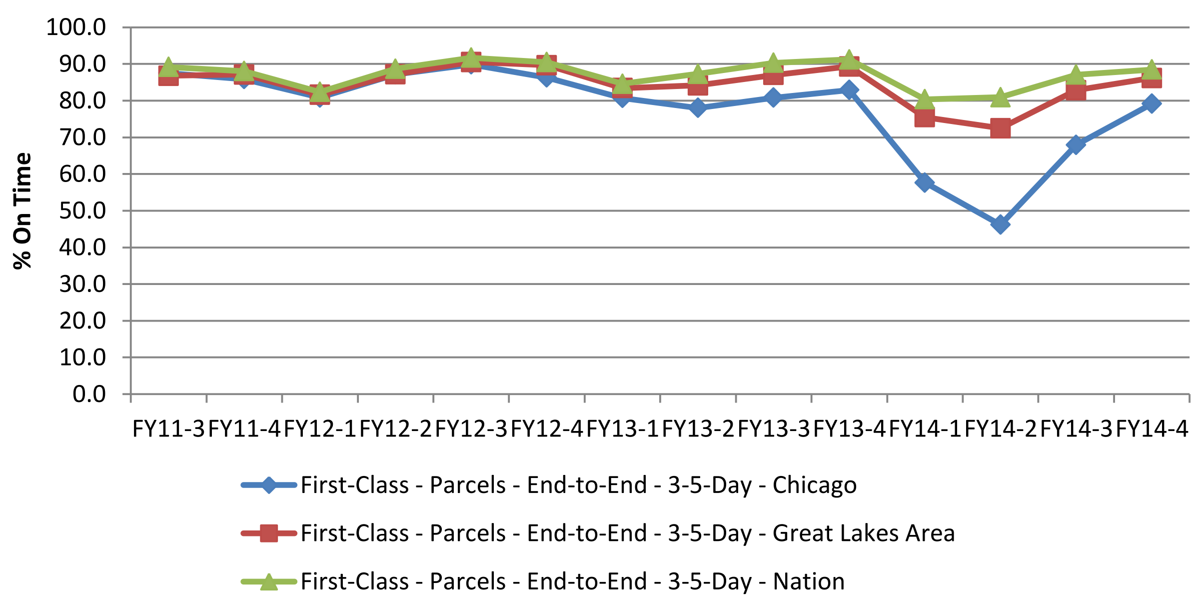


Figure V-10
Parcels – Chicago Service Standard Comparison



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

In FY 2014, service performance for Inbound Letter Post and Outbound Single-Piece First-Class Mail International did not meet its annual target of 94 percent on-time delivery. This is the second year in a row that service performance has been below target. Table V-8 shows that at an aggregate level, service performance results for most inbound and outbound mail has slightly decreased since FY 2013. The Commission notes that a separate system for measuring the service performance of Inbound Letter Post is used by the UPU. For a more complete discussion of the measurement results based upon the other measurement system, *see* Chapter 3, Market Dominant Products: Other Rate and Fee Compliance Issues, Inbound Letter Post, Quality of Service Link to Terminal Dues.

Table V-8
Inbound and Outbound First-Class Mail Service Performance, FY 2013 and FY 2014

On-time Service Performance (%)	FY 2013	FY 2014	Target
Inbound			
Overnight	92.3	91.8	--
2-Day	90.7	89.4	--
3-5-Day	86.5	82.9	--
Combined	**88.0**	**85.2**	***94.0***
Outbound			
Overnight	94.3	93.0	--
2-Day	92.7	93.2	--
3-5-Day	87.5	85.7	--
Combined	**88.9**	**87.8**	***94.0***

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

The Commission finds that, except for Presorted Letters/Postcards overnight and 2-Day, the Postal Service did not meet its service performance targets for First-Class Mail in FY 2014. The Postal Service's claims that severe weather had an adverse impact on 3-5-Day service performance results for Single-Piece Letters/Postcards and Presort Letters/Postcards are, on its face, reasonable. However, weather cannot consistently be employed as a catchall excuse for failing to meet performance standards. The Commission expects service performance to improve in FY 2015.

This is the fourth consecutive year that First-Class Mail Flats did not meet service performance targets. In addition, service performance has not improved since FY 2011. The Commission directs the Postal Service to improve service for First-Class Mail Flats in FY 2015 or to provide an explanation in the FY 2015 ACR for why efforts to improve service performance results for First-Class Mail Flats have been ineffective and detail what changes it plans to make to improve service performance.

b. Standard Mail

Table V-9 shows that service performance results for High Density and Saturation Letters exceeded the on-time delivery targets set by the Postal Service for the second consecutive year. According to the Postal Service, in FY 2014 there was not enough data to report service performance results for Parcels. *See* Library Reference USPS–FY14–29 at 11. Service performance results for Carrier Route did not meet on-time delivery targets, but the product continues to improve its performance. High Density and Saturation Flats/Parcels results were near this year's target of 91 percent on-time delivery. Annual results for Flats remain below 80 percent on-time delivery.

Table V-9
Service Performance Results for Standard Mail, FY 2011–FY 2014

Product	FY 2014		FY 2013		FY 2012		FY 2011	
	% On-Time	Target	% On-Time	Target	% On-Time	Target	% On-Time	Target
High Density and Saturation Letters	92.3	91.0	90.8	90.0	87.2	90.0	86.9	90.0
High Density and Saturation Flats/Parcels	87.2	91.0	87.0	90.0	90.8	90.0	76.6	90.0
Carrier Route	81.4	91.0	79.7	90.0	70.6	90.0	50.1	90.0
Letters	87.1	91.0	85.9	90.0	80.7	90.0	71.3	90.0
Flats	76.2	91.0	76.9	90.0	59.9	90.0	59.9	90.0
Parcels	N/A	91.0	98.7	90.0	N/A	90.0	N/A	90.0
Mixed Product Letters[a]	88.0	91.0	85.9	90.0	79.5	90.0	67.7	90.0
Mixed Product Flats[b]	81.4	91.0	80.2	90.0	66.8	90.0	59.0	90.0

[a,b] Mixed Product Letters and Mixed Product Flats are not products. They are categories that account for Standard Mail Letters and Fats without proper documentation used to categorize a mail piece. *See* FY 2013 ACD, Library Reference USPS–FY12–29 at 11. *See also* Library Reference USPS–FY14–29 at 11.

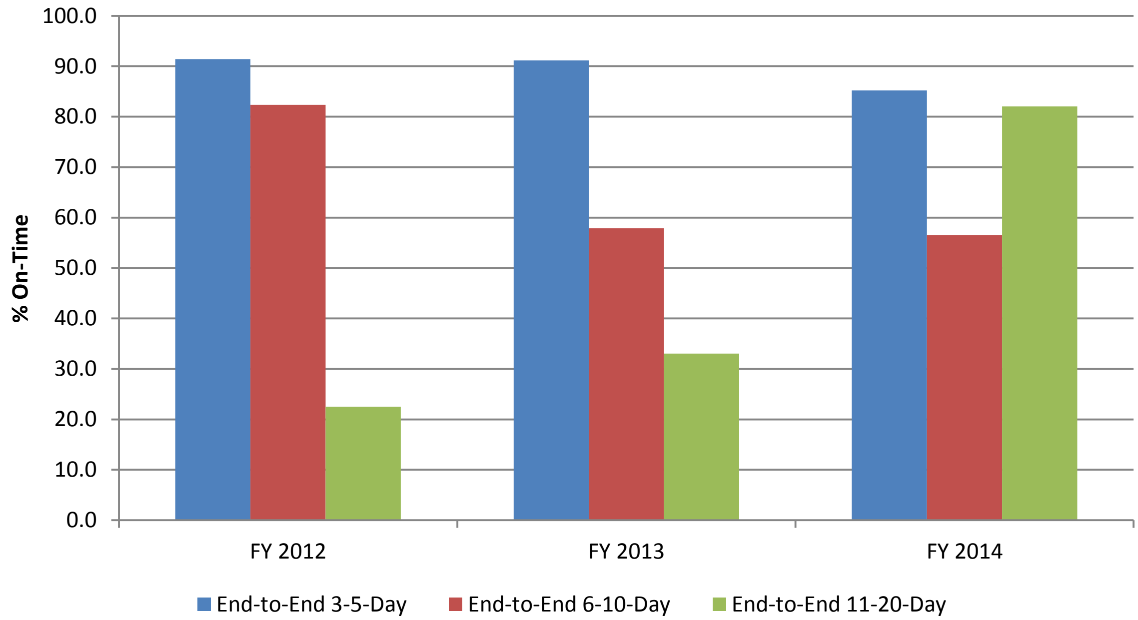
Note: Numbers in red indicate service performance results that did not meet or exceed the annual service performance target.

(1) High Density and Saturation Letters

In FY 2013, service performance results for High Density and Saturation Letters exceeded the annual target of 90 percent on-time delivery for the first time. Service performance results in FY 2014 remain above target, with a significant increase in service performance for the End-to-End 11-Day-and-Above service standard.[169] *See* Figure V-11.

[169] Mail to and from Alaska, Hawaii, Guam, American Samoa, Puerto Rico, and the U.S. Virgin Islands are represented in the 11-Day-and-Above service standard.

Figure V-11
High Density and Saturation Letters End-to-End Service Standards



(2) High Density and Saturation Flats/Parcels

Service performance results for High Density and Saturation Flats/Parcels comprise three service standards for each Destination Entry and End-to-End component. Table V-10 compares results for the past 4 years. FY 2014 was the first year that service performance results for the End-to-End component were reported.

Table V-10
Service Standards for High Density and Saturation Flats/Parcels, FY 2011–FY 2014

	FY 2011	FY 2012	FY 2013	FY 2014
Destination Entry 2-Day (DDU)	95.0	94.7	94.1	93.1
Destination Entry 3-5-Day (SCF)	86.7	83.8	79.5	81.6
Destination Entry 5-Day-And-Above (NDC)	48.1	90.4	88.2	92.0
End-to-End 3-5-Day	N/A	N/A	N/A	75.2
End-to-End 6-10-Day	N/A	N/A	N/A	72.7
End-to-End 11-Day-And-Above	N/A	N/A	N/A	64.4

The amount of High Density and Saturation Flats/Parcels pieces measured by IMb continues to grow; however, many districts did not report service performance results due to a lack of measurable data. Table V-11 lists the number and percent of districts that did not report results in FY 2013 and FY 2014. It illustrates that in FY 2014 service performance results for End-to-End High Density and Saturation Flats/Parcels with an 11-22-Day service standard came from only 25 percent of measured districts. Nevertheless, this is an increase from FY 2013, when none of the 67 districts reported End-to-End service performance results.

