

POSTAL REGULATORY COMMISSION

Postal Regulatory Commission
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Annual Report to the President and Congress

FISCAL YEAR 2014

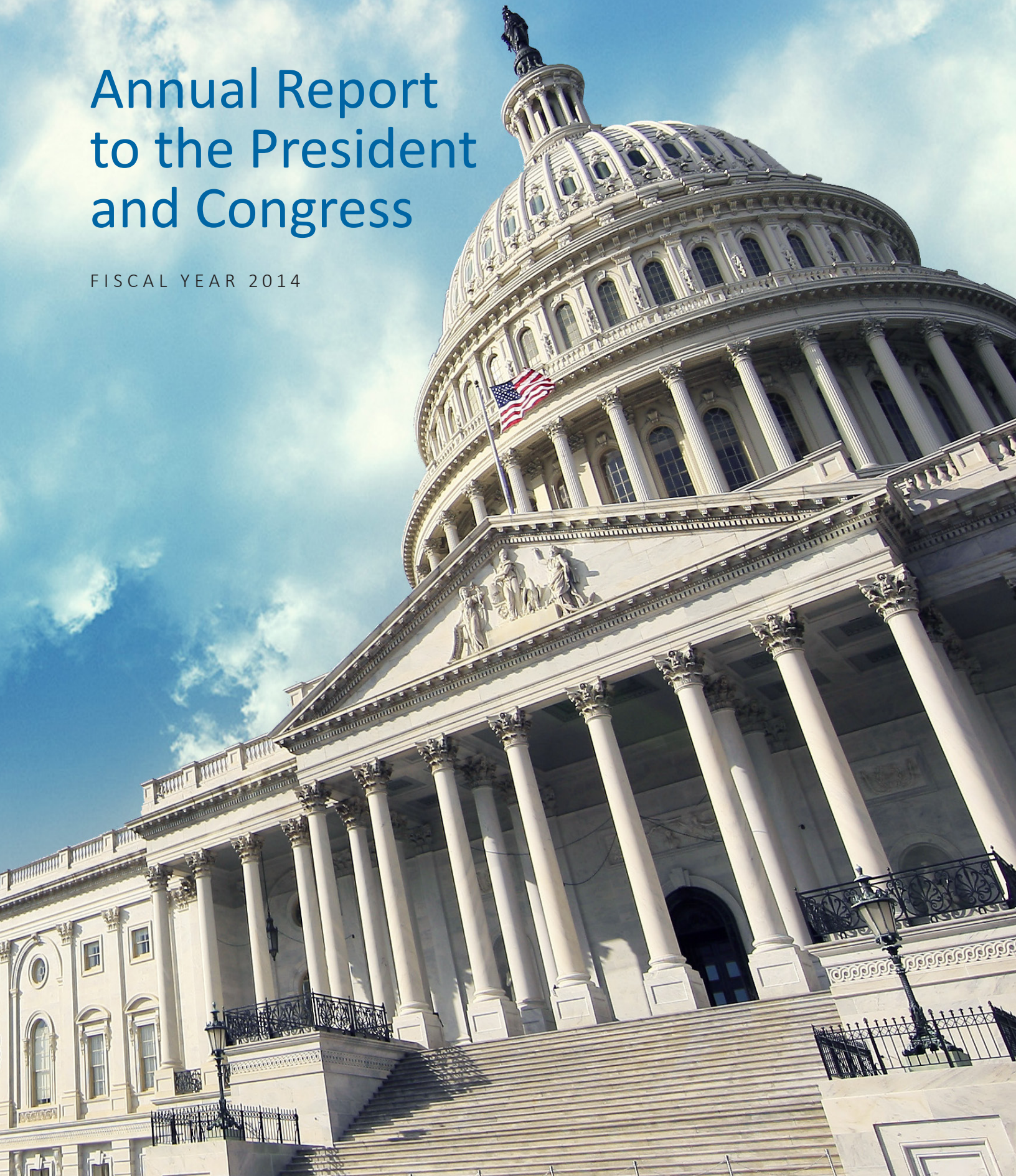


Table of Contents

Chairman’s Message	v
Chapter I. Year in Review	1
Chapter II. About the Commission	5
Staff and Office Structure.....	9
Commission’s Mission and <i>Strategic Plan</i>	10
Office of Public Affairs and Government Relations	11
Office of the Secretary and Administration	14
Public Representative Program.....	17
Chapter III. Effectiveness of Commission Rules to Achieve PAEA Objectives	19
Market Dominant Cases.....	21
Notice of Increase for Rates of General Applicability.....	21
Notice of Exigent Price Increase.....	23
PHI Negotiated Service Agreement.....	27
Alternate Postage Payment.....	27
Round-Trip Mailer	27
<i>Annual Compliance Determination</i>	28
Review of Postal Service Performance Reports	29
Standard Mail Load Leveling	30
Market Dominant Rulemakings	30
Clarifying Price Cap Calculations	30
Market Test Rulemakings	31
Price Elasticities and Internet Diversion.....	32
Form and Content of Postal Service Reports to the Commission	32
Competitive Products	34
Changes in Rates of General Applicability.....	34
Changes in Rates Not of General Applicability: NSAs.....	36
Chapter IV. Universal Service Obligation and Postal Monopoly	39
Background	39
Estimated Cost of the USO.....	40
Element A: Cost of Providing Services to All Areas of the Nation	40
Element B: Estimated Revenue Not Received	42
Element C: Other Public Services or Activities	44
Value of the Postal Monopoly.....	47
Chapter V. Other Proceedings and Actions	51
Rulemaking on Nature of Service Proceedings	51
Post Office Closing Appeals.....	52
Court Appeals	52
Application of Price Cap Rules	52
GameFly Complaint.....	53
Commission Review of Post Office Closing Appeals.....	53
ACD Directive on Standard Mail Rates	54
Research Projects.....	54
Commission’s Role in International Postal Policy.....	55

Acronyms

ACD	<i>Annual Compliance Determination</i>
ACR	<i>Annual Compliance Report</i>
C.F.R.	Code of Federal Regulations
CPI	consumer price index
DSCF	destination sectional center facility
FY	Fiscal Year
GEPS	Global Expedited Package Service
IMb	Intelligent Mail barcode
NPR	non-published rates
NSA	negotiated service agreement
PAEA	Postal Accountability and Enhancement Act
RHBF	Postal Service Retirement Health Benefits Fund
U.S.C.	United States Code
UPU	Universal Postal Union
USO	Universal Service Obligation



POSTAL REGULATORY COMMISSION

Mission Statement

Ensure transparency and accountability of the United States Postal Service and foster a vital and efficient universal mail system.

Guiding Principles

The Commission is committed to and operates by the principles of:

OPENNESS

- Public participation

INTEGRITY

- Fairness and impartiality
- Timely and rigorous analysis

MERIT

- Commitment to excellence
- Collegiality and multi-disciplinary approaches

ADAPTABILITY

- Proactive response to the rapidly changing postal environment





Chairman's Message

JANUARY 2015

On behalf of the Postal Regulatory Commission, I submit the Commission's 2014 *Annual Report to the President and Congress*. It describes Commission activities of the last fiscal year and the extent to which regulations are achieving the objectives set forth by the Postal Accountability and Enhancement Act of 2006.

This report is available on the Commission's website, www.prc.gov. I invite members of the public to send comments to improve the report to:

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The Commission looks forward to building on its Fiscal Year 2014 accomplishments and continuing to fulfill its mission in the most efficient and effective manner possible.

Respectfully,

A handwritten signature in black ink, appearing to read "Robert G. Taub", with a long, sweeping flourish extending to the right.

Robert G. Taub
Acting Chairman





Chapter I. Year in Review

The Postal Regulatory Commission made the following significant accomplishments in Fiscal Year (FY) 2014. All of the Commission's activities supported its mission: to ensure transparency and accountability of Postal Service operations and foster a vital and efficient universal mail system.

1. The Commission published four major reports in FY 2014:
 - *Annual Report to the President and Congress (Annual Report)*, describing the Commission's accomplishments and activities as the regulator of the U.S. Postal Service
 - *Annual Compliance Determination (ACD)*, reviewing the Postal Service's compliance with pricing and service standards
 - *Analysis of Postal Service Financial Results and 10-K Statement for Fiscal Year 2013*, providing an in-depth analysis of the Postal Service's financial health
 - *Review of Postal Service FY 2013 Performance Report and FY 2014 Performance Plan*, evaluating whether the Postal Service met its performance goals as required under Title 39 of the United States Code (U.S.C.), section 3653(d)

The *Analysis of Postal Service Financial Results and 10-K Statement* and the *Review of Postal Service FY 2013 Performance Report and FY 2014 Performance Plan* are new publications introduced in FY 2014. Their contents used to be included as chapters in the ACD, but the Commission decided to create separate, more detailed reports to provide a more comprehensive review of the Postal Service's finances and performance goals.

2. The Commission expeditiously presided over the following major proceedings during the first half of the year, completing its review in 90 days:
 - A rate adjustment due to extraordinary or exceptional circumstances (commonly known as the "exigency case")
 - A Nature of Service case regarding service changes associated with Standard Mail load leveling

3. The Commission considered seven postal rate price adjustment requests by the Postal Service for Market Dominant and Competitive products.
4. The Commission reviewed 17 Postal Service proposals to revise costing methodologies.
5. The Commission approved 83 negotiated service agreements (NSAs) (76 Competitive, 7 Market Dominant).
6. The Commission reviewed five proposed changes to the Market Dominant and Competitive products lists in the *Mail Classification Schedule*. These included the addition of a Gift Cards price category, a proposal for private address forwarding, the transfer of Inbound Surface Parcel Post, and *Mail Classification Schedule* changes for Priority Mail Express International, Restricted Delivery, and Pickup On Demand.
7. The Commission evaluated several complaint cases filed against the Postal Service:
 - The first complaint, filed by the American Postal Workers Union, alleges that the Postal Service is not complying with Market Dominant service standard regulations in violation of Title 39 of the U.S.C. This complaint is under review.
 - The second complaint concerned a change in retail hours in the San Francisco District. The Commission dismissed this complaint on July 28, 2014.
 - The Commission also resumed consideration of an appropriate remedy in a complaint proceeding in which it had previously found that the Postal Service engaged in unlawful discrimination against a DVD mailer. In FY 2013, the mailer successfully challenged on appeal the appropriateness of the Commission's original remedy, which the appellate court remanded for further investigation by the Commission. At the conclusion of the remand proceeding, the Commission prescribed a revised rate for round-trip DVD mail designed to remedy undue discrimination by the Postal Service. The revised rate was upheld on appeal; therefore, the complaint case was closed.
8. The Commission conducted several rulemaking proceedings. It published proposed rules regarding the treatment of rate incentives and *de minimis* rate increases under the price cap. It adopted three final rules that:
 - Streamline advisory opinions on nationwide changes in postal services requested by the Postal Service under 39 U.S.C. § 3661
 - Clarify rate incentives and *de minimis* rate increases under the price cap
 - Implement regulations for market tests of experimental products

9. In other proceedings, the Commission:
 - Established three dockets to evaluate improvements in measurements of price elasticities and Internet diversion; the scope of public service or activity cost reporting in the *Annual Report*; examined and reviewed a Postal Service request to conduct a market test of an experimental product, Customized Delivery
 - Considered a Postal Service request to extend and expand the Metro Post market test
 - Issued an order granting a Postal Service petition to eliminate a periodic reporting rule requiring an alternative format *Cost and Revenue Analysis* report
 - Issued three requests for proposals for studies on inframarginal costs, terminal dues, and Postal Service Parcel products
 - Reviewed four Post Office closing appeals
 - Completed a study of the savings to the Postal Service for reducing the delivery of mail from 6 days to 5 days while maintaining Six-Day Delivery for package service
 - Completed a study of unit avoidable costs that underlie worksharing discounts
 - Responded to nearly 10,000 inquiries, questions, suggestions, complaints, and comments from the general public, primarily involving undelivered, delayed, misdelivered, and missing mail
 - Proceeded with a major modernization of the external website to ensure the content of Commission and Postal Service operations is accessible and transparent to all stakeholders
10. With respect to international postal responsibilities, the Commission:
 - Evaluated 54 Universal Postal Union (UPU) proposals to amend the UPU Acts in accordance with 39 U.S.C. § 407(c)(1)
 - Continued its active role in the UPU Letters and Parcels Remuneration Groups on international letter mail and parcel delivery rates by chairing the UPU Regulatory Issues Project Group on behalf of the U.S. government
 - Furthered its long-standing commitment to building solid working relationships with other postal regulators in promoting a high-quality, affordable universal service network for citizens worldwide
 - Continued collaboration on international postal issues with other government agencies such as the Department of State through its Federal Advisory Committee on International Postal and Delivery Services

USA FIRST-CLASS FOREVER





Chapter II. About the Commission

The Commission is an independent establishment of the executive branch of the United States Government. It has exercised regulatory oversight over the Postal Service since its creation by the Postal Reorganization Act of 1970, with expanded responsibilities under the Postal Accountability and Enhancement Act (PAEA) of 2006. It has five commissioners, each appointed by the president, by and with the advice and consent of the Senate, for a term of 6 years. After the expiration of his or her term, a commissioner may continue to serve for up to 1 year or until a successor is confirmed. No more than three members of the Commission may be from one political party.