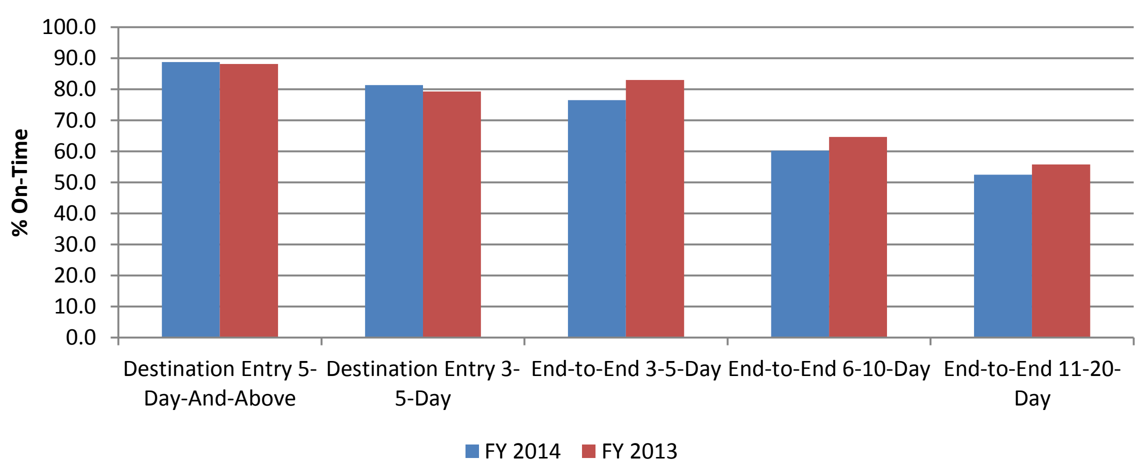
Table V-11
Districts that Did Not Report Annual Service Performance Results, FY 2013 and FY 2014

	FY 2014		FY 2013	
	No. Districts	% of Districts	No. Districts	% of Districts
Destination Entry 2-Day (DDU)	22	32.8%	22	32.8%
Destination Entry 3-5-Day (SCF)	1	1.5	1	1.5
Destination Entry 5-Day-and-above (NDC)	4	5.9	6	9.0
End-to-End 3-5-Day	12	17.9	67	100
End-to-End 6-10-Day	7	10.5	67	100
End-to-End 11-22-Day	51	76.1	67	100
Total Number of Districts without Measurement	**106**	**26.4%**	**239**	**59.5%**

(3) Carrier Route

Service performance for Carrier Route mail increased slightly compared to the previous year. Figure V-12 illustrates that service performance for all service standards of the End-to-End component decreased relative to FY 2013. The service standard for Destination Entry 3-4-Day was lengthened to 3-5-Day for noncontiguous States and territories only due to the Postal Service's shifts in service standards.[170]

Figure V-12
Carrier Route Mail Service Performance

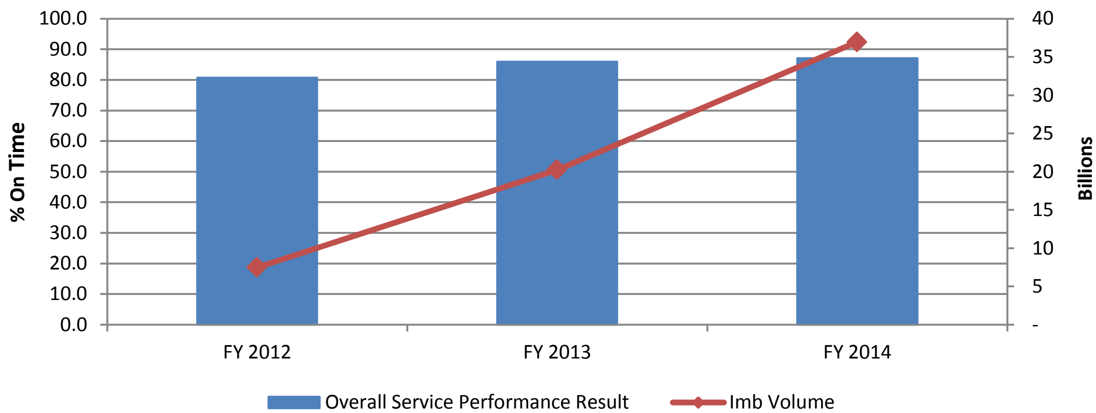


[170] *See* Service Standards for Destination Sectional Center Facility Rate Standard Mail, 79 Fed. Reg. 12,390, 12,390-94 (March 5, 2014).

(4) Letters

Service performance results for Standard Mail Letters, as well as the volume of Standard Mail Letters pieces measured by IMb, continue to increase annually. Figure V-13 illustrates the increasing trend in both volume and service performance since FY 2012.

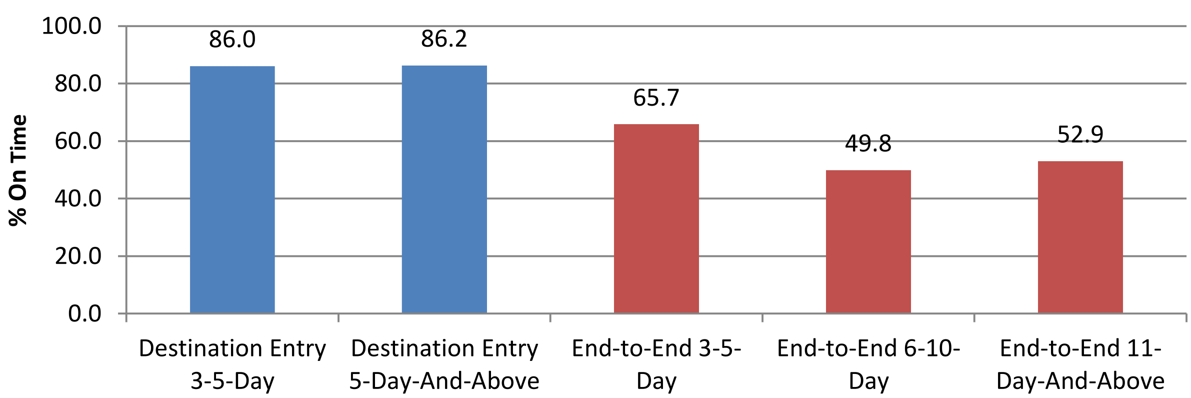
Figure V-13
Service Performance and Full-Service IMb Volume for Standard Mail Letters



(5) Flats

Service performance results for Standard Mail Flats showed significant improvement between FY 2012 and FY 2013. In FY 2014, overall results remained steady relative to FY 2013; however, each End-to-End performance measure remained low and reported delivery results less than 70 percent on-time. Figure V-14 illustrates the stark difference in service performance results for Destination Entry and End-to-End products for FY 2014.

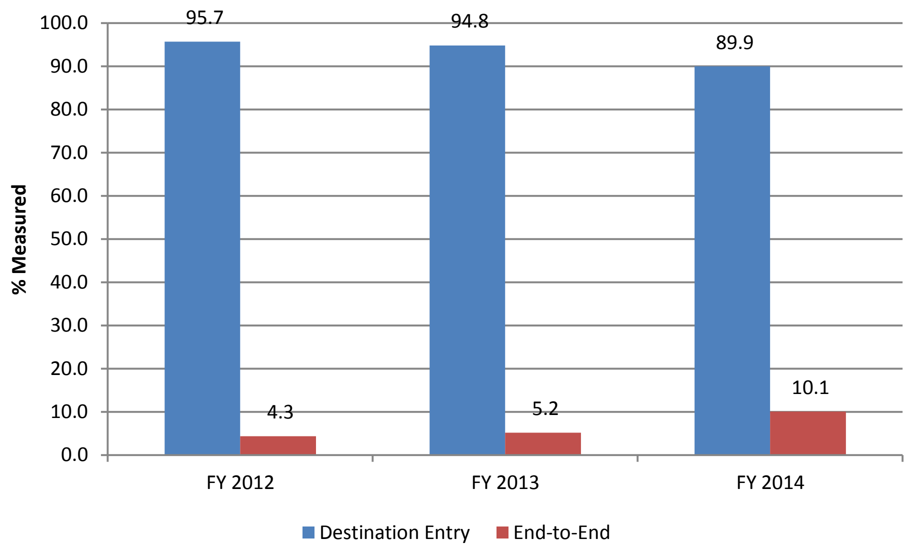
Figure V-14
Flats Components



In FY 2014, the total number of Flats mail pieces measured for service performance increased relative to FY 2013. Figure V-15 depicts this trend by illustrating volumes for

Destination Entry and End-to-End measured mail over 3 years. The figure clearly shows the disproportionate amount of mail measured as Destination Entry.

Figure V-15
Destination Entry and End-to-End Volume for Standard Mail Flats



(6) Parcels

FY 2013 was the first year service performance results for Parcels were reported. In FY 2014, the Postal Service was not able to continue reporting results. It explains that only 53 percent of Standard Mail Parcels had a barcode; of those, 10-15 percent lacked either a start-the-clock or stop-the-clock scan. January 23, 2015, Response to CHIR No. 2, question 12. a. In line with other Market Dominant Parcel products, the Postal Service is requiring mailers to use an Intelligent Mail Package Barcode to increase the volume eligible for measurement, *Id.*, question 12. b., noting that there are no price penalties for noncompliance but the addition of fees will likely yield more Parcel products with barcodes. *Id.*

The Commission commends the Postal Service for making significant strides in service performance results for Standard Mail High Density and Saturation Letters, High Density and Saturation Flats/Parcels, and Letters. In FY 2014, these products met, exceeded, or were near annual service performance targets. Although Standard Mail Parcels represent only 0.1 percent of all Standard Mail, the Postal Service is required by statute to report service performance results for all products. The Commission directs the Postal Service to provide these results in the FY 2015 ACR.

Standard Mail Carrier Route and Flats continue to fall well short of intended annual performance targets. The Commission directs the Postal Service to improve service for these products in FY 2015 or to explain in the FY 2015 ACR why efforts to improve results have been ineffective and what changes it plans to make to improve service performance.

c. Periodicals

Annual service performance results for Periodicals decreased slightly from FY 2013, as shown in Table V-12. The Postal Service attributes the lower scores to the extreme weather during the first two quarters of FY 2014. January 29, 2015, Response to CHIR No. 2, question 14. a.

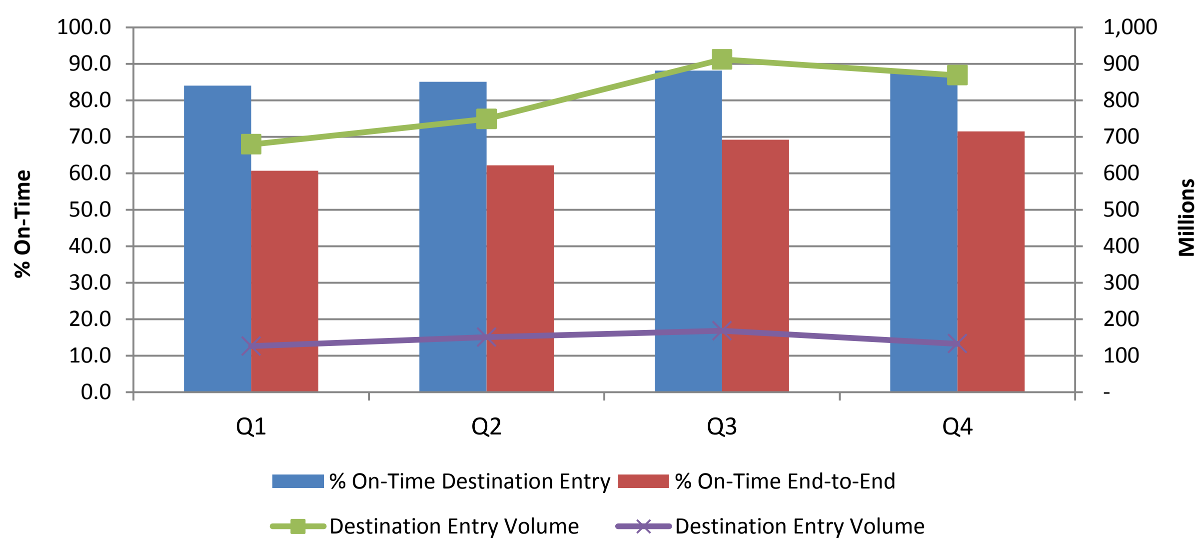
Table V-12
Annual Service Performance Results for Periodicals, FY 2012–FY 2014

Product	FY 2014		FY 2013		FY 2012	
	Target	% On-Time	Target	% On-Time	Target	% On-Time
In-County	91.0	80.9	91.0	82.0	91.0	68.7
Outside County	91.0	80.8	91.0	82.1	91.0	68.7

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

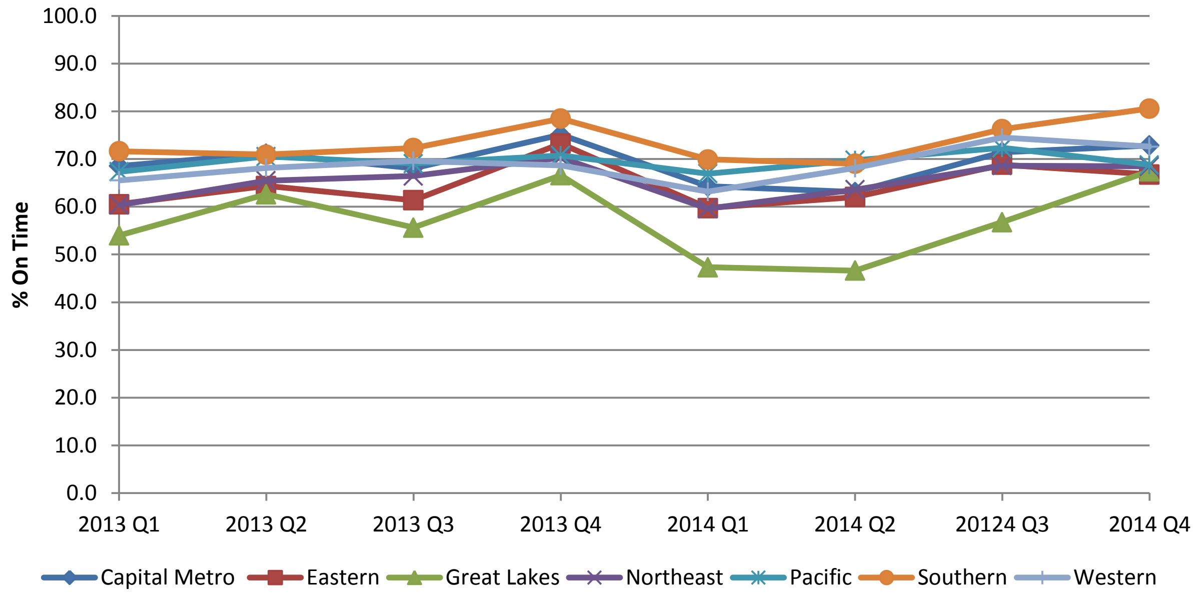
Figure V-16 shows that the difference in quarterly service performance scores due to weather was relatively minimal in FY 2014. The difference between service performance results for Destination Entry and End-to-End measurement was pronounced.

Figure V-16
Destination Entry Versus End-to-End



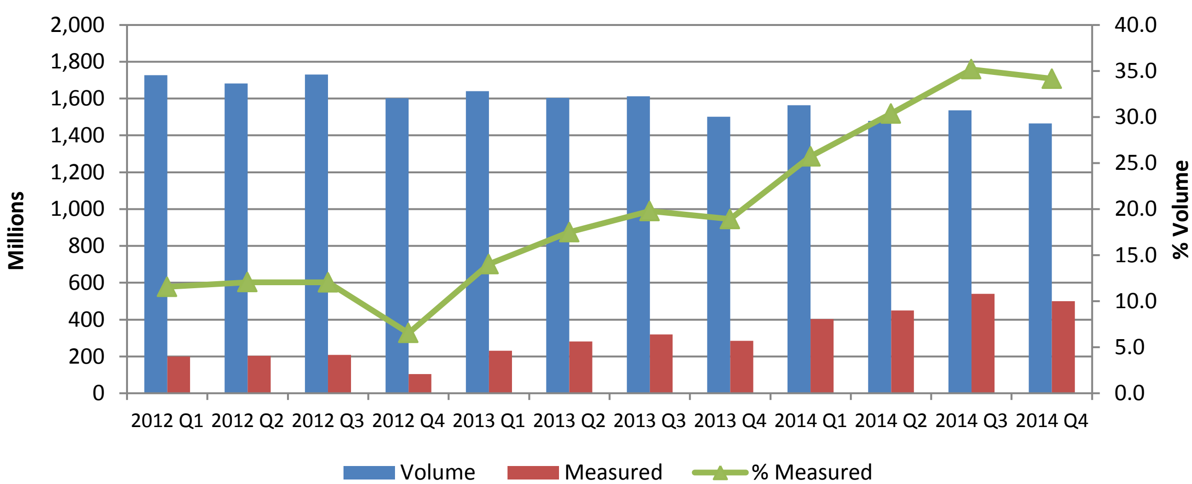
For FY 2013 and FY 2014, the Great Lakes region reported the lowest End-to-End service performance scores of any region. *See* Figure V-17. The Postal Service plans to increase service performance results for all geographic areas by making operational changes to its processing windows. January 29, 2015, Response to CHIR No. 2, question 14. b.

Figure V-17
Regional Comparison of Service Performance Results, FY 2013 and FY 2014



In FY 2014, the proportion of Periodicals measured for service performance continued to increase. The Postal Service, in its FY 2014 ACR, emphasizes the importance of increasing the amount and proportion of mail pieces in measurement. FY 2014 ACR at 39. Figure V-18 illustrates the steady increase in the amount of measured Periodicals.

Figure V-18
Measured Volume for Periodicals



The Postal Service again did not meet its delivery performance targets for its Periodicals product. The Commission directs the Postal Service to improve service for Periodicals in

FY 2015 or to explain in its FY 2015 ACR why efforts to improve results have been ineffective and what changes it plans to make to improve performance.

d. Package Services

Only service performance for BPM Parcels and Media Mail/Library Mail met annual service performance targets within the Package Services category. *See* Table V-13. Both products have met or exceeded the annual target for 3 consecutive years. Service performance for Inbound Surface Parcel Post (at UPU rates) decreased slightly compared with FY 2013. Alaska Bypass Service, which was created when Single-Piece Parcel Post moved to the Competitive product list, was granted a semi-permanent exemption from service performance reporting in FY 2014. Library Reference USPS–FY14–29 at 18.

Table V-13
Service Performance for Package Services, FY 2012–FY 2014

Product	FY 2014		FY 2013		FY 2012	
	Target	% On-Time	Target	% On-Time	Target	% On-Time
Parcel Post/Alaska Bypass	90.0	N/A	90.0	85.0	90.0	86.8
Bound Printed Matter Flats	90.0	60.2	90.0	62.6	90.0	54.3
Bound Printed Matter Parcels	90.0	99.3	90.0	98.4	90.0	94.4
Media Mail/Library Mail	90.0	91.7	90.0	93.3	90.0	92.7
Inbound International Surface Parcel Post (at UPU rates)	90.0	85.2	90.0	87.8	90.0	86.8

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

In FY 2014, service performance for BPM Flats was well below other Package Services products for the third consecutive year. In FY 2013, the Postal Service suggested that improved diagnostics and an increase in mailers using Full-Service Intelligent Mail should lead to improved service performance results.[171] Figure V-19 shows that the percent of BPM Flats measured for service performance has barely reached 10 percent in 12 quarters of measurement.

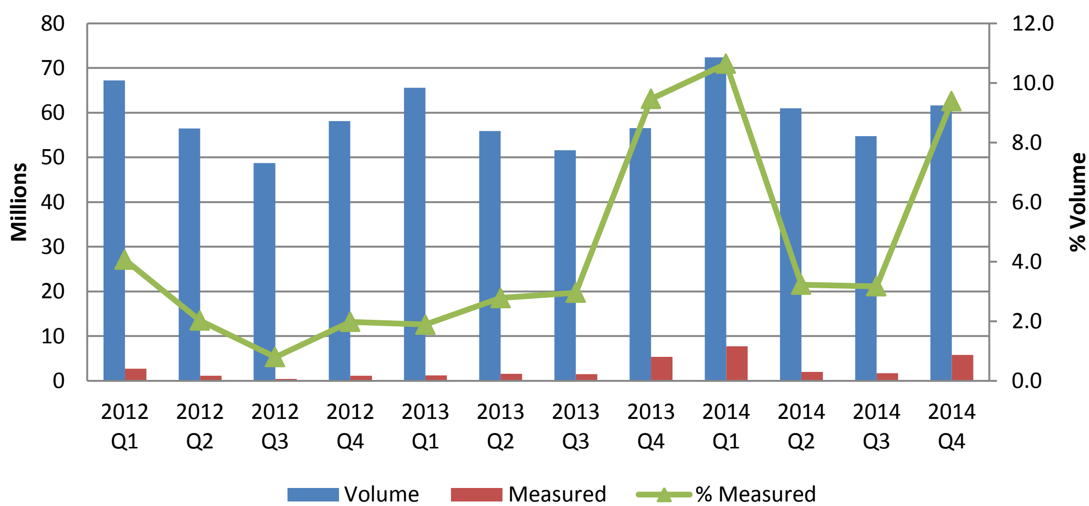
In FY 2014, there was also limited data available for BPM Parcels. The Postal Service explains this is a problem because some pieces did not have a barcode, or either a start-the-clock or stop-the-clock scan. January 23, 2015, Response to CHIR No. 2, question 15. a. As a result, it has implemented policies to barcode all parcels. *Id.,* question 15. b. The Postal Service reports extending Intelligent Mail Package Barcode requirements to all Parcel products, including Market Dominant products such as Standard Mail, BPM, Media

[171] FY 2013 ACD at 114. *See also* Library Reference USPS–FY13–29 at 20.