Robert G. Taub, Acting Chairman

Mr. Taub was designated acting chairman by President Barack Obama on December 4, 2014. He was sworn in as a commissioner in October 2011; his term expires on October 14, 2016. The Commission elected him vice chairman for calendar year 2013. His previous 30 years of public service include special assistant to Secretary of the Army John McHugh; chief of staff to U.S. Representative John McHugh; 12 years in senior positions on the House of Representatives' Committee on Oversight & Government Reform, including staff director of its former Postal Service Subcommittee; senior policy analyst with the U.S. Government Accountability Office; and staff member for three members of Congress, a member of the British Parliament, and state and county officials in upstate New York.



Mark D. Acton, Vice Chairman

Mr. Acton was appointed as a commissioner on August 3, 2006; his term expires on October 14, 2016. He served as Commission vice chairman from 2007 to 2008, 2011 to 2012, and 2014 to 2015, and as special assistant to former Postal Rate Commission Chairman George Omas. His other positions have included staff director of the Republican National Committee Counsel's Office; deputy to the chairman of the 2004 Republican National Convention; special assistant to the Republican National Committee chief counsel and Counsel's Office government relations officer and redistricting coordinator; executive director, Republican National Convention, Committee on Permanent Organization, and deputy executive director, Committee on Rules; and executive director of the Republican National Committee Redistricting Task Force.



Ruth Y. Goldway, Commissioner

Ms. Goldway was appointed as a commissioner on April 7, 1998, and in her third term was designated chairman by President Barack Obama on August 6, 2009. That term expired on November 22, 2014. Beginning in 1999, she served on the State Department delegation to the UPU. She served as vice chairman for calendar year 2001. Her previous positions include manager of public affairs for the Getty Trust; director of public affairs, California State University, Los Angeles; council member and mayor, City of Santa Monica, California; founder and former chairperson, Santa Monica Pier Restoration Corporation; assistant director of the California Department of Consumer Affairs; and co-founder of Women in Logistics and Delivery Services.



Tony L. Hammond, Commissioner

Mr. Hammond was reappointed commissioner and sworn in on December 11, 2014. His term expires October 14, 2018. He was first appointed as a commissioner on August 15, 2002. He served as the Commission's vice chairman from 2003 to 2005, and again from 2009 to 2010. On May 1, 2012, he was sworn in for a third term as a commissioner; that term expired on October 14, 2013. Before joining the Commission, Mr. Hammond was the owner and managing member of T. Hammond Company, LLC; senior consultant to Forbes 2000, Incorporated; senior vice president of FL&S, a direct marketing firm; director of campaign operations for the Republican National Committee; executive director and finance director of the Missouri Republican Party; and served 10 years on the staff of former U.S. Representative Gene Taylor (R-MO).



Nanci E. Langley, Commissioner

Ms. Langley was reappointed as commissioner and sworn in on December 11, 2014. Her term expires November 22, 2018. She was first appointed as a commissioner on June 6, 2008; that term expired on November 22, 2013. She served as Commission vice chairman from 2008 to 2009, and all of 2012. Her previous positions include director of public affairs and government relations at the Commission; 17 years as a senior adviser to Senator Daniel K. Akaka (D-HI), including 9 years as a deputy staff director on the U.S. Senate Committee on Homeland Security and Governmental Affairs Federal Workforce and Government Management Subcommittee; and communications director to former U.S. Senator Spark M. Matsunaga (D-HI). She is an elected fellow of the National Academy of Public Administration.





Robert Taub, Ruth Goldway, Mark Acton

Staff and Office Structure

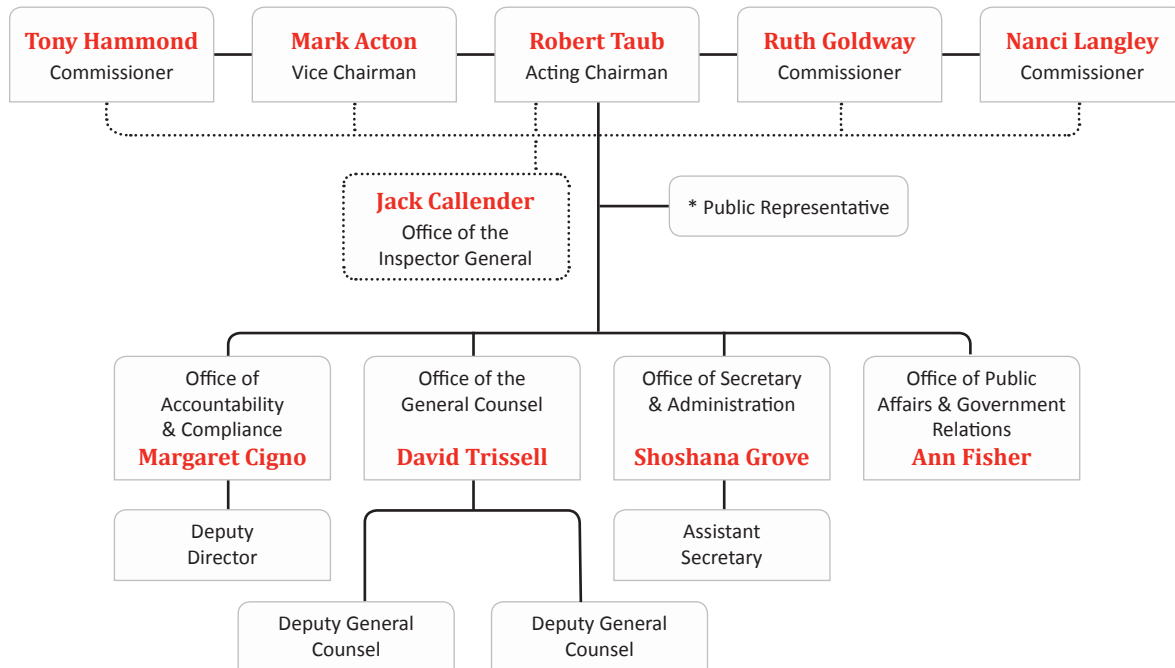
Commission staff has expertise in law, economics, finance, statistics, and cost accounting.

The Commission is organized into four operating offices:

- **Accountability and Compliance.** The Office of Accountability and Compliance is responsible for technical analysis and formulating policy recommendations for the Commission in domestic and international matters.
- **General Counsel.** The Office of the General Counsel provides legal assistance on matters involving the Commission's responsibilities, defends Commission decisions before the courts, manages the formal complaint process, and ensures the Commission fulfills its statutory responsibilities.
- **Public Affairs and Government Relations.** The Office of Public Affairs and Government Relations facilitates prompt and responsive communications with the public, Congress, Federal agencies, the Postal Service, and media.
- **Secretary and Administration.** The Office of Secretary and Administration records the Commission's official actions; manages the Commission's records, human resources, budget and accounting, and information technology; and provides other support services.

The Commission maintains an independent Office of the Inspector General. It conducts, supervises, and coordinates audits and investigations relating to Commission programs and operations, and identifies and reports fraud and abuse in these programs and operations.

Figure II-1. Organizational Structure



** 39 U.S.C. § 505: The PRC shall designate an Officer of the Commission in all public proceedings who shall represent the interests of the general public.*

Commission’s Mission and *Strategic Plan*

The Commission’s mission is to ensure transparency and accountability of the Postal Service and foster a vital and efficient universal mail system.

The Commission’s *Strategic Plan* outlines its strategic goals, implementation approaches, and accountability plans for 2012 to 2016. Each quarter, the commissioners meet with agency office heads to gauge progress toward meeting these goals and carrying out the Commission’s mission, and to ascertain where challenges might exist and the plan to address them. Each office head is responsible for presenting commissioners with an updated action plan for discussion. As the Commission’s principal executive officer, the chairman may then use these action plans to implement the *Strategic Plan*.

The *Strategic Plan* can be viewed or downloaded on the Commission’s website, www.prc.gov.



Ann Fisher

Office of Public Affairs and Government Relations

The Commission's Office of Public Affairs and Government Relations is the primary office providing assistance to the general public. It supports public outreach and education, complaint processing, and media relations, and liaises with Congress, presidential administrations, the Postal Service, and other government agencies. It informs and advises commissioners and Commission staff on legislative issues and policies related to the Commission and the Postal Service, and coordinates the preparation of Congressional testimony and responses to Congressional inquiries concerning Commission policies and activities.

Another of its critical functions is to answer inquiries, questions, suggestions, and comments from the public, business owners, government bodies, and other stakeholders.

Comments and Inquiries

INQUIRIES BY SOURCE

During FY 2014, the Office of Public Affairs and Government Relations received 9,677 inquiries, questions, suggestions, and comments, a 114 percent increase over last year. Approximately 77 percent of consumer inquiries were submitted online through "Contact PRC" on the *www.prc.gov* website. Of the remaining inquiries, 19 percent came by phone and 4 percent by mail. Table II-1 shows the number of inquiries from Postal Service stakeholders from FY 2009 to FY 2014.

Table II-1. Inquiries Submitted to the Office of Public Affairs and Government Relations

Source/Stakeholder	Year					
	FY 2014	FY 2013	FY 2012	FY 2011	FY 2010	FY 2009
Consumer	8,919	4,058	5,227	4,663	12,971	1,241
Business owner	482	224	67	81	1,300	0
Postal employee	151	92	250	427	2,978	55
Media	54	48	94	132	152	85
Federal/state/local govt.	47	72	214	223	129	97
Mailer	21	16	18	53	595	310
Postal organization	3	6	6	69	45	12
TOTAL	9,677	4,516	5,876	5,648	18,170	1,800

The office met with the Postal Service Office of Consumer and Industry Contact in May and August 2014 to discuss the complaint resolution process. Commission Order No. 195 directs that the Postal Service must respond within 45 days to rate and service inquiries forwarded to its Office of the Consumer Advocate. In FY 2014, the Commission forwarded 760 such inquiries. The order also requires the Postal Service to file a monthly report summarizing the general nature of these inquiries. The reports are available on the Commission’s website.

INQUIRIES BY LOCATION

The Postal Service’s geographic landscape is divided into seven Area offices and 67 District offices. In FY 2014, the number of comments and inquiries received was consistent with previous years. Table II-2 shows the FY 2014 breakdown by Area office, top issues raised, and total number received.

Table II-2. Comments and Inquiries by Area Office

Area Office	Top Issues					Total Received FY 2014*
	Missing	Undelivered	Delayed	Rudeness	Misdelivered	
Northeast	164	383	173	79	170	1,510
Southern	115	190	208	58	212	1,297
Capital Metro	115	164	140	36	140	1,039
Eastern	100	181	164	36	139	1,022
Pacific	106	160	136	33	142	963
Western	79	131	138	37	125	934
Great Lakes	58	189	169	28	93	871

*Totals may be lower due to missing, unavailable, or unknown information.