Mail/Library Mail, and Parcels. *Id.* These requirements took full effect on January 25, 2015, but there is no price penalty for not complying with the requirement. *Id.* The Postal Service expects measurable volumes to increase if noncompliance fees are added to the Parcel products. *Id.*

In FY 2014, the percentage of BPM Flats measured for service performance reached a high of approximately 10 percent in Quarters 1 and 4. Figure V-20 illustrates this, as well as the measured volume from FY 2012 is not much greater into FY 2014.

Figure V-19
Measured Volume for BPM Flats



There are two other concerns with BPM Flats: volume and performance differences between Destination Entry and End-to-End mail pieces. As figure Figure V-20 shows, despite the growth in volume of measured BPM Flats, there remains a significant discrepancy between the number of pieces in measurement for Destination Entry and End-to-End. In terms of service performance, BPM has consistently lagged behind other products and performance has not shown sustained improvement. *See* Figure V-21 for a comparison of End-to-End service performance for all Package Service products.

Figure V-20
Destination Entry and End-to-End Volume for BPM Flats

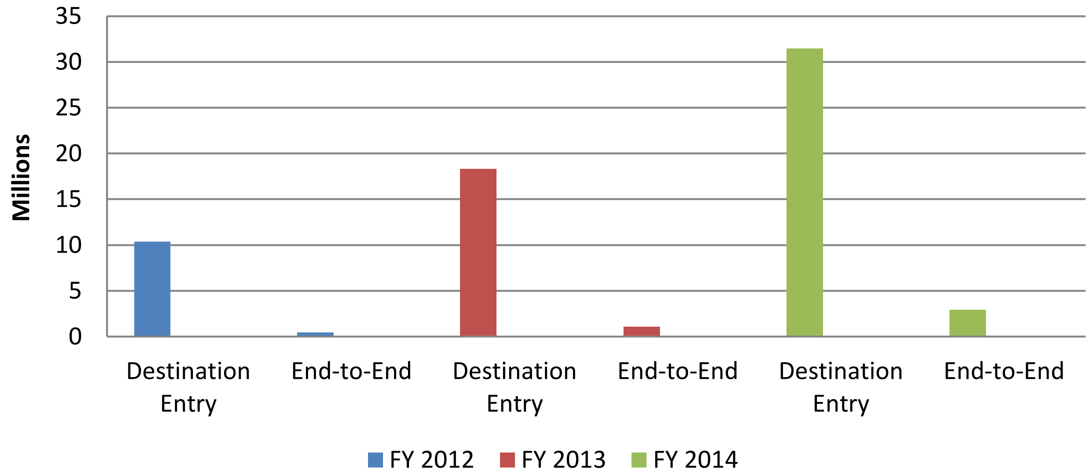
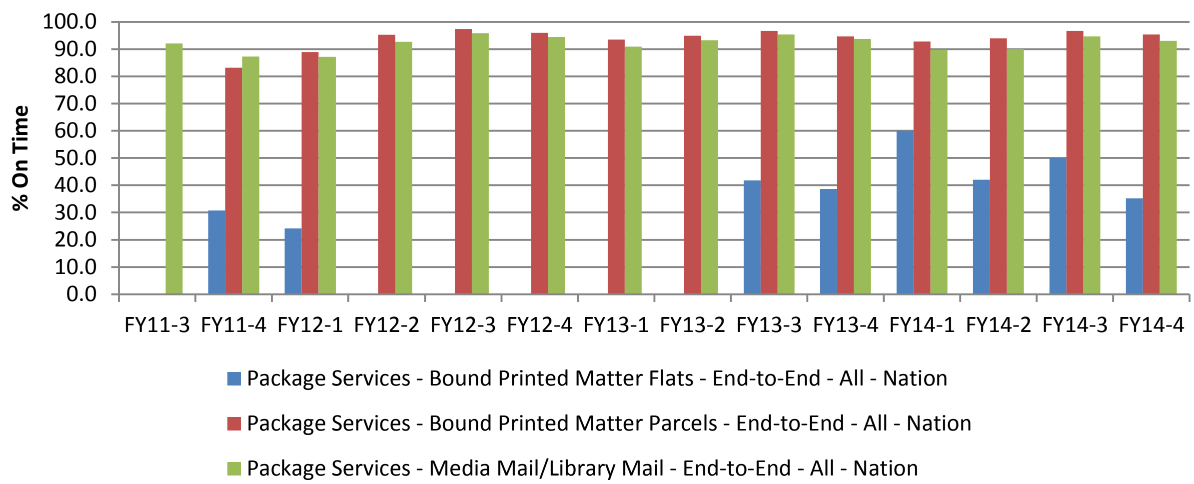


Figure V-21
Package Services Delivery Performance Comparison



Media Mail/Library Mail and Bound Printed Matter Parcels exceeded the Postal Service's annual service performance target of 90 percent on-time delivery for the third consecutive year. Service performance for Inbound International Surface Parcel Post remained relatively similar to FY 2013 and is close to its annual target. Results for BPM Flats remain the lowest among Package Service products and have decreased since FY 2013. The Commission views the Postal Service's previous strategies to increase performance results as largely ineffective. It directs the Postal Service to improve performance for BPM Flats in FY 2015 or include a discussion of its FY 2015 strategies to increase results and measureable volume in its FY 2015 ACR.

e. Special Services

Service performance results exceeded targets for each product within the Special Services category except for Address List Services. The Postal Service explains that the score for Address List Services, which is based on 12 transactions, was adversely affected by delayed processing from a single office.[172] Due to other high priority work, it took that office 7 days longer than the 15-day requirement to process the request. *Id*. Table V-14 compares the most recent results to previous years and the annual target.

Table V-14
Special Services' Performance Results, FY 2011–FY 2014

Product	FY 2014	FY 2013	FY 2012	FY 2011	Target
Ancillary Services	92.3	91.4	93.4	93.4	90.0
International Ancillary Services	99.7	99.3	99.6	99.6	90.0
Address List Services	33.3	100.0	83.3	93.3	90.0
Caller Services	--	--	--	--	--
Change-of-Address Credit Card Authentication	--	--	--	--	--
International Reply Coupon Service	--	--	--	--	--
International Business Reply Mail Service	--	--	--	--	--
Money Orders	98.3	99.2	99.2	97.2	90.0
Post Office Box Service	90.2	90.9	92.6	93.1	90.0
Customized Postage	--	--	--	--	--
Stamp Fulfillment Service	98.4	99.5	96.7	--	--

Notes: (1) Dashes indicate data not measured. (2) Number in red indicates service performance results that did not meet or exceed the annual service performance target.

B. Customer Access

1. Introduction

Pursuant to 39 C.F.R. § 3055.91, the Postal Service must provide the Commission with data on the number and type of post offices, including those under emergency suspension, and information about the number of collection boxes and similar collection points in its

[172] *See* FY 2014 ACR. Library Reference USPS–FY14–29 at 27.

network. Section 3055.91 also requires the Postal Service to provide information about average customer wait time in line by fiscal quarter.

Pursuant to 39 C.F.R. § 3055.92, the Postal Service must provide the Commission a copy of its *Customer Insight Survey*.[173] It must also provide additional information, including the type of customer surveyed, the number of surveys initiated and received, and the number of responses for each question (if a question is subject to multiple responses) disaggregated by each of the possible responses. The Postal Service supplements its reporting with information on alternative access channels.

Maintaining adequate customer access continues to be important. Over the years, the Postal Service has reduced its retail network by closing retail facilities or adjusting their hours. Since initiating its POStPlan in 2012, the Postal Service has reduced the hours of operation at many small post offices rather than closing them. The number of collection boxes and other collection points continues to be reduced. However, access to postal services has been supplemented with the addition and enhancement of alternative marketing channels.

2. Retail Facilities

The aggregate number of Postal Service-operated retail facilities (*i.e.*, post office stations and branches) has declined each year since FY 2012. However, the total number of retail outlets not operated by the Postal Service increased from FY 2013 to FY 2014, reflecting the establishment of 374 Village Post Offices (VPOs). The number of contract postal units (CPUs) and community Post Offices (CPOs) together declined by 127 facilities from FY 2013 to FY 2014. There were a total of 35,641 facilities in FY 2014, 207 more than the previous fiscal year. Table V-15 shows the number of these facilities for FY 2012 through FY 2014.

In FY 2014, the Postal Service opened nearly 400 VPOs within convenience stores, markets, and other neighborhood businesses. VPOs offer a limited selection of Postal Service products and services, which may include Post Office Boxes, Forever stamps, and flat rate boxes. They are often open longer than regular post offices, making them a convenient option for customers. More than 750 VPOs have opened since their inception in FY 2011.[174]

CPUs and CPOs sell stamps and offer a range of other postal services. CPUs are usually located within a place of business and operated by a contractor who accepts mail from the public, sells postage and supplies, and provides special services (*e.g.*, Postal Money Orders and Registered Mail). CPOs provide services in communities where independent post offices have been discontinued.[175] As Table V-15 illustrates, the number of CPUs and CPOs continues to decline.

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[173] Library Reference USPS–FY14–38.

[174] Witness Day testified that the Postal Service sees VPOs "now as an enhancement rather than a replacement" of a POStPlan post office and that the Postal Service will "make a maximum effort to get village post offices in those communities" with POStPlan offices. Docket No. N2012-2, Advisory Opinion on Post Office Structure Plan, August 23, 2012, at 49-50.

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

Table V-15
Postal Service Operational Retail Facilities

Facility Type	FY 2014	FY 2013	FY 2012	FY 2014 Change from FY 2013	FY 2013 Change from FY 2012
Post Offices	26,669	26,670	26,755	(1)	(85)
Classified Stations & Branches and Carrier Annexes	4,993	5,032	5,102	(39)	(70)
Total Postal-managed	**31,662**	**31,702**	**31,857**	**(40)**	**(155)**
Contract Postal Units	2,660	2,718	2,792	(58)	(74)
Village Post Offices	759	385	47	374	338
Community Post Offices	560	629	673	(69)	(44)
Total Non-Postal-managed	**3,979**	**3,732**	**3,512**	**247**	**220**
Total Offices, Stations & Branches	**35,641**	**35,434**	**35,369**	**207**	**65**

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

Source: United States Postal Service 2014 *Annual Report to Congress* at 45 and FY 2013 ACD at 117.

3. POStPlan

On May 25, 2012, the Postal Service requested an advisory opinion from the Commission on POStPlan*,* a proposal to realign the hours of operation at approximately 17,700 of its nearly 32,000 post office retail locations to more closely reflect the workload at these offices.[176] The Commission issued its advisory opinion on August 23, 2012, in which it stated that if implemented properly, the POStPlan should help balance service and cost savings in a manner consistent with title 39.[177]

As a result of POStPlan, the hours of operation at nearly 13,000 post offices nationwide are being reduced to 6, 4, or 2 hours per weekday. In a few locations, hours of operation will increase. Table V-16 shows the total number of offices subject to POStPlan.

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

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

Table V-16
Proposed Changes in Hours of Operation Under POStPlan

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

Source: Library Reference USPS–LR–N2012–2/11.

Although POStPlan may reduce retail service and customer convenience at certain post offices by reducing weekday hours of operation, the Postal Service plans to maintain retail access to postal services in the following ways:

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

The Postal Service is implementing POStPlan in several phases. The first set of post offices transitioned were those slated to be upgraded to Executive and Administrative Schedule Level 18, which entails increased administrative responsibilities for the Postmaster but no change in hours of operation. The Postal Service is currently transitioning those post offices slated for reduced operating hours where there is a Postmaster vacancy. During the final POStPlan phase in early FY 2015, those post offices with occupied Postmaster positions will begin to transition.

Table V-17 shows the POStPlan progress through the end of FY 2014. The table demonstrates that a little more than 75 percent of the post offices proposed for reduced hours have been transitioned. The implementation of POStPlan appears to be uniformly distributed among projected Level 2 (2 hours per weekday), Level 4 (4 hours per weekday), and Level 6 (6 hours per weekday) offices. The Postal Service places POStPlan Headquarters Status Updates and dates of upcoming POStPlan community meetings on its website to keep the public informed of potential changes in operating hours at their local post offices. The Postal Service states that implementation of POStPlan has resulted in over $250 million in annual savings.[178]

[178] United States Postal Service Responses to Questions 8, 11, and 15-19 of Chairman's Information Request No. 13, March 19, 2015, question 15. a. (March 19, 2015, Response to CHIR No. 13).

Table V-17
POStPlan Status Through FY 2014

Projected Office Level	Number of Offices: As Proposed in N2012-2	Number of Offices: Status as of End of FY 2014	% Converted
Level 2	1,891	1,319	69.8%
Level 4	6,837	5,225	76.4%
Level 6	4,333	3,261	75.3%
Total	**13,061**	**9,805**	**75.1%**

Source: United States Postal Service FY 2014 *Annual Report to Congress* at 48.

4. Post Office Suspensions

The number of post offices under suspension at the end of FY 2014 is equal to the number at the start of the fiscal year, plus the number suspended during the year, and minus the number reopened during the year. Table V-18 shows the number of Postal Service-operated retail facilities with suspended operations at the end of FY 2014. The number of post offices under suspension has continued to grow.

Table V-18
Number of Offices Under Suspension at the End of FY 2014

	Under Suspension at the Start of Fiscal Year	Suspended During Fiscal Year	Reopened During Fiscal Year	Under Suspension at End of FY 2014
Post Office	334	88	30	392
Station/Branch	86	14	3	97
Total	**420**	**102**	**33**	**489**

Source: Library Reference USPS–FY14–43.

According to Postal Service Handbook PO-101, *Postal Service-Operated Retail Facilities Discontinuance Guide*, the circumstances that may justify a suspension include:

- A natural disaster
- Termination of a lease or rental agreement when suitable alternate quarters are not available in the community, especially when the termination is sudden or unexpected
- Lack of qualified personnel to run the office
- Irreparable damage when no suitable alternate quarters are available in the community
- Severe damage to, or destruction of, the office
- Challenge to the sanctity of the mail

- Lack of adequate measures to safeguard the office or its revenues[179]

Lease expirations/terminations are the leading cause of suspensions, followed by lack of qualified personnel. Table V-19 categorizes the 489 offices with suspended operations at the end of FY 2014 by the justification for the suspension.

Table V-19
Number of Offices Under Suspension

Reason for Suspension	Number of Offices	% of Total FY 2013
Lease Expiration/Termination	233	47.6%
Lack of Qualified Personnel	101	20.7%
Health/Safety	97	19.8%
Natural Disasters	50	10.2%
Other	4	0.8%
No Data	4	0.8%
Grand Total	**489**	**100.0%**

Source: Library Reference USPS–FY14–43.

The Postal Service's formal discontinuance process is set out in Handbook PO-101 at 29-33. The first step is an official decision to undertake a feasibility study. Among other things, this step involves information gathering, including customer questionnaires to gather additional information about a community, its postal customers, and their access to delivery and retail services. After a headquarters review coordinator confirms that the review complies with Federal law and Postal Service policy, a formal proposal to discontinue the facility is prepared and forwarded to the district manager before it is issued. A community meeting can be held any time after the customer questionnaires have been sent out and before any final determination can be made.

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

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

[179] United States Postal Service Handbook PO-101, *Postal Service-Operated Retail Facilities Discontinuance Guide*, October 2012, at 39 (Handbook PO-101).

Data supplied by the Postal Service appear to indicate that as many as three-quarters of post offices remaining under suspension have entered the formal discontinuance process.[180] However, at least 82 offices had final determinations issued, primarily in FY 2011 and FY 2013, and yet remain under suspension.[181] The discontinuance studies performed for many of these offices are more than 2 years old; they may have to be updated if the Postal Service chooses to proceed in discontinuing these offices. The Commission is concerned that the number of post office suspensions is increasing, not decreasing.

The Commission has previously recommended that the Postal Service proceed expeditiously in either discontinuing offices under suspension or reopening them.[182] It reiterates that recommendation in this proceeding.

5. Delivery Points

Total delivery points increased by 971,543 from FY 2013 to FY 2014. This growth was due entirely to an increase in residential delivery points, as the number of business delivery points continued to decline.

Table V-20 provides the number of residential and business delivery points by delivery type for FY 2011 through FY 2014, plus the change in delivery points between the years. Table V-21 shows the average number of pieces per delivery point from FY 2009 to FY 2014. This figure has decreased more than 30 percent since FY 2000,[183] attributable to the simultaneous increase in delivery points and decrease in mail volume.

[180] *See* Library Reference USPS–FY14–43.

[181] *See* Library Reference USPS–FY11–44.

[182] *See* FY 2013 ACD at 121.

[183] FY 2012 ACD at 67.

Table V-20
Postal Service Delivery Point Statistics

Delivery Points	FY 2014	FY 2013	FY 2014 Change from FY 2013	FY 2012	FY 2013 Change from FY 2012
Residential					
City Delivery	81,650,586	81,297,883	352,703	81,040,591	257,292
Rural	40,750,668	40,111,620	639,048	39,449,400	662,220
PO Box	15,858,668	15,882,717	-24,049	15,994,508	-111,791
Highway Contract	2,774,213	2,736,005	38,208	2,678,508	57,497
Total Residential	**141,034,135**	**140,028,225**	**1,005,910**	**139,163,007**	**865,218**
Business					
City Delivery	7,592,773	7,554,231	38,542	7,525,979	28,252
Rural	1,554,422	1,524,741	29,681	1,493,644	31,097
PO Box	3,634,467	3,738,314	-103,847	3,889,964	-151,650
Highway Contract	76,179	74,922	1,257	73,957	965
Total Business	**12,857,841**	**12,892,208**	**-34,367**	**12,983,544**	**-91,336**
Grand Total Delivery Points	**153,891,976**	**152,920,433**	**971,543**	**152,146,551**	**773,882**

Source: United States Postal Service 2014 *Annual Report to Congress* at 45.

Table V-21
Annual Pieces per Delivery Point

	FY 2014	FY 2013	FY 2012	FY 2011	FY 2010	FY 2009
No. of Pieces (Millions)	155,375	158,384	159,859	168,297	170,859	176,744
Pieces/Delivery Point	1,010	1,036	1,051	1,111	1,133	1,177

Source: Commission calculation based on United States Postal Service 2014 *Annual Report to Congress* at 45.

6. Collection Points

Collection points—locations where a customer drops off mail for collection by the Postal Service—are an important access channel for Single-Piece First-Class Mail. They can include collection boxes, mail chutes, firm pickups, Self-Service Kiosks, lobby drops, and mail collection racks. The responsible district is required to enter all collection points in the Collection Point Management System, a database that includes collection point addresses, location types (*e.g.,* Business, Residential, Post Office Lobby), box types (*e.g.,* standard, jumbo, snorkel), days of the week the point is accessed, and the times it is accessed, including the final collection time.

Table V-22 shows the number of collection points by location type. Table V-23 shows the last pick-up times from collection boxes for FY 2010 and FY 2014 for selected time intervals. In general, the intervals between noon and 4:59 p.m. accounted for nearly 63 percent of the pick-up times. The profile of last pick-ups has shifted slightly earlier overall between FY 2010 and FY 2014.

Table V-22
Number of Collection Points by Location Type

Location Type	Year			Change in No.	% Change	Change in No.	% Change
	2014	2013	2006	2014–2006		2014–2013	
Business	76,304	78,721	108,116	-31,812	-29.4%	-2,417	-3.1%
Residential[a]	38,590	39,714	61,027	-22,437	-36.8%	-1,124	-2.8%
Post Office Outside	40,912	41,780	52,763	-11,851	-22.5%	-868	-2.1%
Post Office Lobby	38,421	38,579	37,068	1,353	3.7%	-158	-0.4%
Customer Lobby	2,890	3,062	4,057	-1,167	-28.8%	-172	-5.6%
Other	1,157	1,082	2,641	-1,484	-56.2%	75	6.9%
Contract Station	1,053	988	928	125	13.5%	65	6.6%
Mail Room	440	461	797	-357	-44.8%	-21	-4.6%
Customer Dock	128	143	425	-297	-69.9%	-15	-10.5%
Airport	131	140	150	-19	-12.7%	-9	-6.4%
Government Building	282	278	68	214	314.7%	4	1.4%
Approved Shipper	215	117	0	215	N/A	98	83.8%
Grand Total	**200,523**	**205,065**	**268,040**	**-67,517**	**-25.2%**	**-4,542**	**-2.2%**

[a] Collection boxes account for more than 99% of residential collection points.

Source: Library Reference USPS–FY13–43 and FY 2013 ACD at 124.

Table V-23
Collection Box Pick-Up Times

Last Pick-Up Time Range	2014	2010
Midnight to 11:59 a.m.	20.3%	22.4%
Noon to 2:59 p.m.	29.8%	30.7%
3:00 p.m. to 4:59 p.m.	32.9%	32.2%
5:00 p.m. to 6:59 p.m.	16.7%	14.3%
7:00 p.m. to 11:59 p.m.	0.3%	0.4%
Total	**100.0%**	**100.0%**

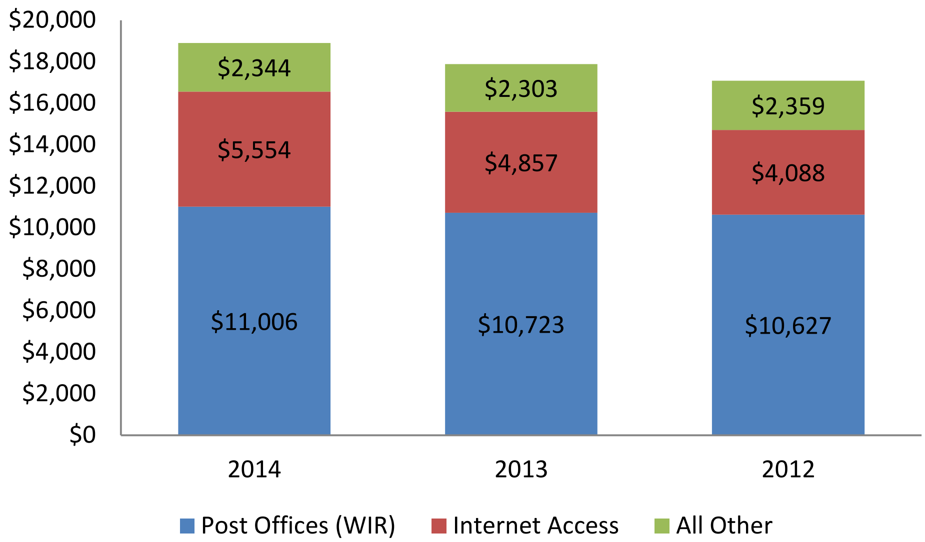
Source: FY 2014: January 16, 2015, Response to CHIR No. 1, question 19. FY 2010: Postal Regulatory Commission calculation based on Docket No. ACR2010, Library Reference USPS–FY10–43.