INQUIRIES BY ISSUE

As in past years, the predominant types of inquiries the Commission received from business owners were undelivered mail (mail not being delivered), delayed mail (mail not being picked up by the carrier, or being delivered late in the day or after close of business), and return-to-sender (mail being returned to the sender in error). Of the 151 inquiries from Postal Service employees, 49 reported concerns with delayed mail, specifically in areas with plant consolidations.

Service continues to be the highest inquiry category. The Commission received 8,053 inquiries regarding delivery service. There were 685 service-related inquiries regarding the carrier not making an initial attempt to deliver a package; 671 reports of mail not being delivered to residences; 624 reports of mail being misdelivered or delivered to nearby addresses; 1,099 reports of packages delayed or missing in the mail; and 255 reports of mail not being forwarded. There were 480 inquiries regarding employee behavior, including 378 reports of rudeness by Postal Service employees. In Quarter 2, there was an increase in undelivered mail due to weather-related suspensions in service. Table II-3 shows inquiries categorized by issue for FY 2014.

Table II-3. Comments and Inquiries by Issue

Issue	FY 2014	FY 2013	FY 2012	FY 2011	FY 2010	FY 2009
Undelivered mail	1,651	520	137	107	71	16
Delayed mail	1,513	469	94	89	39	24
Misdelivered mail	1,192	393	76	51	52	15
Missing mail	1,023	601	211	159	129	38
Return-to-sender	410	139	64	47	22	8
Rudeness	378	207	43	21	22	8

Modernized Website

In FY 2014, the Commission continued its effort to audit and modernize its external website to ensure the content of Commission and Postal Service operations is accessible and transparent to all stakeholders. The project is expected to be completed in early 2015. The site's main features will include:

- A “Consumer Assistance” button to make it easier for the general public to locate information
- An “Active Cases” section with all the open cases before the Commission
- A “How to Participate” tab that provides consumers with information about how to participate in Commission hearings and other activities
- Intuitive menu options that simplify the manner in which stakeholders access information
- Improved access to documents

Office of the Secretary and Administration

The Office of the Secretary and Administration provides financial and records management, organizational support, planning, and human capital resources to ensure that the Commission has the physical, financial, information technology, and human capital infrastructures needed to accomplish its mission. Administrative staff identifies and proposes process improvements, implements strategic plans, and provides support to ensure the success of the Commission's mission.

The Commission is committed to enhancing a system that fosters recruitment, development, and retention of a talented, skilled, diverse, and adaptable workforce as part of its Human Capital Plan within the 2012–2016 *Strategic Plan*. In line with the president's guidance, the Commission continued to support its Flexible Work Program to include alternate work schedules and telework opportunities. During FY 2014, 66 percent of those eligible participated. Furthermore, there were no accidents, on-the-job injuries, or resultant lost workdays in FY 2014.

Employee Engagement

In FY 2014, the Commission again participated in the Federal Employee Viewpoint Survey. The Commission is committed to developing strategic action plans based on the survey results.

The Commission's response rate (66 percent) was higher than the government-wide rate (59 percent). Compared with responses in six indices from staff at other small Federal agencies, Commission staff had a higher degree of satisfaction and a more positive view of their work and office environment. Table II-4 shows these results.

Table II-4. FY 2014 Federal Employee Viewpoint Survey Scores

Index	Commission Response (%)	All Small Agencies' Response (%)
Leadership and Knowledge Management	71	59
Results-Oriented Performance Culture	62	56
Talent Management	64	59
Employee Engagement	69	65
Diversity and Inclusion	62	58
Global Satisfaction	61	59

Over the last several years, the Commission has successfully managed a rapidly increasing workload within a challenging budgetary climate. In response to these challenges, it has designed programs for training and professional development directed at employee engagement and retention.

Training

This year, the Commission ensured that employees were in compliance with mandatory training requirements in areas such as cybersecurity, the Hatch Act, ethics, and travel card usage.

Equal Employment Opportunity

During FY 2014, the Commission had no formal Equal Employment Opportunity complaint filings. To sustain its commitment to maintain a diverse and competent workforce, the Commission requires all staff to complete annual training about Equal Employment Opportunity and the Notification and Federal Employee Antidiscrimination and Retaliation Act of 2002.

Diversity

In FY 2014, the Commission continued its commitment to support initiatives to recruit, develop, and retain a skilled, high-achieving, and diverse workforce. Women and minorities account for 66 percent and 35 percent of the workforce, respectively. Women fill 41 percent of the Commission's executive positions; minorities fill 8 percent.

The Commission provides internship opportunities to aid the recruitment and development of professionals with diverse backgrounds. It will continue to monitor and offer opportunities to increase diversity, including the use of formal recruitment channels such as local universities, veterans' groups, and other organizations and groups that target under-represented populations.

Transparency and Open Government

The Commission continued its commitment to transparency, accountability, and its compliance with the Freedom of Information Act. In FY 2014, it enhanced network, website, and security measures, receiving a favorable review in the Department of Justice's FY 2014 *Assessment of Agency Progress*.

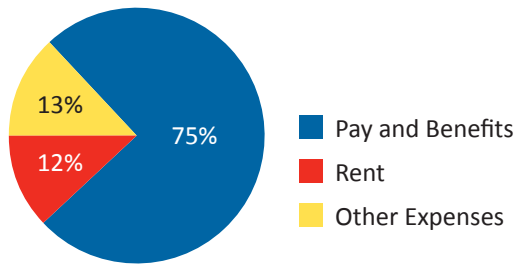
As part of its mission of ensuring transparency, accountability, and openness, the Commission continued to provide live audiocasts of hearings, technical conferences, and public meetings. These are available on the Commission's website, www.prc.gov.

Budget and Finance

The Commission's appropriation of \$14,152,000 was obligated to maintain staffing levels of 75 full-time employees and for operating expenses. This figure includes the 2 percent across-the-board cut for all Federal agencies for FY 2014 required by the Office of Management and Budget. The Commission's FY 2014 budget is set up so the majority of funds are allocated to staff pay and benefits (\$10,587,145). A significantly smaller amount (\$3,564,855) is used for operating expenses.

Figure II-2 shows the Commission's FY 2014 budget expenditures. Rent includes commercial office space, and "other expenses" includes consulting services, office supplies, information technology, and printing.

Figure II-2. The Commission’s Annual Budget Expenditures



In response to the 2009 presidential memorandum regarding government contracting, and in line with Executive Order 13576, “Delivering an Efficient, Effective, and Accountable Government” (2011), the Commission continued to improve its contracting policy and standard operating procedures, resulting in increased accountability and cost savings. The Commission continues to work within budget, improving accounting and contracting processes so they are more cost-effective and efficient. Furthermore, the Commission has successfully partnered with women and minority-owned businesses.

Information Technology

Improvements to the Commission’s docket infrastructure are nearly complete. The new system will optimize public access and ease of use, and maintain the integrity of Commission records. Building on last year’s infrastructure update, the Commission converted employees to virtual desktops and upgraded phone and Internet systems. These initiatives have increased the Commission’s cybersecurity posture and are providing employees a smooth work interface. The Commission is also on schedule to launch its new website in early FY 2015. It will be

more user-focused and -friendly, and address accessibility issues. All of these information technology improvements continue the Commission’s commitment to openness and transparency.

Dockets and Records Management

In FY 2014, the Dockets section completed a thorough review of internal and external access to protected materials. All internal users were notified of new procedures governing access to these materials.

Records management team members have continued to receive training under the guidance of the National Archives and Records Administration, which approved a revised Commission records schedule. During a records management evaluation in FY 2014, the Commission received good ratings and sound guidance for proceeding with and expanding its records management program. In consultation with the National Archives and Records Administration, the Commission completed a comprehensive inventory of its records and began updating key material such as file plans and a records management manual.



Public Representative Program

The Commission is one of the few regulatory agencies that is required by statute to designate an “officer of the Commission” to represent the interests of the general public in all public proceedings. These officers are known as public representatives. The Commission’s Public Representative program provides public representatives with relevant training, resource assistance, and strategic feedback to maximize their role of representing the interests of the general public on issues ranging from Post Office closings to the Postal Service Nature of Service changes.


This fiscal year, public representatives filed comments in nearly 150 dockets.

These comments were carefully reasoned analyses and cogent arguments, and covered issues such as:

- The continued importance of traditional post in rural and remote areas, despite the expansion of the Internet (CP2013-75/MC2013-57)
- The legitimacy and longevity of an exigency rate increase (R2013-11)
- The examination of a proposed Load Leveling Plan (N2014-1)
- The potential economic benefit to welcoming innovative product ideas that originate outside the Postal Service (MC2013-60)

The Commission often cites the public representatives’ comments in its final orders, a reflection of the important role that these individuals play in Commission deliberations.





Chapter III. Effectiveness of Commission Rules to Achieve PAEA Objectives

Summary

The Commission is required by 39 U.S.C. § 3651 to submit an annual report to the president and the Congress that includes an analysis of “the extent to which regulations are achieving the objectives under sections 3622 and 3633” of the PAEA.

The objectives applicable to Market Dominant products are:

1. Maximize incentives to reduce costs and increase efficiency
2. Create predictability and stability in rates
3. Maintain high-quality service standards established under section 3691
4. Allow the Postal Service pricing flexibility
5. Assure adequate revenues, including retained earnings, to maintain financial stability
6. Reduce the administrative burden and increase the transparency of the ratemaking process
7. Enhance mail security and deter terrorism
8. Establish and maintain a just and reasonable schedule for rates and classifications; however, the objective under this paragraph shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail
9. Allocate the total institutional costs of the Postal Service appropriately between Market Dominant and Competitive products

Section 3622(b) establishes a tension between the restrictions of an inflation-based price cap on Market Dominant rate increases and the objective that the Postal Service must be self-sufficient and maintain financial stability. Furthermore, though the PAEA provides incentives via the price cap to reduce costs and increase efficiency, it also imposes new personnel-related expenses requiring the pre-funding of future healthcare costs for Postal Service retirees.

For Competitive products, the requirements of section 3633 are:

1. Prohibit the subsidization of Competitive products by Market Dominant products
2. Ensure that each Competitive product covers its attributable costs
3. Ensure that all Competitive products collectively cover what the Commission determines to be an appropriate share of the institutional costs of the Postal Service

The Commission's rules for applying the price cap and the application of those rules help to achieve several objectives of the PAEA. Enforcing the limitation that rates for each class of mail do not exceed inflation, for example, incentivizes the Postal Service to reduce costs and increase efficiency (objective 1). This year the Commission issued an advisory report on a Postal Service proposal to increase efficiency through load leveling.

The Commission also applies the price cap at the class level. Within each class, there are very few restrictions on the prices the Postal Service sets. This helps advance pricing flexibility (objective 4).

The Commission's rules for reviewing market tests and NSAs facilitate Postal Service implementation of these innovative uses of pricing flexibility. Refining the rules to clarify how the price cap is applied to a greater variety of potential circumstances and pricing innovations increases the transparency of the ratemaking process (objective 6) and the predictability of rates (objective 2). By balancing the tension between these objectives, the Commission's rules and procedures help maintain a just and reasonable schedule for rates and classifications (objective 8).

This year the Commission approved, with modification, the first application of a rate increase in excess of the consumer price index (CPI) price cap due to extraordinary or exceptional circumstances (*i.e.*, an exigent rate increase). The Commission found that a temporary increase above the price cap was necessary due to the negative financial impact of the Great Recession. Facilitating a rate increase to offset this impact helps assure adequate revenues to maintain financial stability (objective 5). The Commission's development of rules for market tests, and the review and approval of NSAs, also helped achieve this objective.

Each year, the Commission analyzes the Postal Service's rates and service and reports its findings in the ACD. In FY 2014, it issued separate, expanded reports that focused on the Postal Service's financial results and its *Performance Plan* under sections 2803 and 2804 of the PAEA. Publishing the information in these reports reduced the administrative burden and increased the transparency of the ratemaking process (objective 6). By reviewing

the Postal Service's *Performance Plan* and service performance, the Commission helps to maintain high-quality service standards (objective 3). Furthermore, the Commission's rules for reviewing potential changes to the methods underlying the development of data the Postal Service reports help ensure accuracy and reliability. Accurate, reliable cost estimates are essential to appropriately allocating the total institutional costs of the Postal Service between Market Dominant and Competitive products (objective 9). This year, the Commission sponsored a study by CMPW Partnership to examine the behavior of institutional costs. An improved understanding of these costs will also help to achieve the objective.