7. Alternative Access

In addition to providing postal products and services at postal retail counters, the Postal Service has continued to expand postal access through additional marketing channels. In FY 2014, more than 40 percent of retail revenue was generated through means other than a postal retail counter.

Figure V-22 identifies the FY 2014 revenue each retail channel generated. The channels are post offices' walk-in revenue, which is post office walk-in revenue plus walk-in revenue from CPUs; Internet Access, which consists of PC Postage and Click-N-Ship; and "All Other," which consists of "Stamps only sales by retail partners," Automated Postal Centers, and "Stamps by mail/phone/fax."

Figure V-22
Retail Revenue by Channel
($ Millions)



Source: Response to CHIR No. 1, question 18; FY 2013 ACD at 126.

Table V-24 shows the number of Self-Service Kiosks in use for FY2014 and FY2013. Fifty-eight kiosks were added in FY 2014. The Postal Service indicates that the increase reflects the addition of several hundred Self-Service Kiosks between October 2012 and December 2013 as part of its Self-Service Expansion Program. This program involved the addition of two kiosks in the inner lobbies and counter lines in five major urban markets: Chicago, Washington, D.C., Miami, Los Angeles, and New York City. The Postal Service further indicates that some kiosks may have been installed outside of the Self-Service Expansion Program.

Table V-24
Number of Self-Service Kiosks, FY 2013 and FY 2014

Fiscal Year	Number of Self-Service Kiosks
2014	2,843
2013	2,785

Source: February 23, 2015, Response to CHIR No. 7, question 12.

C. Customer Satisfaction

For Market Dominant products, 39 U.S.C. § 3652 (a)(2)(B)(ii) requires the Postal Service to report "the degree of customer satisfaction with the service provided." The Postal Service accomplishes this by measuring retail experience using the Retail Customer Experience program and customer attitudes with the newly implemented Customer Insights (CI) measurement.

According to the Postal Service, the previous Customer Experience Measurement (CEM) relational survey methodology, which had been used to measure customer perception towards the Postal Service, was conducted on a random sample of the population and provided perception-based results from potential customers. Because the survey was offered to a random sample of the United States population, it included individuals who may not actually be customers. The new CI methodology is event-driven and ensures that all feedback is reflective of actual customers. Responses are received in a more timely fashion as compared to the CEM and the CI composite is comprised of multiple touch points, which provides a more accurate representation of the entire customer base.[184]

The Postal Service believes the CI methodology represents an improvement over the Customer Experience Measurement survey. However, changing measurement methodology without some baseline makes it difficult to make year-over-year comparisons of the surveys' results and inhibits transparency and impedes the Commission's ability to fulfill its responsibility. The Commission will be taking a more extensive look at this survey and the relevant practices in its analysis of the Postal Service's FY 2014 Performance Report and FY 2015 Performance Plan.

1. Wait Time in Line

To provide insight into customer experiences at its retail outlets, the Postal Service, through the Retail Customer Experience program, hires private "mystery shoppers" who test customer experiences at approximately 8,600 of its larger retail outlets.[185] Wait Time reports are taken at different times of the day and different days of the week. Table V-25 shows the average wait time in line by administrative area for FY 2012 to FY 2014.

[184] United States Postal Service Responses to Questions 1-3 of Chairman's Information Request No. 11, March 3, 2015, question 3.

[185] United States Postal Service FY 2014 *Annual Report to Congress* at 50.

Table V-25
Postal Service Identified Average Wait Time in Line

Area	Average Wait Time in Line		
	FY 2014	FY 2013	FY 2012
Capital Metro	2:03	2:19	2:22
Eastern	2:00	2:16	2:24
Great Lakes	2:00	2:00	1:57
Northeast	2:28	2:21	2:23
Pacific	3:07	3:19	3:25
Southern	2:23	2:22	2:33
Western	2:47	2:48	2:58
National	**2:24**	**2:29**	**2:34**

Source: Library Reference USPS–FY14–33 and FY 2013 ACD at 122.

The Postal Service has emphasized that "One key measure of a customer's retail experience is wait time in line. The service standard for this attribute is 'Five Minutes or Less.'"[186] According to the Postal Service, this wait time is the ideal balance of cost effectiveness, efficiency, and service. Table V-26 summarizes survey responses about wait time in line the Postal Service received from post office customers.[187]

Table V-26
Customer Insights Identified Wait Time in Line, FY 2014

Wait Time in Line (Minutes)	FY 2014
1-3	64.9%
4-5	18.6%
6-10	8.8%
11-15	3.4%
16+	4.3%

Source: Library Reference USPS–FY14–38.

2. Customer Insights

As noted above, in FY 2013, the Postal Service changed how it measures customer experience. It transitioned from the Customer Experience Measurement system, which was implemented in FY 2011, to a system called Customer Insights. The four key components of this new measurement system are the Point of Sale survey, the Business Service Network survey, the Delivery (Residential/Small & Medium Business) survey, and the Customer Care Center survey. Each is described below.

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[186] United States Postal Service FY 2014 *Annual Report to Congress* at 50.

[187] In its February 19, 2015, Response to CHIR No. 7, question 14, the Postal Service stated, "The existing POS [Point of Sale] Survey does not offer a selectable option for time periods less than one minute. For future surveys, [the] Postal Service is considering revisions that would address wait times greater than zero seconds but less than one minute."

3. Point of Sale Survey

The Point of Sale survey "includes all retail customers who conduct transactions at Postal Service locations with POS [Point of Sale] equipment."[188]

Table V-27 and Table V-28 identify responses to questions the Postal Service considers to be the most important. Table V-27 shows the overall satisfaction of customers after their visit to a post office. More than 70 percent of customers were very satisfied with their visit; just 9.1 percent left very dissatisfied. These results stem from a sample size of more than 170,000 people.[189] Table V-28 shows satisfaction results for the question, "What was the most important characteristic for a sales associate to be: knowledgeable, efficient, positive, or courteous?" Each person surveyed picked one factor and shared their thoughts about how the sales associate embodied it.

Table V-27
Post Office Visit Satisfaction

Overall Satisfaction	FY 2014
Very Satisfied	73.1%
Mostly Satisfied	8.5%
Somewhat Satisfied	3.7%
Somewhat Dissatisfied	2.7%
Mostly Dissatisfied	2.9%
Very Dissatisfied	9.1%

Source: Library Reference USPS–FY14–38.

Table V-28
Sales Associate Factors

Customer Response	Be Knowledgeable?	Work Efficiently?	Have a Positive Attitude?	Treat You With Courtesy?
Strongly Agree	82.3%	65.7%	80.0%	75.2%
Mostly Agree	8.1%	15.7%	8.3%	5.8%
Somewhat Agree	3.1%	6.7%	3.9%	2.7%
Somewhat Disagree	1.3%	3.0%	1.7%	1.8%
Mostly Disagree	1.4%	2.9%	1.8%	3.0%
Strongly Disagree	3.8%	6.0%	4.3%	11.5%

Source: Library Reference USPS–FY14–38.

[188] United States Postal Service FY 2014 *Annual Report to Congress* at 39.

[189] Library Reference USPS–FY14–38.

4. Business Service Network Survey

The Business Service Network survey "assists major mailers with the resolution of service issues and information requests. It measures the customer's level of satisfaction with their BSN [Business Service Network] Account Representative."[190] Table V-29 shows the level of satisfaction customers felt after dealing with their representative. More than 84 percent ended the communication feeling very satisfied.

Table V-29
Satisfaction with Business Service Network Representative

Customer Response	Rate
Very Satisfied	84.1%
Mostly Satisfied	9.9%
Somewhat Satisfied	3.2%
Somewhat Dissatisfied	1.3%
Mostly Dissatisfied	0.9%
Very Dissatisfied	0.6%

Source: Library Reference USPS–FY14–38.

A component of high-quality customer service is how quickly problems are resolved. Table V-30 shows the average amount of time it took to resolve a problem.

Table V-30
Average Amount of Time to Resolve a Problem

Time Frame	Result
Immediate resolution	30.7%
Less than one day	35.7%
1-2 days	19.7%
3-5 days	5.1%
More than 5 days	2.5%
Still Unresolved	6.3%

Source: Library Reference USPS–FY14–38.

5. Delivery (Residential/Small & Medium Business) Survey

The Delivery (Residential/Small & Medium Business) survey is "mailed to randomly selected residential and small- and medium-sized business customers (those with fewer

[190] United States Postal Service FY 2014 *Annual Report to Congress* at 39.

than 250 employees at one site) who are asked to complete a survey online or via telephone."[191] It focuses on customers' satisfaction with Postal Service delivery. As shown in Tables V-31 and V-32, the majority of customers in this category reported satisfaction with the Postal Service's delivery practices.

Table V-31
Residential Customer Delivery Satisfaction

Customer Response	Rate
Very Satisfied	61.1%
Mostly Satisfied	20.5%
Somewhat Satisfied	5.9%
Somewhat Dissatisfied	5.3%
Mostly Dissatisfied	3.5%
Very Dissatisfied	3.8%

Source: Library Reference USPS–FY14–38.

Table V-32
Small Business Customer Delivery Satisfaction

Customer Response	Rate
Very Satisfied	54.4%
Mostly Satisfied	23.4%
Somewhat Satisfied	7.4%
Somewhat Dissatisfied	5.9%
Mostly Dissatisfied	3.8%
Very Dissatisfied	5.1%

Source: Library Reference USPS-FY14-38.

6. Customer Care Center Survey

The Customer Care Center survey is "for residential customers who call the USPS Care Center at 1-800-ASK-USPS and interact with a live agent. A random sampling of all callers is afforded an opportunity to participate in the survey, which measures customer satisfaction with the agent's performance."[192] Survey responses range from 1 (Extremely dissatisfied) to 5 (Extremely satisfied). The questions address different topics; some pertain to the quality of the representative, others ask about the overall quality of the Postal Service. *See* Table V-33 and Table V-34.