The Commission did not develop any rules or review any cases in FY 2014 with a direct effect on mail security or terrorism (objective 7).

The remainder of this chapter discusses how individual cases in FY 2014 relate to relevant objectives.

Market Dominant Cases

During FY 2014, the Commission approved Postal Service requests for changes in postal rates and classifications. The Commission also approved price reductions associated with promotional rates. This year, the Postal Service requested a rate increase in excess of the annual CPI limitation, as allowed where necessary under extraordinary or exceptional circumstances. The Commission approved this request, but modified it by limiting the duration of the above-CPI rates. The Commission also approved

the implementation of several new rates and adopted modifications to the rules governing the application of the price cap.

Notice of Increase for Rates of General Applicability

In FY 2014, the allowable annual increase for rates of general applicability under the CPI for all urban consumers price cap was 1.696 percent.¹ The Postal Service proposed increasing prices for rate categories of each class of mail by different percentages, exercising its pricing flexibility while staying within the overall class-level price cap.²

To advance the objectives of allowing pricing flexibility and assuring adequate revenue, Commission rules in Title 39 of the Code of Federal Regulations (C.F.R.), section 3010.23, allow the calculation of the CPI rate cap to include price reductions associated with rate incentives.³ This gives the Postal Service an incentive to use promotions to maintain or increase volume.

The Commission approved all eight rate promotions and one incentive filed with the Postal Service's notice of price adjustment.⁴ Five of the eight promotions were included in the price cap calculation: Branded Color Mobile Technology; Emerging

¹ Docket No. R2013-10, Notice of Market Dominant Price Adjustment, September 26, 2013, at 2 (Order No. 1842).

² *Id.* at 5.

³ Docket No. RM2013-2, Order Adopting Final Rules for Determining and Applying the Maximum Amount of Rate Adjustments, July 23, 2013, at 3 (Order No. 1786); *see also* Docket No. RM2014-3, Order Adopting Final Rules on the Treatment of Rate Incentives and *De Minimis* Rate Increases for Price Cap Purposes, June 3, 2014 (Order No. 2086).

⁴ Docket No. R2013-10, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 21, 2013, at 53-61, 75-77 (Order No. 1890).

Technology Featuring NFC [near field communication]; Mail Drives Mobile Commerce; Earned Value Reply Mail; and Mail and Digital Personalization.⁵ The Postal Service chose not to include the other three promotions (Premium Advertising, Color Print in First-Class Mail Transactions, and the Every Door Direct Mail Coupon program) or the Saturation and High-Density incentive in the price cap calculation.

The PAEA gives the Postal Service broad discretion in the use of pricing flexibility, subject to only a few restrictions. It limits the Postal Service's pricing flexibility in objective, quantitative, and mandatory terms in three areas:

1. Prices for each class are capped at CPI [section 3622(d)].
2. Workshare discounts are limited to avoided costs [section 3622(e)].
3. Preferred category revenues are restricted to specified percentages of corresponding regular-rate category revenues (section 3626).⁶

As it does for each Market Dominant rate adjustment, the Commission evaluated the Postal Service's proposal for compliance with these restrictions.

The Commission found that, absent plans to require certain mail to comply with Full-Service Intelligent Mail barcode (IMb) requirements, the planned

rates did not violate the price cap.⁷ However, the Postal Service's proposal to implement Full-Service IMb requirements in conjunction with rate increases would violate the price cap limitation for First-Class Mail, Standard Mail, and Periodicals.⁸ The Commission concluded that the Full-Service IMb requirements constituted a classification change resulting in the deletion or redefinition of rate cells, and that the effects must be included in the price cap calculation.

The simultaneous implementation of these changes would have caused rates to increase by more than the CPI rate authority of 1.696 percent.⁹ Therefore, the Postal Service could not implement the Full-Service IMb requirements contemporaneously with the proposed rates without adjusting the rates to comply with the price cap. The Postal Service elected to defer implementation of these IMb requirements until after 2014.¹⁰

The Commission also determined that the unequal commercial and nonprofit discounts for Standard Mail 5-digit Automation flats violated the requirement that disparities between these discounts must be justified by a statutory exception.¹¹ On remand, the Postal Service equalized the commercial and nonprofit discounts by decreasing the commercial discount to 9 cents¹²; the modified discount raised the average price increase of the Standard Mail Flats product to 2.078 percent.¹³

⁵ The Postal Service proposed to exclude Branded Color Mobile Technology, Mail and Digital Personalization, and Earned Value Reply Mail volumes and rates, as well as the effects of discontinuing eligibility of First-Class Mail for the Emerging Technology Featuring NFC promotion from the price cap calculation. Consistent with previous practice and to ensure that the Postal Service is held accountable for future price cap effects of termination of the promotions, the Commission found that they must be included in the price cap calculation. *Id.* at 57-61.

⁶ Docket No. RM2009-3, Order Adopting Analytical Principles Regarding Workshare Discount Methodology, September 14, 2010, at 18 (Order No. 536).

⁷ Order No. 1890 at 1-2.

⁸ *Id.* at 2.

⁹ *Id.*

¹⁰ Docket No. R2013-10, Response of the United States Postal Service to Order No. 1890, November 29, 2012, at 2 (Postal Service Response to Order No. 1890).

¹¹ Order No. 1890 at 2-3.

¹² Postal Service Response to Order No. 1890 at 2.

¹³ *Id.* at 4.

The Postal Service’s pricing flexibility is also subject to restrictions on workshare discounts—reduced rates for mail prepared or entered to avoid certain activities the Postal Service would otherwise have to perform. These discounts are based on estimates of costs that the Postal Service avoids because mailers perform the activity.

The Commission, informed by 39 U.S.C. 3622(e)(2), ensures that workshare discounts do not exceed the costs the Postal Service avoids unless an exception is met. This provision effectively limits the Postal Service’s ability to set worksharing discounts that exceed 100 percent of avoided costs, except where unusual circumstances justify it. Those exceptions are:

- The discount is associated with a new Postal Service or workshare initiative and will be phased out over time.
- It is necessary to avoid rate shock and will be phased out over time.
- The discount is provided in connection with subclasses of mail exclusively of educational, cultural, scientific, or informational value.
- Reduction or elimination of the discount would impede the efficient operation of the Postal Service.
- If reducing the discount would lead to volume losses large enough to reduce aggregate contribution from the discounted categories.
- If reducing the discount would result in further rate increases for mailers not able to take advantage of the discount.

To date, Commission rules have been effective in balancing the Postal Service’s pricing flexibility with the statutory requirements for worksharing discounts. The Commission has accomplished this by adjusting discounts, reviewing the Postal Service’s justification for its exceptions, or, in some cases, initiating rulemakings intended to clarify worksharing relationships.

Notice of Exigent Price Increase

On September 26, 2013, the Postal Service filed a request for a rate adjustment due to extraordinary or exceptional circumstances in accordance with 39 U.S.C. § 3622(d)(1)(E).¹⁴ It proposed a rate increase of approximately 4.3 percent above the CPI price cap for Market Dominant products.¹⁵ The Postal Service filed testimony of three witnesses who explained why the request satisfied the requirements of the statute and relevant regulations.

On September 30, 2013, the Commission issued an order providing public notice of the request, setting a procedural schedule, inviting comments and reply comments from interested persons, and appointing a public representative.¹⁶ To clarify the Docket No. R2010-4R Request, the presiding officer issued 12 information requests. Technical conferences with the Postal Service’s witnesses were held on October 24, October 31, and November 1, 2013;¹⁷

¹⁴ Docket No. R2010-4R, Renewed Exigent Request of the United States Postal Service in Response to Commission Order No. 1059, September 26, 2013 (Docket No. R2010-4R Request).

¹⁵ *Id.* at 1-2.

¹⁶ Docket No. R2013-11, Notice and Order Concerning Exigent Request, September 30, 2013 (Order No. 1847).

¹⁷ *Id.* at 7-8, Attachment.



the Commission conducted a public hearing on November 19 and 20, during which it questioned the Postal Service's witnesses.¹⁸ Following the hearing, the Commission received 17 comments and 11 reply comments.

On December 24, 2013, the Commission issued Order No. 1926, which found that mail volume declined by 25.3 billion pieces due to the Great Recession.¹⁹ The Commission concluded that the Postal Service was entitled to collect \$2.8 billion in 2014 after-rates contribution to compensate for the contribution lost as a result of this decline.²⁰ It also found that the Postal Service met its

burden to show the rate adjustment was reasonable, equitable, and necessary in accordance with the requirements of 39 U.S.C. § 3622(d)(1)(E).²¹ The Commission held that the increased rates could not be collected indefinitely and directed the Postal Service to present a plan to treat the increased rates as a surcharge, to be removed when it had collected the amount the Commission allowed.²² To ensure this amount is monitored and to prevent over-collection, the Commission ordered the Postal Service to file quarterly revenue collection reports and submit a plan to remove the surcharge when the lost contribution is recovered.²³

¹⁸ *Id.* at 6-7, Attachment.

¹⁹ Docket No. R2013-11, Order Granting Exigent Price Increase, December 24, 2013, at 2 (Order No. 1926).

²⁰ *Id.*

²¹ *Id.* at 3.

²² *Id.* at 170.

²³ *Id.* at 185.

Figures III-1 through III-4 illustrate how the Postal Service used pricing flexibility in the FY 2013 rate adjustments and the addition of the exigent surcharge. The green lines represent the overall percentage available at the class level under the CPI for all urban consumers rate cap. The Postal Service exercised its pricing flexibility by applying different percentage increases to products while staying within the overall class-level price cap; the blue columns represent these increases. The red columns represent the exigent surcharge, which is in addition to the rate increases under the price cap.

Figure III-1. First-Class Mail

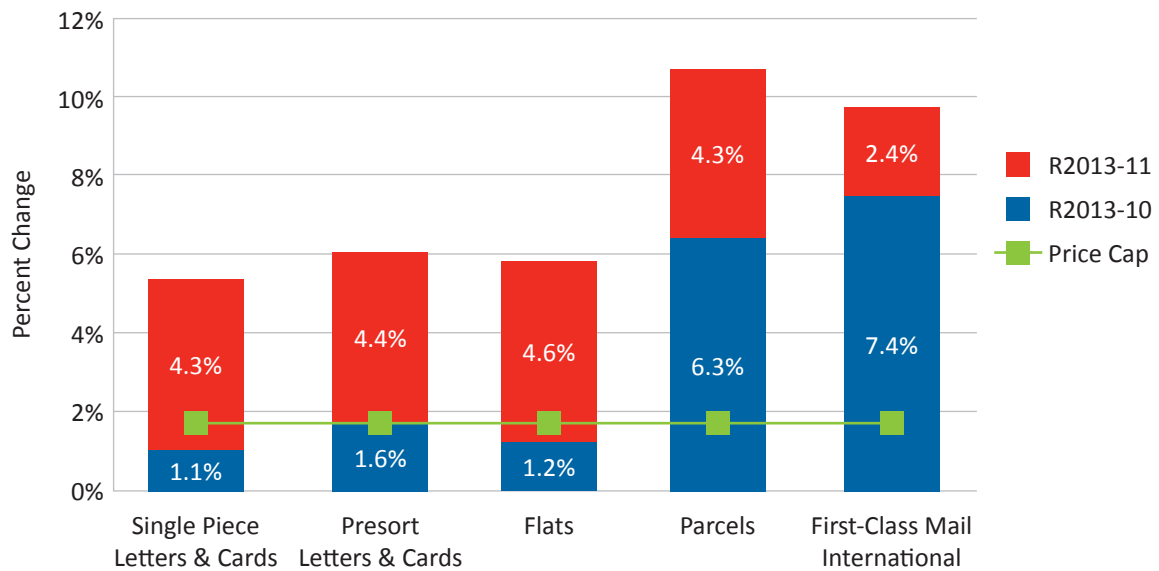


Figure III-2. Periodicals

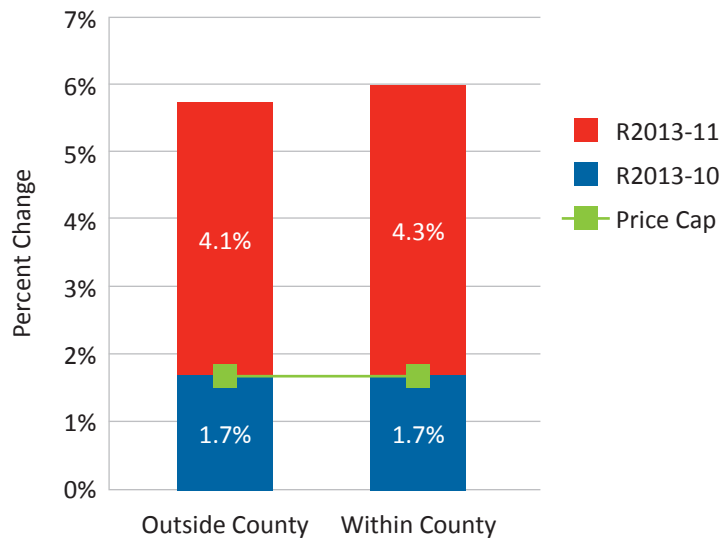


Figure III-3. Standard Mail

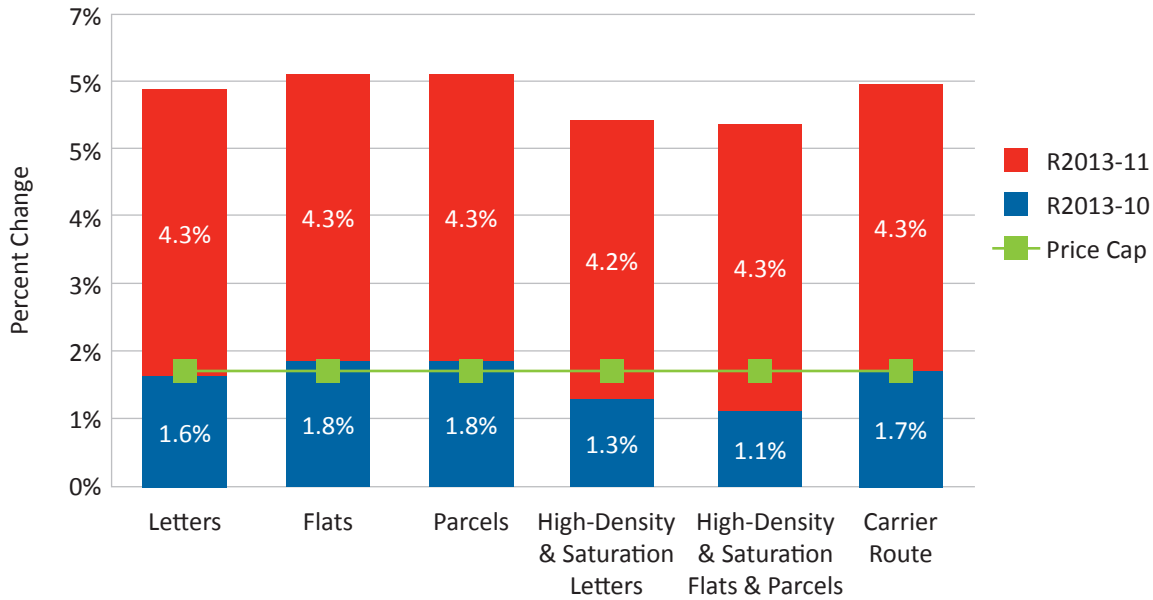
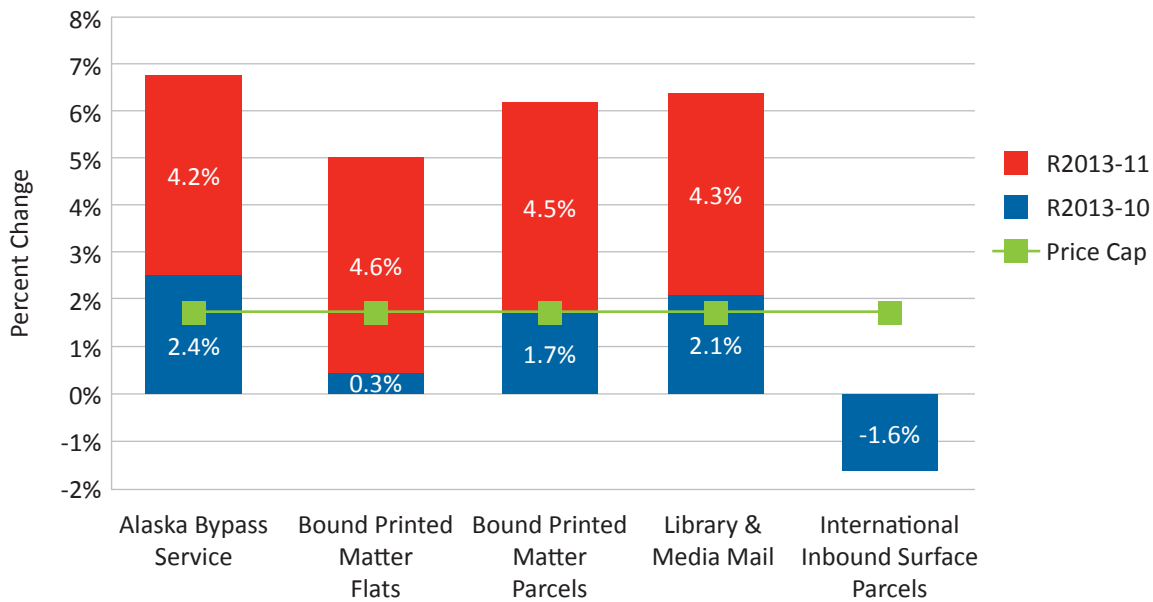


Figure III-4. Package Services



On January 23, 2014, the Postal Service petitioned the United States Court of Appeals for the District of Columbia Circuit for review of Order No. 1926.²⁴ The same day, a coalition of 17 mailers and mailing-related associations also petitioned for review of the order.

On September 9, 2014, a three-judge panel held oral arguments on the petitions for review, which are still pending before the court.²⁵

²⁴ Case No. 14-1010, *United States Postal Service v. Postal Regulatory Commission*, January 23, 2014.

²⁵ See United States Court of Appeals for the District of Columbia Circuit's current oral argument calendar, Case No. 14-1009, *Alliance of Nonprofit Mailers v. PRC*, September 9, 2014.

PHI Negotiated Service Agreement

On June 19, 2014, the Commission approved the addition of the PHI Acquisitions, Inc. NSA to the Market Dominant product list.²⁶ An example of the Postal Service exercising pricing flexibility afforded by the PAEA, it is designed to generate additional revenue that will help maintain financial stability.

The NSA went into effect on July 1, 2014, and will end in 5 years.²⁷ It is designed to increase the total contribution the Postal Service receives from PHI Standard Mail Carrier Route flats by offering rebates on any volume of that product that exceeds a negotiated threshold specified in the NSA. In the first year of the agreement, eligible volume up to 10 percent above the quarterly threshold receives a 10 percent rebate from published rates; eligible volume between 10.01 percent and 18 percent receives a 15 percent rebate; and eligible volume more than 18 percent receives a 20 percent rebate.²⁸ In each subsequent year of the agreement, the quarterly thresholds are adjusted based on PHI's volume of Standard Mail Carrier Route flats in the previous year.

Based on its review, the Commission concluded that the NSA was consistent with the relevant statutory criteria and regulatory requirements of 39 U.S.C. § 3622(c)(10) and 39 C.F.R. § 3010.40(a) and (b).

²⁶ 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).

²⁷ *Id.* at 4.

²⁸ *Id.* at 44.

Alternate Postage Payment

The Commission approved the Postal Service's proposal to add Alternate Postage Payment, formerly an experimental product, as a new, permanent price category within First-Class Mail, Single-Piece Letters/Postcards.²⁹ The classification and the price adjustment allow mailers to prepay postage, eliminating the need to affix a stamp to First-Class Mail, Single-Piece Letters/Postcards. Customers need only address the mail piece and drop it in a collection box,³⁰ an easy process that is thought will make customers more likely to mail greeting cards and other correspondence.

The Commission found the proposal consistent with the PAEA's objectives and factors.³¹ The new price categories demonstrate mailing flexibility, and Alternate Postage Payment is expected to enhance the Postal Service's financial position and help to cover First-Class Mail attributable costs.³²

Round-Trip Mailer

On July 26, 2013, the Postal Service filed a request to add a new product, Round-Trip Mailer, to the Competitive product list.³³ Submitted in response to the Commission's order on remand in Docket No. C2009-1R, the request features equalized rates for letter-shaped and flat-shaped round-trip DVD mail.³⁴ This

²⁹ Docket No. R2014-1, Notice of Market Dominant Price Adjustment for Alternate Postage Payment Method, December 20, 2013 (Order No. 1917).

³⁰ *Id.* at 6.

³¹ See 39 U.S.C. § 3622(b)(4).

³² See 39 U.S.C. §§ 3622(b)(5), 3622(c)(1) and (2).

³³ Docket No. C2009-1R, Request of the United States Postal Service Under Section 3642 to Create Round-Trip Mailer Product, July 26, 2013, at 2 (Docket No. C2009-1R Request).

³⁴ See Order No. 1763, Docket No. C2009-1R, Order on Remand, June 26, 2013.

product would replace the existing First-Class Mail Round-Trip Mailer options on the Market Dominant product list. The PAEA provides pricing flexibility to transfer products of a competitive nature from the Market Dominant product list to the Competitive product list if the Commission determines that certain criteria have been met.

The Commission established proceedings in Docket Nos. MC2013-57 and CP2014-75 to consider the request³⁵ and has received comments and sworn statements addressing issues it raised. The Commission is reviewing the request to ensure it complies with 39 U.S.C. § 3642 and the Commission's regulations at 39 C.F.R. § 3020.30 et seq. As of the end of FY 2014, the request is pending before the Commission.

Annual Compliance Determination

The ACD is an important tool for enhancing transparency and ensuring the Postal Service complies with statutory pricing and service policies. Pursuant to the PAEA and regulations adopted by the Commission, the Postal Service has 90 days after the close of the fiscal year to collect, audit, and submit its *Annual Compliance Report* (ACR), which provides important data for the Commission's ACD. The Commission then has 90 days to solicit comments from the public, evaluate the data, and prepare the ACD.

On March 27, 2014, the Commission issued its FY 2013 ACD. The seventh ACD since the PAEA was enacted, it differed from its predecessors in that it focused

exclusively on 39 U.S.C. § 3653(b)(1) and (b)(2), which require the Commission to determine whether any rates and fees in effect during FY 2013 were not in compliance with applicable provisions in chapter 36 of the statute, and whether the Postal Service met its service standards in effect during FY 2013.

To further enhance transparency, the Commission issued two additional reports during FY 2014: *Analysis of Postal Service Financial Results and 10-K Statement* and the *Review of Postal Service FY 2013 Performance Report and FY 2014 Performance Plan*. The content of these reports used to be included in the ACD, but the Commission decided to separate them to provide a more comprehensive review of the Postal Service's finances and performance goals.

In the FY 2013 ACD, the Commission recognized Postal Service improvement in several important areas. It observed that Competitive products achieved a higher overall cost coverage and provided a larger contribution to institutional costs than in FY 2012. The Commission also noted that the Periodicals class and the Standard Mail Flats product reduced losses and improved cost coverage compared with FY 2012. These improvements are responsive to the Commission's recommendations and directives to improve the financial results of these products.³⁶ In addition, the Commission found that through Postal Service efforts, an increasing number of mail pieces used the Full-Service IMb. The Commission has consistently encouraged increased use of the Full-Service IMb as a means of producing a more robust service performance measurement.