[191] United States Postal Service FY 2014 *Annual Report to Congress* at 39-40.

[192] United States Postal Service FY 2014 *Annual Report to Congress* at 40.

Table V-33
Satisfaction with Postal Service

Rank	Rate
5 (Best)	27.4%
4	19.3%
3	17.5%
2	11.6%
1 (Worst)	24.2%

Source: Library Reference USPS–FY14–38.

Table V-34
Likelihood to Select Postal Service for Next Shipping Need

Rank	Rate
5 (Best)	37.3%
4	15.9%
3	15.1%
2	9.4%
1 (Worst)	22.4%

Source: Library Reference USPS–FY14–38.

Appendix A: Commission-Directed Undertakings that May Result in Future Analytical Principle Changes

COMMISSION-DIRECTED UNDERTAKINGS THAT MAY RESULT IN FUTURE ANALYTICAL PRINCIPLE CHANGES (FY 2014 ACD)

Periodicals Pricing Efficiency

- *In the FY 2015 ACR, the Postal Service shall provide a detailed analysis of the cost and contribution impact of the worksharing incentives offered for 5-Digit and Carrier Route presortation. FY ACD at Chapter 2, page 16.*

- *In the FY 2015 ACR, the Postal Service shall provide a report on its progress in improving Periodicals pricing efficiency. FY 2014 ACD at Chapter 2, page 17.*

Inbound Letter Post Service Performance

- *The Commission directs the Postal Service to report within 90 days on its plans to improve on-time service performance scores for Inbound Letter Post. In its report, the Postal Service shall identify systemic problems preventing on-time service performance scores from achieving the UPU quality-of-service target each year and its plans to address these problems. FY 2014 ACD at Chapter 3, page 55.*

Valassis Collection Fee

- *Accordingly, the Postal Service shall report the information required by Order No. 1448 to be filed within 60 days of the end of each contract year. That information includes, but is not limited to, information regarding the payment of the $100,000 transaction fee/penalty. Order No. 1448 at 41. FY 2014 ACD at Chapter 3, page 62.*

Royal PostNL NSA

- *The Commission finds that the NSA with Royal PostNL did not comply with 39 U.S.C. § 3622(c)(10)(A). The Commission directs the Postal Service to report within 90 days on the following: the factors that caused the Royal PostNL NSA cost coverage at the*

UPU terminal dues to exceed the cost coverage at the negotiated rates; the extent to which the Postal Service incorporated knowledge of these factors into its financial model for the successor NSA that was the subject of Docket No. R2015-3; and whether the successor NSA with Royal PostNL will improve the Postal Service's net financial position during FY 2015. FY 2014 ACD at Chapter 3, page 57.

- *The Commission finds that the Royal PostNL NSA (Docket No. CP2013-24) did not satisfy 39 U.S.C. § 3633(a)(2). Moreover, the negotiated rates do not comply with 39 U.S.C. § 407(a) because such rates distort competition. For the successor NSA with Royal PostNL in Docket No. CP2015-18, the Commission directs the Postal Service to report within 90 days on the financial model's projected change in cost compared with the actual change in cost for mail processing, delivery, and other costs, and whether the successor NSA is expected to cover costs during FY 2015. The Postal Service shall provide financial workpapers to support any statements or analysis in its report. FY 2014 ACD at Chapter 4, page 82.*

IMTS—Outbound and IMTS—Inbound Products

- *For FY 2014, the Commission finds that the IMTS—Outbound and IMTS—Inbound products do not comply with 39 U.S.C. § 3633(a)(2). The Commission directs the Postal Service to report within 90 days on the feasibility of developing attributable costs for both products based on alternatives to the IOCS methodology. In its report, the Postal Service should discuss the feasibility of conducting engineering studies or utilizing costs from other Special Services with similar functions, such as domestic Money Orders. In addition, the Commission considers a price increase for the IMTS—Outbound product to be one option the Postal Service may want to implement to reduce current losses. FY 2014 ACD at Chapter 4, page 76.*

Inbound Air Parcel Post

- *The Commission concludes that the entry of inbound air parcels post from EPG-member countries is inconsistent with 39 U.S.C § 407(a)(2). The Commission therefore recommends that the Postal Service pursue additional improvements in on-time service performance through implementation of the EPG continuous improvement plan so as to improve the financial results for Inbound Air Parcel Post (at non-UPU rates) during FY 2015. The Commission directs the Postal Service to negotiate compensatory rates within the EPG-Agreement or extricate itself from the Agreement. FY 2014 ACD at Chapter 4, page 81.*

First-Class Flats–Service Performance

First-Class Flats

- *This is the fourth consecutive year that First-Class Mail Flats did not meet service performance targets. In addition, service performance has not improved since FY 2011. The Commission directs the Postal Service to improve service for First-Class Mail Flats in FY 2015 or to provide an explanation in the FY 2015 ACR for why efforts to improve service performance results for First-Class Mail Flats have been ineffective and detail what changes it plans to make to improve service performance. FY 2014 ACD at Chapter 5, page 104.*

Standard Mail High Density and Saturation Letters, High Density and Saturation Flats/Parcels, and Letters

- *The Commission commends the Postal Service for making significant strides in service performance results for Standard Mail High Density and Saturation Letters, High Density and Saturation Flats/Parcels, and Letters. In FY 2014, these products met, exceeded, or were near annual service performance targets. Although Standard Mail Parcels represent only 0.1 percent of all Standard Mail, the Postal Service is required by statute to report service performance results for all products. The Commission directs the Postal Service to provide these results in the FY 2015 ACR. FY 2014 ACD at Chapter 5, page 109.*

Standard Mail Carrier Route and Flats–Service Performance

- *Standard Mail Carrier Route and Flats continue to fall well short of intended annual performance targets. The Commission directs the Postal Service to improve service for these products in FY 2015 or to explain in the FY 2015 ACR why efforts to improve results have been ineffective and what changes it plans to make to improve service performance. FY 2014 ACD at Chapter 5, page 109.*

Periodicals–Service Performance

- *The Postal Service again did not meet its delivery performance targets for its Periodicals product. The Commission directs the Postal Service to improve service for Periodicals in FY 2015 or to explain in its FY 2015 ACR why efforts to improve results have been ineffective and what changes it plans to make to improve performance. FY 2014 ACD at Chapter 5, page 111-112.*

Media Mail/Library Mail and Bound Printed Matter Parcels–Service Performance

- *Media Mail/Library Mail and Bound Printed Matter Parcels exceeded the Postal Service's annual service performance target of 90 percent on-time delivery for the third consecutive year. Service performance for Inbound International Surface Parcel Post remained relatively similar to FY 2013 and is close to its annual target. Results for BPM Flats remain the lowest among Package Service products and have decreased since FY 2013. The Commission views the Postal Service's previous strategies to increase performance results as largely ineffective. It directs the Postal Service to improve performance for BPM Flats in FY 2015 or include a discussion of its FY 2015 strategies to increase results and measureable volume in its FY 2015 ACR. FY 2014 ACD at Chapter 5, pages 114.*

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

Excess Passthroughs Resulting from Timing of Price Adjustments

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

    - The Postal Service filed a Notice of Market-Dominant Price Adjustment (Docket No. R2015-4) on January 15, 2015. The cost avoidances used in that docket reflected the FY 2014 costs available in the FY 2014 ACR. This solved the timing issue.

Investigation of Certain Additional Costs

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

    - The Postal Service has not yet investigated the additional costs.

Further Derivation of Elasticity for Standard Mail Products

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

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

    - On May 2, 2014, the National Postal Policy Council, the Association for Mail Electronic Enhancement, the Association of Marketing Service Providers, GrayHair Software, Inc., the Greeting Card Association, the International Digital Enterprise Alliance, Inc., the Major Mailers Association, and the National Association of Presort Mailers (Petitioners) filed a petition pursuant to 39 C.F.R. § 3050.11. The petition requests that the Commission initiate a proceeding to review and consider improvements to the econometric elasticities demand model used by the Postal Service and the Commission.[3]

    - On May 9, 2014, the Postal Service filed its answer opposing the petition. It contends that a proceeding would serve no useful purpose and that the interests

[1] Docket No. ACR2013, Chairman's Information Request No. 4, January 27, 2014.

[2] Docket No. ACR2013, Reponses of the United States Postal Service to Questions 1-20 of Chairman's Information Request No. 4, February 6, 2014 (Response to CHIR No. 4)

[3] Docket No. RM2014-5, Petition to Improve Econometric Demand Equations for Market-Dominant Products and Related Estimates of Price Elasticities and Internet Diversion, May 2, 2014.

of the Commission and the Postal Service would be better served by focusing their scarce resources elsewhere.[4]

- On July 9, 2014, the Commission established Docket No. RM2014-5 for consideration of the matters raised by the petition. The Commission also scheduled a technical conference for August 13, 2014. Order No. 2117.[5]

- On August 13, 2014, the Commission held the technical conference to consider the elasticity of demand issue by exploring alternative methods that have already been developed and can be presented for discussion, of which a paper titled *A Branching AIDS Model for Estimating U.S. Postal Price Elasticities* by Lyudmila Y. Bzhilyanskaya, Margaret M. Cigno, and Edward S. Pearsall, was discussed.

- Between September 19-22, 2014, comments in response to the technical conference were filed.

Costing Methodology for Parcel Return Service Full Network Contracts

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

  - On June 20, 2014, the Postal Service submitted a modification of the International Priority Airmail (IPA) costing methodology as Proposal Three in Docket No. RM 2014-6.[6]

  - On September 10, 2014, the Commission approved Proposal Three because the proposed methodology reflects mailer-specific information and therefore improves the cost estimate for Parcel Return Service Contract 4.[7]

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[4] Docket No. RM2014-5, Answer of the United States Postal Service in Opposition to Petition to Initiate a Proceeding Regarding Postal Demand Analysis, May 9, 2014.

[5] Docket No. RM2014-5, Notice and Order Scheduling Technical Conference, July 9, 2014 (Order No. 2117).

[6] Docket No. ACR2013, Responses of the United States Postal Service to Commission Requests for Additional Information in the FY 2013 Annual Compliance Determination, June 25, 2014, answer 1.

Costing of IPA Product

- *The Commission therefore directs that the Postal Service report within 90 days and reconfirm that the IPA product will cover the projected attributable costs in FY 2014. The Postal Service shall provide an analysis of the causes of the FY 2013 loss and decrease in cost coverage. In addition, the Postal Service is to recommend modifications to its current methodology of developing costs and, if necessary, propose the modifications in a rulemaking, so as to improve the reliability of such cases for the IPA product. FY 2013 ACD at 86.*
  - On June 20, 2014, the Postal Service submitted a proposed modification of the IPA costing methodology as Proposal Four in Docket No. RM 2014-6.[8]
  - On September 10, 2014, the Commission approved Proposal Four because the proposed methodology more accurately reflects the distribution of container costs and weight-related settlement charges between the IPA product and IPA NSAs. Order No. 2180.