³⁵ Docket Nos. C2009-1R, MC2013-57, and CP2013-75, Notice and Order on Request to Add Round-Trip Mailer Product to Competitive Product List, July 30, 2013 (Order No. 1794).

³⁶ See, e.g., 2010 ACD at 94 and 106-07.

In reviewing Market Dominant products for compliance with the statutory pricing policies, the Commission found 18 of 42 workshare discounts did not comply with the requirement of 39 U.S.C. § 3622(e) that price discounts not exceed costs avoided. The Commission also identified nine Market Dominant products that did not generate sufficient revenues to cover their attributable costs. Of those products, Standard Mail Flats, and Within County and Outside County Periodicals, were of recurring concern.

For Standard Mail Flats, the Commission determined that Postal Service progress toward addressing issues raised in previous ACDs warranted no further remedial action. For Periodicals, the Commission instructed the Postal Service to provide a detailed analysis of progress made toward improving cost coverage in its FY 2014 ACR. This analysis will include an examination of how pricing flexibility was used to improve efficiency and the progress toward and impact of implementing the operational strategies outlined in the Periodicals Mail Study.³⁷

Though Competitive products as a whole generated a profit, the Commission identified four products that did not cover their attributable costs and, therefore, were not in compliance with 39 U.S.C. § 3633(a)(2): Parcel Return Service Contract 4, International Priority Air Mail, Inbound Air Parcel Post (at non-UPU rates), and International Money Transfer Service-Outbound. The Commission directed the Postal Service to take corrective actions.

With respect to FY 2013 service performance, the Commission found

that the Postal Service met its targets for First-Class Mail, Single Piece Letters/Postcards. Despite significant improvement during the year, however, a majority of Market Dominant products did not meet their annual targets. The Commission also observed that comparison of FY 2013 reported service performance with prior years was complicated by the Postal Service's implementation of new service standards for several classes of mail during the year.

Review of Postal Service Performance Reports

On July 7, 2014, the Commission issued its *Review of Postal Service FY 2013 Performance Report and FY 2014 Performance Plan*. This report evaluated whether the Postal Service had met the performance goals in its FY 2013 *Performance Report* and reviewed the initiatives and targets established in the FY 2014 *Performance Plan*. In previous years, the Commission included this report as a chapter in its ACD; in FY 2014, it produced an expanded, stand-alone report to provide a more comprehensive review of the Postal Service's performance goals.

The Commission concluded that the Postal Service partially met the Service, Financial Results, and Workplace Environment performance goals, but did not meet the Customer Service goal. It found that the FY 2013 *Performance Report* and FY 2014 *Performance Plan* satisfied all applicable statutory and regulatory filing requirements for each performance goal except for covering each program activity set forth in the Postal Service budget. The Commission also provided recommendations for the

³⁷ Periodicals Mail Study, Joint Report of the United States Postal Service and the Postal Regulatory Commission, September 2011.

FY 2014 *Performance Report* and FY 2015 *Performance Plan*, such as suggesting that the Postal Service explore why a significant percentage of large business survey respondents did not meet its definition of “large business.”

Standard Mail Load Leveling

In its Docket No. N2014-1, the Commission issued its Advisory Opinion on the Postal Service’s proposed destination sectional center facility (DSCF)³⁸ Standard Mail Load Leveling Plan on March 26, 2014.³⁹ The Postal Service proposed that plan to facilitate workload equalization throughout the week for processing and delivery of DSCF-entered Standard Mail. Load leveling would be accomplished by changing the 3-day service standard to 4 days for DSCF Standard Mail entered after critical entry times on Thursdays and before them on Saturdays.

The Commission found that the Postal Service’s DSCF Load Leveling Plan may provide a means of leveling DSCF Standard Mail daily delivery volumes. However, limited testing appeared to be inconclusive regarding the plan’s nationwide effects.⁴⁰ The Commission, observing that the plan needed further development, recommended the Postal Service take certain actions before proceeding, including:

- Performing a cost-benefit analysis at the national level to ensure the plan is cost effective while providing the anticipated benefits⁴¹

- Assessing the plan’s impact on volume and co-mailing/co-palletization activities⁴²
- Performing additional field testing because the results of the limited field testing may not be representative at the national level⁴³
- Further analysis of the plan’s effect on service performance⁴⁴
- Conducting more extensive customer outreach to obtain a clearer understanding of mailers’ questions and concerns⁴⁵

Market Dominant Rulemakings

There were four key FY 2014 Market Dominant rulemakings.

Clarifying Price Cap Calculations

The Commission finalized rule changes relating to the price cap on June 3, 2014.⁴⁶ The changes clarify the rules for rate decreases, the treatment of deleting rate cells for which no alternative rate is available, and allow for *de minimis* rate increases without triggering a full price cap proceeding. These rules are intended to increase transparency in the ratemaking process and ensure predictability, stability, and a just and reasonable rate schedule.

The rule changes reflect efforts for clarifying the treatment of a rate decrease by means of a Type 1-C rate

³⁸ A DSCF is a mail processing facility where final sortation of mail occurs before it is dispatched to the delivery unit.

³⁹ Docket No. N2014-1, Advisory Opinion on Service Changes Associated with Standard Mail Load Leveling, March 26, 2014 (Docket No. N2014-1 Advisory Opinion).

⁴⁰ *Id.* at 1, 22, 30.

⁴¹ *Id.* at 1-2, 31-36, 38.

⁴² *Id.* at 2, 27-29, 31-38.

⁴³ *Id.* at 1-2, 31-38.

⁴⁴ *Id.* at 53.

⁴⁵ *Id.* at 50-52.

⁴⁶ See Order No. 2086.

adjustment—an adjustment to a rate of general applicability that contains only a decrease. The Postal Service is not required to calculate an annual limitation for this type of adjustment, but it must choose whether or not it will generate unused rate adjustment authority at the time of filing.⁴⁷

The Commission defined a “rate of general applicability” to help mailers better understand which promotions and incentives may be included in the price cap calculations.⁴⁸ In the proceeding, the Commission provided a detailed discussion of the definition’s application to international mail, volume-based incentives, niche classifications, rates that require “ministerial approval” by the Postal Service, and particular rates identified by the parties. The Commission found that the proposed definition accurately summarized its previous treatment of rates proposed by the Postal Service. In order to clarify the application of the definition for international mail, the Commission modified it to include references to the *International Mail Manual* and foreign postal operators.⁴⁹

A previous Commission rule, 39 C.F.R. § 3010.23(d), required the Postal Service to make reasonable adjustments to its billing determinants when it proposed a classification change that introduced, deleted, or redefined a rate cell. Under the new rule, if a classification change deletes a rate cell for which an alternate rate cell is not available, the billing determinants should be adjusted to zero.⁵⁰ If the Postal Service does not do so, it must explain how it proposes to treat the rate cell.

⁴⁷ *Id.* at 5. See 39 C.F.R. §§ 3010.6(b), 3010.20(e), 3010.23(b)(2), and 3010.27.

⁴⁸ *Id.* at 12-27. See 39 C.F.R. § 3010.1(g).

⁴⁹ *Id.* at 15-16. See 39 C.F.R. § 3010.1(g).

⁵⁰ *Id.* at 29. See 39 C.F.R. § 3010.23(d)(4).

The Commission established a *de minimis* rate increase threshold of 0.001 percent.⁵¹ Under the new rules, if the Postal Service wishes to increase rates by less than 0.001 percent, it may do so without triggering a full price cap proceeding.

These rule changes were designed to clarify the Commission’s existing rules and to provide transparency and simplicity for the mail community.

Market Test Rulemakings

On August 28, 2014,⁵² the Commission issued final regulations that established new procedures for Postal Service requests to conduct market tests of experimental products in accordance with 39 U.S.C. § 3641. Taking effect on October 14, 2014, the regulations balance the Commission’s oversight authority for market tests with the Postal Service’s need for flexibility to test new product ideas. The regulations also reflect the lessons learned from past market tests.

The new rules provide increased clarity for the Postal Service, mailers, and the public regarding how such market tests are to be conducted and evaluated under the law. The rules offer the Postal Service the flexibility to conduct market tests of experimental products and to gain valuable experience from them, but also include safeguards to avoid disruptions to the commercial marketplace. The rules also discuss the elements the Postal Service must include in a market test proposal, the Commission’s review process, the revenue and time limitations, the data to be collected from a test,

⁵¹ *Id.* at 32-34. See 39 C.F.R. § 3010.30.

⁵² Docket No. RM2013-5, Order Adopting Final Rules for Market Tests of Experimental Products, August 28, 2014 (Order No. 2173).

and the mechanisms by which the Postal Service can seek to change tests or transition experimental products to permanent products. With such clearly defined procedures, the rules will facilitate the Postal Service's use of pricing flexibility and ensure adequate transparency of market tests.

Price Elasticities and Internet Diversion

On May 2, 2014, the National Postal Policy Council, along with seven other parties, filed a petition requesting the Commission to "initiate and conduct a proceeding to review and improve the econometric volume demand model and associated factors relating to price elasticity estimates and Internet diversion used by the Commission and Postal Service."⁵³ Petitioners claim that the "econometric volume demand model prepared by the Postal Service materially understates the true price elasticities of demand for major postal products."⁵⁴

On May 9, 2014, the Postal Service responded to the petition,⁵⁵ claiming it would serve no useful purpose. It also stated that the petition facts had already been addressed, that approval of demand elasticities were outside the scope of the Commission's authority, and the petition could interfere with another Commission docket now before the Court of Appeals.⁵⁶

⁵³ 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, at 1 (Petition); National Postal Policy Council, Association for Mail Electronic Enhancement, Association of Marketing Service Providers, GrayHair Software, Inc., Greeting Card Association, International Digital Enterprise Alliance, Inc., Major Mailers Association, and National Association of Presort Mailers (Petitioners).

⁵⁴ Petition at 2.

⁵⁵ 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 (Postal Service Answer).

⁵⁶ See Postal Service Answer.

Petitioners responded to the Postal Service's answer on May 19, 2014.⁵⁷

After deliberating the petitioners' claims, the Commission found reason to "explore areas of possible improvement in demand analysis and forecasting" and initiated Docket No. RM2014-5.⁵⁸ In addition, Order No. 2117 scheduled a technical conference, appointed a public representative to act on behalf of the interests of the general public, and invited interested persons to comment on an alternate method attached to the order and matters raised at the conference.⁵⁹

Following the technical conference on August 13, 2014, the Commission received six comments from interested persons. The docket is still pending.

Form and Content of Postal Service Reports to the Commission

The Commission's periodic reporting rules allow the Commission and the public to review changes to analytical principles before the Postal Service applies these principles to estimate its financial results in its ACR.^{60,61} The Commission's rules approach analytical issues through a process that is intended

⁵⁷ Reply in Support of Petition, May 19, 2014 (Petitioners' Reply).

⁵⁸ Docket No. RM2014-5, Notice and Order Scheduling Technical Conference, July 9, 2014, at 5 (Order No. 2117); *id.* at 4.

⁵⁹ *Id.* at 6; Lyudmila Y. Bzhilyanskaya, Margaret M. Cigno, and Edward S. Pearsall, "A Branching AIDS Model for Estimating U.S. Postal Price Elasticities." (Attachment A). The Commission emphasizes that the views expressed in Attachment A are those of its authors and have not been reviewed or endorsed by the Commission or any commissioner. *Id.* at 5.

⁶⁰ Docket No. RM2008-4, Notice of Final Rule Prescribing Form and Content of Periodic Reports, April 16, 2009, at 19. See 39 C.F.R. § 3050.11, Proposals to change an accepted analytical principle applied in the Postal Service's annual periodic reports to the Commission (Order No. 203).