Performance Measure for Inbound Surface Parcel Post/Alaska Bypass Service

- *Within 90 days of the issuance of this ACD, the Postal Service shall propose to the Commission appropriate measurement systems for both Inbound Surface Parcel Post (at UPU rates) and Alaska Bypass Service. FY 2013 ACD at 115.*
  - In the 2012 ACD, the Commission instructed the Postal Service to "propose use of an appropriate measurement system or proxy for Inbound Surface Parcel Post (at UPU rates) for service performance measurement in FY 2013." FY 2012 ACD at 61. The Postal Service continues to use Single-Piece Parcel Post as the proxy to measure service performance for Inbound Surface Parcel Post (at UPU rates).[9] On October 1, 2014, the Postal Service filed a request for a semi-permanent exception from periodic reporting of service performance measurement and customer satisfaction for Alaska Bypass Service, pursuant to 39 C.F.R. § 3055.3.

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[7] Docket No. RM2014-6, Order on Analytical Principles Used in Periodic Reporting (Proposals Three through Eight), September 10, 2014 (Order No. 2180).

[8] Docket No. ACR2013, Responses of the United States Postal Service to Commission Requests for Additional Information in the FY 2013 Annual Compliance Determination, June 25, 2014, answer 2.

[9] *See* Docket No. ACR2013, Responses of the United States Postal Service to Questions 1-9 of Chairman's Information Request No. 6, February 18, 2014, question 9 (Response to CHIR No. 6).

- The Commission issued Order No. 2206, which established Docket No. RM2015-1 for consideration of matters raised by the Postal Service's request.[10]

- On December 23, 2014, the Commission issued Order No. 2303 granting the Postal Service's request concerning service performance measurement because the "cost of implementing a measurement system would be prohibitive in relation to the revenue generated by the product." However, the Commission did not grant the Postal Service's request to eliminate reporting of customer satisfaction because rule 3055.3 does not provide an exception and the request did not address why any exception to the reporting rules should be extended. *See* Order No. 2303 at 5.[11]

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

- *The Commission directs the Postal Service to develop a costing methodology that adequately measures the attributable costs of the enhanced services for the competitive Post Office Box service. The Commission also directs the Postal Service to file the proposed methodology in a rulemaking proceeding prior to including the methodology in any future competitive rate adjustment for competitive Post Office Box service or in its FY 2013 ACR. See FY 2012 ACD at 163.*

    - On November 8, 2013, the Postal Service filed a petition pursuant to 39 C.F.R. § 3050.11 requesting the Commission to initiate an informal rulemaking proceeding to consider changes to analytical principles for use in periodic reporting.[12] Among other things, the Postal Service proposed to update and improve the methodology for developing attributable costs for the enhancements to the competitive Post Office Box service. The Commission reviewed the proposal in Docket No. RM2014-1.

[10] Docket No. RM2015-1, United States Postal Service Request for Semi-Permanent Exception from Periodic Reporting of Service Performance Measurement for Alaska Bypass Service, October 1, 2014.

[11] Docket No. RM2015-1, Order Concerning Semi-Permanent Exception from Periodic Reporting of Service Performance Measurement for Alaska Bypass Service, December 23, 2014 (Order No. 2303).

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

- On May 8, 2014, the Commission issued Order No. 2076 approving the updated methodology because it represented an improvement compared with the current procedure.[13]

[13] Docket No. RM2014-1, Order on Analytical Principles Used in Periodic Reporting (Proposals Six through Nine), May 8, 2014 (Order No. 2076).

Appendix B: Commenters 2014 *Annual Compliance Determination*

Commenter	Comment Citation	Citation Short Form
American Catalog Mailers Association (ACMA)	Initial Comments of the American Catalog Mailers Association, February 2, 2015	ACMA Comments
	Reply Comments of the American Catalog Mailers Association, February 13, 2015	ACMA Reply Comments
American Postal Workers Union, AFL-CIO (APWU)	Initial Comments of American Postal Workers Union, AFL-CIO, February 2, 2015	APWU Comments
	Reply Comments of American Postal Workers Union, AFL-CIO, February 13, 2015	APWU Reply Comments
Association for Postal Commerce (PostCom)	Initial Comments of the Association for Postal Commerce, February 2, 2015	PostCom Comments
	Reply Comments of the Association for Postal Commerce, February 13, 2015	PostCom Reply Comments
Citizens Against Government Waste (CAGW)	Comments Before the Postal Regulatory Commission, February 2, 2015	CAGW Comments
Douglas F. Carlson (Carlson)	Comments on Annual Compliance Report, January 16, 2015	Carlson Comments
Federal Express Corporation (FedEx)	Reply of Federal Express Corporation, February 18, 2015	FedEx Reply Comments
Greeting Card Association (GCA)	Initial Comments of the Greeting Card Association, February 2, 2015	GCA Comments
	Reply Comments of the Greeting Card Association, February 13, 2015	GCA Reply Comments

Commenter	Comment Citation	Citation Short Form
Magazine Publishers of America, Inc., and Alliance of Nonprofit Mailers (MPA & ANM)	Reply Comments of Magazine Publishers of America, Inc., and Alliance of Nonprofit Mailers, February 13, 2015	MPA & ANM Reply Comments
National Association of Presort Mailers (NAPM)	Reply Comments of the National Association of Presort Mailers, February 13, 2015	NAPM Reply Comments
National Postal Policy Council (NPPC)	Comments of the National Postal Policy Council, February 2, 2015	NPPC Comments
	Reply Comments of the National Postal Policy Council, February 13, 2015	NPPC Reply Comments
National Taxpayers Union (NTU)	Comments of Pete Sepp, President, National Taxpayers Union Before the Postal Regulatory Commission, February 2, 2015	NTU Comments
PHI Acquisitions, Inc. (PHI)	Initial Comments of PHI Acquisitions, Inc., February 2, 2015	PHI Comments
	Reply Comments of PHI Acquisitions, Inc., February 13, 2015	PHI Reply Comments
Pitney Bowes Inc. (Pitney Bowes)	Comments of Pitney Bowes Inc., February 2, 2015	Pitney Bowes Comments
	Reply Comments of Pitney Bowes Inc., February 13, 2015	Pitney Bowes Reply Comments
	Surreply Comments of Pitney Bowes Inc., February 18, 2015	Pitney Bowes Surreply Comments
Public Representative (PR)	Public Representative Comments, February 2, 2015	PR Comments
Progressive Direct Mail Advertising (Progressive)	Comments on Annual Compliance Report, February 2, 2015	Progressive Comments
Stamps.com (Stamps.com)	Initial Comments of Stamps.com, February 2, 2015	Stamps.com Comments

Commenter	Comment Citation	Citation Short Form
	Reply Comments of Stamps.com, February 18, 2015	Stamps.com Reply Comments
Taxpayers Protection Alliance (TPA)	Comments on Annual Compliance Report, January 30, 2015	TPA Comments
United Parcel Service (UPS)	Comments of United Parcel Service on Postal Service's FY 2014 Annual Compliance Report, February 2, 2015	UPS Comments
United States Postal Service (USPS)	Reply Comments of the United States Postal Service, February 18, 2015	USPS Reply Comments
Utah Hispanic Chamber of Commerce (UHCC)	Utah Hispanic Chamber of Commerce Comments of Annual Compliance Report, February 2, 2015	UHCC Comments
Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. (Valpak)	Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Initial Comments on the United States Postal Service FY 2014 Annual Compliance Report, February 2, 2015	Valpak Initial Comments
	Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Reply Comments on the United States Postal Service FY 2014 Annual Compliance Report, February 13, 2015	Valpak Reply Comments

Note: On February 18, 2015, the Postal Service and two commenters filed motions requesting late acceptance of their reply comments. Motion of the United States Postal Service for Late Acceptance of ACR Reply Comments, February 18, 2015; Motion of Federal Express Corporation, February 18, 2015; and Motion for Late Acceptance of Reply Comments of Stamps.com, February 18, 2015. In addition, Pitney Bowes filed a motion for leave to file surreply comments. Motion of Pitney Bowes Inc. for Leave to File Surreply, February 18, 2015. The motions are unopposed. The Commission grants each of these motions.

Appendix C: Acronyms and Abbreviations

Acronym/Abbreviation	Meaning
AADC	Automated area distribution center
ACD	*Annual Compliance Determination*
ACMA	American Catalog Mailer Association
ACR	*Annual Compliance Report*
ADC	Area distribution center
AFSM	Automated Flats Sorting Machine
APWU	American Postal Workers Union
BPM	Bound Printed Matter
BSN	Business Service Network
CAGU	Citizens Against Government Waste
Carlson	Douglas F. Carlson
CEM	Customer Experience Measurement
C.F.R.	Code of Federal Regulations
CHIR	Chairman’s Information Request
CI	Customer Insights
CPI	Consumer price index
CPI-U	Consumer price index for all urban consumers
CPO	Community Post Office
CPU	Contract postal unit
CRA	Cost and Revenue Analysis
DDU	Destination delivery unit
DFSS	Destination Flats Sequencing System
Discover	Discover Financial Services
DNDC	Destination network distribution center
DSCF	Destination sectional center facility
ECSI	Educational, cultural, scientific or informational (value)
EMS	Express Mail Service
EPG	E-Parcel Group
EXFC	External First-Class Measurement
FedEx	Federal Express Corporation
FSS	Flats Sequencing System
FY	Fiscal Year
GCA	Greeting Card Association

Acronym/Abbreviation	Meaning
GEPS	Global Expedited Package Service
GREPS	Global Reseller Expedited Package Service
ICRA	International Cost and Revenue Analysis
iMAPS	Intelligent Mail Accuracy and Performance System
IMb	Intelligent Mail barcode
IMMS	International Mail Measurement System
IMTS-Inbound	International Money Transfer Service-Inbound
IMTS-Outbound	International Money Transfer Service-Outbound
Mixed ADC	Mixed area distribution center
MPA & ANM	Magazine Publishers of America, Inc., and Alliance of Nonprofit Mailers
IOCS	In-Office Cost System
NAPM	National Association of Presort Mailers
NDC	Network distribution center
NPPC	National Postal Policy Council
NSA	Negotiated service agreement
NTU	National Taxpayers Union
PAEA	Postal Accountability and Enhancement Act
PHI	PHI Acquisitions, Inc.
Pitney Bowes	Pitney Bowes Inc.
POS	Point of Sale
PostCom	Association for Postal Commerce
PTS	Product Tracking System
PR	Public Representative
Progressive	Progressive Direct Mail Advertising
QBRM	Qualified Business Reply Mail
SASP	Seamless Acceptance and Service Performance
SFS	Stamp Fulfillment Services
TPA	Taxpayers Protection Alliance
UFSM	Upgraded Flats Sorting Machine
UHCC	Utah Hispanic Chamber of Commerce
U.S.C.	United States Code
UPS	United States Parcel Service
UPU	Universal Postal Union
Valassis	Valassis Direct Mail, Inc.
Valpak	Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc.
VPO	Village Post Office

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