⁶¹ The Commission's rulemaking proceedings conform to the Administrative Procedure Act's "notice and comment" requirements. This means that the Commission issues a notice (or advance notice) of a proposed rulemaking, invites public comments, and issues a final rulemaking following consideration of comments.

to be highly flexible and vary according to the complexity of the proposed change and the level of documentation supporting it.⁶²

In anticipation of filing its FY 2014 ACR, the Postal Service sought consideration of 18 proposals that were primarily improvements to its estimation methodologies and a minor change in the format of its section 3652 report. These were filed between August 2013 and June 2014. The proposals led to a series of rulemakings to change accepted analytical principles applied to the financial data used in the Postal Service's FY 2013 ACR. Because most of these proposed changes are expected to improve the quality, accuracy, and completeness of the financial data or data analysis, the Commission approved them. It also made additional recommendations and requests for information for several proposals, and partially denied a portion of a proposal that did not show improved accuracy.

Commission Rule 3050.11(b)(1) requires the Postal Service to show the calculations it uses to develop the proposed changes and the impact of the analytical changes on individual products. For two FY 2014 proposals, the Postal Service did not provide this information with its initial filing, and the Commission directed it to provide supporting materials with future proposals or in the next ACR, as appropriate.⁶³

Five of the proposed changes in analytical principles the Postal Service initiated responded to directives from the FY 2013 ACD. Three of these proposals responded to directives the Commission issued

because certain Competitive products did not satisfy the section 3633(a) (2) requirement to cover attributable costs.⁶⁴ Another Commission-directed undertaking provided additional explanation of the development of attributable costs for the Competitive P.O. Box Service enhanced services.⁶⁵ The Postal Service also responded to the Commission directive requiring an updated methodology for calculating the attributable costs of products handled by the Services Center.⁶⁶

The remainder of the proposals included initiatives designed to improve the calculation of transportation costs, handling costs, and worksharing savings associated with destination entry discounts.⁶⁷ The proposals affected a variety of products, including Parcel Return Service, Competitive P.O. Boxes, Philatelic Sales, USPS Tracking (née Delivery Confirmation), and several international products, including NSAs. In addition, the Commission approved a proposal to eliminate the requirement for the Postal Service to provide an alternate format *Cost and Revenue Analysis* report, designed to facilitate comparisons with pre-PAEA classifications. The usefulness of this as an analytical tool has substantially diminished and is no longer relevant.

⁶² Docket No. RM2008-4, Notice of Proposed Rulemaking Prescribing Form and Content of Periodic Reports, August 22, 2008, at 31 (Order No. 104).

⁶³ Docket No. RM2014-4, Order on Analytical Principles Used in Periodical Reporting (Proposals One and Two), June 25, 2014, at 6, 9 (Order No. 2101).

⁶⁴ Parcel Return Service Full Network NSA, International Priority Airmail, and Global Plus 2B and 2C products did not cover their attributable costs.

⁶⁵ The Commission noted that the Postal Service did not show how it developed the total estimate for the information technology costs. FY 2012 ACD at 163; 39 C.F.R. § 3050.11(b) (1). If the notice of proceeding or petition proposes that a specific alternative analytical principle should be followed, it should include the data, analysis, and documentation on which the proposal is based.

⁶⁶ The Commission directive stated that the updated methodology should describe how the costs, revenues, and volumes are attributed to Stamp Fulfillment Services, Philatelic Services, and any other products handled at the Services Center. FY 2012 ACD at 143.

⁶⁷ Destination entry discounts are worksharing discounts provided for dropshipping, when mailers enter mail at downstream facilities that are close to the delivery destination.

Competitive Products

The Commission reviews Competitive product prices to ensure compliance with three statutory criteria:⁶⁸

1. *39 U.S.C. § 3633(a)(1)*. Competitive products must not be cross-subsidized by Market Dominant products. The Commission uses incremental costs to test whether Competitive products are being cross-subsidized; there is no cross-subsidy where the Commission finds that Competitive product revenues as a whole are equal to or exceed total incremental costs.
2. *39 U.S.C. § 3633(a)(2)*. Each Competitive product must cover its attributable costs. In the ACD and in response to a Postal Service notice of change in Competitive product prices, the Commission reviews whether revenues for each Competitive product exceed its attributable costs to determine compliance with this objective.
3. *39 U.S.C. § 3633(a)(3)*. This requires Competitive products to collectively cover an appropriate share of institutional costs. A recent Commission review determined that contribution from Competitive products as a whole must be at least 5.5 percent of the Postal Service's total institutional costs.⁶⁹

Within the constraints of these statutory criteria, Commission rules provide flexibility to the Postal Service to set prices for Competitive products.⁷⁰ For Competitive products featuring rates

“of general applicability” (*i.e.*, products available to the general mailing public), the Commission completes its review within 30 days. For Competitive products featuring rates “not of general applicability” (*i.e.*, products with rates offered only to specific mailers), the Commission completes its review within 15 days.

Changes in Rates of General Applicability

During FY 2014, the Commission reviewed price changes for Competitive products featuring prices of general applicability in four docketed proceedings.

Annual price change for Competitive products. On November 13, 2013, the Postal Service filed notice of its annual change in prices of general applicability for several domestic and international Competitive products.⁷¹ It also proposed changes to the *Mail Classification Schedule* related to some of these products.⁷²

On December 12, 2013, the Commission determined that the Postal Service's proposed price changes satisfied 39 U.S.C. § 3633(a) for all but the International Direct Sacks-Airmail M-bags (Airmail M-bags) product. The new prices and classification changes went into effect on January 26, 2014.

⁷¹ Docket No. CP2014-5, Notice of the United States Postal Service of Changes in Rates of General Applicability for Competitive Products Established in Governors' Decision No. 13-2, November 13, 2013. Order No. 1903, Order Approving Changes in Rates of General Applicability for Competitive Products, December 12, 2013.

⁷² The Postal Service's notice identified price changes for the following Competitive products: Priority Mail Express, Priority Mail, Parcel Select Service, Parcel Return Service, First-Class Package Service, Standard Post, Domestic Extra Services, International Expedited Services, Priority Mail International, International Priority Airmail, International Surface Air Lift, International Direct Sacks-Airmail M-bags, First-Class Package International Service, and International Special Services.

⁶⁸ 39 U.S.C. §§ 3633(a)(1), 3633(a)(2), and 3633(a)(3).

⁶⁹ Docket No. RM2012-3, Order Reviewing Competitive Products' Appropriate Share Contribution to Institutional Costs, August 23, 2012 (Order No. 1449).

⁷⁰ See 39 C.F.R. § 3015.

For Airmail M-bags, the Commission found that revenue from the proposed prices did not cover the product's costs. Recognizing the product's history of covering costs, however, the Commission allowed the proposed prices to take effect. In addition, the decline in revenue, pieces, and pounds supported the Postal Service's suggestion that cost or revenue data for the Airmail M-bag product may be anomalous.⁷³ The Commission also directed the Postal Service to provide no later than May 26, 2014, a report addressing statistical issues resulting in prices that cannot cover costs.⁷⁴ The Postal Service's report, filed on May 23, 2014, determined that Airmail M-bag volumes were under-reported and presented revised financial results showing that the product was expected to cover costs.⁷⁵

Standard Post price change. On February 14, 2014, the Postal Service proposed to add a new price category, Limited Overland Routes, to the Standard Post product.⁷⁶ It proposed this category in response to the Standard Post classification and price changes implemented on January 26, 2014, which had a disproportionate impact on certain Standard Post mailers in Alaska who often send heavier-than-average Standard Post pieces within Zones 1-5. The Limited Overland Routes price category applies only to pieces delivered to or from ZIP Codes in Alaska

not connected by overland routes; therefore, it will affect only a small, discrete number of designated ZIP Codes with low volume.⁷⁷ The proposed prices for this category were set equal to the Standard Post prices on January 27, 2013, the effective date of the omnibus price change.

On March 7, 2014, the Commission approved the new price category; based upon the proposed price, it determined the Standard Post product should continue to avoid cross-subsidization by Market Dominant products and cover its attributable costs as required by 39 U.S.C. § 3633(a).⁷⁸ The prices became effective on March 20, 2014.⁷⁹

Priority Mail price change. On July 1, 2014, the Postal Service filed price changes for the Priority Mail product.⁸⁰ As proposed, the Priority Mail Retail average price increase was 1.7 percent. For Commercial Base and Commercial Plus, the Postal Service proposed average price decreases of 0.9 percent and 2.3 percent, respectively.⁸¹ The overall average price change for Priority Mail was 0 percent. According to the Postal Service, price decreases were focused on ground zones (Zones 1-4) and heavier weights (6-20 pounds) within the Priority Mail product in order to enhance its position in the 6- to 20-pound market for parcels relying on ground transportation.⁸² There were no classification changes.

⁷³ Docket No. CP2014-5, Order Approving Changes in Rates of General Applicability for Competitive Products, December 12, 2013, at 12 (Order No. 1903).

⁷⁴ *Id.* at 13.

⁷⁵ Docket No. CP2014-5, Notice of the United States Postal Service of Filing of Response to Request in Order No. 1903 for Report Concerning Airmail M-bags Cost Coverage, May 23, 2014. The report was filed under seal. Order No. 1903, Order Approving Changes in Rates of General Applicability for Competitive Products, December 12, 2013.

⁷⁶ Docket No. CP2014-27, Order Approving Changes in Rates of General Applicability for Standard Post, March 7, 2014 (Order No. 2012).

⁷⁷ *Id.* at 2.

⁷⁸ *Id.* at 4.

⁷⁹ *Id.* at 1.

⁸⁰ Docket No. CP2014-55, Notice of the United States Postal Service of Changes in Rates of General Applicability for Competitive Products Established in Governors' Decision No. 14-3, July 1, 2014. Order No. 2156, Order Approving Changes in Rates of General Applicability for Priority Mail, August 15, 2014 (Order No. 2156).

⁸¹ Decision of the Governors of the United States Postal Service on Changes in Rates of General Applicability for Competitive Products, June 18, 2014, at 1 (Governors' Decision No. 14-03).

⁸² *Id.*

On August 15, 2014, the Commission approved the changes in rates of general applicability for the Priority Mail product.⁸³ The rates became effective on September 7, 2014.⁸⁴

Price change for Inbound Air Parcel Post (at UPU rates). Pursuant to UPU regulations, the Postal Service (and other UPU member countries) are permitted to implement revised rates for inbound air parcels effective January 1 and July 1 of each calendar year. The revised rates are derived from UPU formulas. Accordingly, on December 30, 2013, and June 26, 2014, the Commission approved revised rates for the Inbound Air Parcel Post (at UPU rates) product.⁸⁵ In both instances, the Commission determined that the UPU established rates were consistent with the statutory criteria of 39 U.S.C. § 3633(a).

Changes in Rates Not of General Applicability: NSAs

During FY 2014, the Commission reviewed competitive NSAs in 76 docketed proceedings. Table III-1 shows these NSAs, as well as those the Commission approved during each of the past six fiscal years.⁸⁶ These NSAs require prior Commission approval for compliance with the statutory criteria.

Table III-1. Competitive NSAs Approved by the Commission

Competitive NSAs	FY 2014	FY 2013	FY 2012	FY 2011	FY 2010	FY 2009
Competitive domestic NSAs	40	52	32	13	13	32
Competitive international NSAs	36	29	22	48	111	34
Total competitive NSAs	76	81	54	61	124	66

The Commission completed its review of each competitive NSA in an average of 13.4 days. Forty of these were Competitive domestic NSAs involving domestic shipping services, including Priority Mail Express, Priority Mail, Parcel Select, Parcel Return Service, and First-Class Package Service. The Commission determined that the negotiated rates for each NSA request complied with 39 U.S.C. § 3633(a).

The remaining 36 were competitive international NSAs. The Commission reviewed these products:

Inbound services:

- International Business Reply Service Competitive Contracts 1
- International Business Reply Service Competitive Contracts 3
- Inbound Direct Entry Contracts with Foreign Postal Administrations

⁸³ Order No. 2156.

⁸⁴ *Id.* at 1, 13.

⁸⁵ Docket No. CP2014-14, Order Accepting Price Changes for Inbound Air Parcel Post (at UPU Rates), December 30, 2013 (Order No. 1936); Docket No. CP2014-52, Order Accepting Price Changes for Inbound Air Parcel Post (at UPU Rates), June 26, 2014 (Order No. 2102).

⁸⁶ Specifically, Table III-1 shows approved NSAs that were filed as new products to be added to the *Mail Classification Schedule* and functionally equivalent to a baseline agreement in a previously approved *Mail Classification Schedule* product.

- Inbound Direct Entry Contracts with Foreign Postal Administrations 1
- Inbound International Expedited Services 2
- Royal Mail Group Inbound Air Parcel Post Agreement
- Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1

Outbound services:

- Global Expedited Package Services 3
- Global Plus 1C
- Global Plus 2C
- Global Reseller Expedited Package Contracts 1
- Global Reseller Expedited Package Contracts 2

In addition, non-published rates (NPR) products authorize the Postal Service to enter into contracts featuring negotiated rates without prior Commission approval. Such NPR contracts must comply with Commission classification and regulatory requirements, including pre-approved pricing formulas, minimum cost coverage, and documentation. The absence of pre-implementation review streamlines the approval process, providing the Postal Service with additional flexibility. The Commission has approved six NPR products since their inception in FY 2011. See Table III-2 below.

- Global Expedited Package Services (GEPS) – NPR 1
- GEPS – NPR 2
- GEPS – NPR 3
- GEPS – NPR 4
- Priority Mail – NPR
- Priority Mail International Regional Rate Boxes – NPR

Table III-2 also shows the number of NPR contracts included in these NPR products.⁸⁷ The Priority Mail – NPR product is the only Competitive domestic NPR product currently in effect; the other five are Competitive international NPR products.

Table III-2. NPR Contracts Implemented by the Postal Service by Product

NPR Products	NPR Contracts			
	FY 2014	FY 2013	FY 2012	FY 2011
GEPS–NPR 1, 2, 3, and 4	124	129	141	168
Priority Mail–NPR	1	2	3	3
Priority Mail International Regional Rate Boxes–NPR	0	0	N/A	N/A
Total	125	131	144	171

⁸⁷ For display purposes, Table III-2 lists all four GEPS-NPR products as a single line item.





Chapter IV. Universal Service Obligation and Postal Monopoly

Background

In this chapter, the Commission provides its annual estimate of the cost of the Universal Service Obligation (USO) and the value of the postal monopoly. The USO is the Postal Service’s “obligation to provide postal services to bind the Nation together through ... the correspondence of the people ... [by providing] prompt, reliable, and efficient services to patrons in all areas and ... postal services to all communities.”⁸⁸ The postal monopoly refers to the exclusive rights of the Postal Service to carry and deliver certain categories of mail and deposit mailable matter in any mailbox.⁸⁹ An estimate of the cost of the USO is required by statute; the value of the postal monopoly is not required. The Commission provides an estimate of both the cost of the USO and the value of the postal monopoly to provide a balanced perspective on the trade-offs between the benefits of a monopoly and the costs of the mandates to provide universal service.

The Commission first estimated the cost of the USO and the value of the postal monopoly in its 2008 *Report on Universal Service and the Postal Monopoly*.⁹⁰ Over time, the Commission has refined its method of calculating the cost of the USO. In its FY 2011 *Annual Report*, the Commission accepted the basic features of the Postal Service’s method to estimate the rural carrier costs of delivering 6 days a week (Six-Day Delivery) rather than 5 days a week in the Docket No. N2010-1 Request.⁹¹ It also provided a more disaggregated method of developing the cost of Six-Day Delivery for city delivery, compared with the method previously used.⁹² In its FY 2012 *Annual Report*, the Commission added the costs of providing Group E Post Office Boxes and losses from Market Dominant package services to the cost of the USO.

⁸⁸ 39 U.S.C. § 101(a); *Report on Universal Postal Service and the Postal Monopoly*, December 19, 2008, at 18 (Report).

⁸⁹ Report at 10 n.1.

⁹⁰ Report.

⁹¹ Docket No. N2010-1, Request of the United States Postal Service for an Advisory Opinion on Changes in the Nature of Postal Services, March 30, 2010 (Docket No. N2010-1 Request).

⁹² FY 2011 *Annual Report to the President and Congress*, December 21, 2011, at 41 (FY 2011 *Annual Report*).

In this chapter, the Commission uses the same basic methodology to estimate the value of the postal monopoly for FY 2013 as it did in previous years. However, it has modified its method of estimating the costs of maintaining Six-Day Delivery. In previous reports, office and street time from the Rural Mail Count was used to update the values provided by the Postal Service in Docket No. N2010-1.⁹³ Upon further review, the Commission has determined that evaluated time should be divided into fixed and attributable time, with savings coming from a reduction in fixed delivery time. It also modified the service-wide factor developed by the Postal Service in Docket No. N2010-1, based on the Commission's determination that indirect costs were slightly lower than those the Postal Service estimated.⁹⁴

Because data for FY 2014 are not yet available, the new estimates rely upon FY 2013 data.

Estimated Cost of the USO

The Commission estimates the cost of the USO by calculating the costs the Postal Service incurs in providing:

- Postal services to areas of the Nation where ... the Postal Service either would not provide services at all or would not provide such services ... if the Postal Service were not required

⁹³ See Docket No. N2010-1 Request.

⁹⁴ See Docket No. N2010-1, Advisory Opinion on Elimination of Saturday Delivery, March 24, 2011, at 67 (Docket No. N2010-1 Advisory Opinion). Annual values of the postal monopoly for previous years may not exactly match the estimates in prior annual reports because of changes in assumptions for several years of cost estimates and updated coding and spreadsheet data.

to provide prompt, reliable, and efficient services to patrons in all areas and all communities ...

- Free or reduced rates for postal services as required by [U.S.C. Title 39]
- Other public services or activities which, in the judgment of the [Commission], would not otherwise have been provided by the Postal Service but for the requirements of law⁹⁵

These can be summarized as:

- Element A: Cost of Providing Services to all Areas of the Nation
- Element B: Estimated Revenue Not Received
- Element C: Other Public Services or Activities

Element A: Cost of Providing Services to All Areas of the Nation

The Commission's estimate of Element A costs is the sum of three components: maintaining small Post Offices, the Alaska Air Subsidy, and Group E Post Office Boxes. Table IV-1 compares the costs of these components from FY 2009 to FY 2013. Element A costs were relatively stable—around \$700 million from FY 2009 to FY 2012—but decreased by more than \$250 million in FY 2013. This decline is mainly due to the decrease in the cost of maintaining small Post Offices. Specifically, although the number of small Post Offices did not change substantially since last year, the cost of postmaster salaries distributed to Cost

⁹⁵ 39 U.S.C. § 3651(b)(1).

Ascertainment Group classifications K and L declined by \$194 million.⁹⁶ This appears to be largely a result of the implementation of POSTPlan.

Given recent changes in Postal Service operations, consolidations of delivery routes, and the transfer of some package services from the Market Dominant to the Competitive product list, future refinements of the cost estimate for Element A may be appropriate.

Table IV-1. Estimated Cost of Providing Services to All Areas of the Nation Required by Title 39 FY 2009 to FY 2013 (\$ Millions)

Element A USO Components	FY 2013	FY 2012	FY 2011	FY 2010	FY 2009
Maintaining small Post Offices	332	587	583	566	536
Alaska Air Subsidy	114	122	123	118	121
Group E Post Office Box service	31	34	36	30	37
Total	477	743	742	714	694

SMALL POST OFFICES

The Postal Service uses Cost Ascertainment Group classifications A to L to categorize Post Offices by the amount of revenue they generate. Small Post Offices are those that fall within the K to L classifications; they have higher unit transaction costs than larger Post Offices and lower levels of annual revenue.⁹⁷ The Commission calculates the cost of maintaining small Post Offices by determining the savings that would be achieved if the Post Office activities provided by rural carriers on the street were to replace retail transactions currently provided by small Post Offices.⁹⁸ This cost estimate includes the fixed portion of salaries, benefits, rents, utilities, and other operating costs.

The Commission uses the FY 2013 Rural Mail Count to obtain the cost of the Post Office activities that rural carriers provide on their routes at rural neighborhood collection box units. In FY 2013, the cost of maintaining small Post Offices was \$332 million. Most of the decrease in this cost from FY 2012 is a result of the reduction in postmaster salaries and indirect costs distributed to small Post Offices due to the implementation of POSTPlan.

⁹⁶ Applying the appropriate piggyback factor to this number suggests that the entire decrease is due to the reduction in postmaster costs distributed to small Post Offices.

⁹⁷ Robert Cohen and Charles McBride, "Study on Universal Postal Service and the Postal Monopoly," Appendix F-3, "Estimates of the Current Costs of the USO in the U.S." at 26, George Mason University School of Public Policy (November 2008) (GMU Study).

⁹⁸ The Rural Mail Count classifies all remunerable activities of rural carriers as either Post Office or street activities. However, some Post Office activities can occur on the street. For example, even though it occurs on the street, parcel acceptance is considered a Post Office activity because it can substitute for a customer sending a parcel at a Post Office window.

ALASKA AIR SUBSIDY

The Alaska Bypass mail program allows businesses in Anchorage and Fairbanks to ship food items and other cargo on pallets directly to rural customers in Alaska.⁹⁹ It uses commercial airline carriers to deliver items in pallets to hub airports.¹⁰⁰ Smaller airline companies or independent pilots (*e.g.*, bush airlines) then break down these pallets and deliver them to remote bush sites, bypassing the Postal Service's network.¹⁰¹

The Alaska Bypass mail program requires the Postal Service to pay for air transportation provided by Alaskan bush airline carriers. Because this payment serves areas that otherwise cannot be reached by ground service, the Commission considers the payments to be a component of Element A costs. This is referred to as the Alaska Air Subsidy; it is the difference in the cost of flying mail to remote areas and the average cost of highway transportation.¹⁰²

The calculation of the Alaska Air Subsidy treats part of the domestic Alaska air transportation cost for parcels as an institutional, not an attributable, cost.¹⁰³ The Commission estimates the cost of the subsidy by calculating the amount of air transportation costs transferred from attributable to institutional costs. The

⁹⁹ United States Postal Service Office of Inspector General, "Alaska Bypass: Beyond Its Original Purpose," November 28, 2011, at 1 (RARC-WP-12-005) (Alaska Bypass mail program).

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² FY 2013 *Annual Report* at 28.

¹⁰³ In Docket No. R90-1, the Commission held that the extra cost of air transportation of bypass mail carried by air transport should be considered an institutional cost because these extra costs were universal service costs (*i.e.*, costs incurred only because of the Postal Service's USO). See Docket No. R90-1, Opinion and Recommended Decision, January 4, 1991. This decision was subsequently affirmed in *United Parcel Service, Inc. v. United States Postal Service*, 184 F.3d 827, at 841-43, 337 U.S. App. D.C. 247, at 261-63 (D.C. Cir. 1999).

Alaska Air Subsidy has been relatively constant over time, hovering between \$114 and \$123 million since FY 2009. It was \$114 million in FY 2013.

GROUP E POST OFFICE BOXES

Group E Post Office Boxes are offered free of charge to postal customers who do not receive mail delivery. In FY 2012, the Commission approved treating the cost of these Post Office Boxes as an institutional cost in order to more equitably distribute the cost of the USO. The Commission also concluded that this treatment was analogous to, and consistent with, the treatment of intra-Alaska air transportation.¹⁰⁴ Consequently, the cost of Group E Post Office Boxes, which are primarily facility-related, has been added to the cost of the USO. They cost \$37 million in FY 2009, but this has slowly declined (with the exception of FY 2010) to the current estimated cost of \$31 million.

Element B: Estimated Revenue Not Received

Element B consists of the cost the Postal Service incurs in providing free or reduced rates for postal services required by Title 39 of the U.S.C.¹⁰⁵ The Commission calculates this cost by quantifying the difference in revenue between mail that is statutorily required to receive a discount and the revenue that would have been received if the prices for those mail pieces were not discounted. The cost of Element B also includes the losses on Periodicals. The

¹⁰⁴ Docket No. RM2011-9, Order Concerning Analytical Principles Used in Periodic Reporting (Proposal One), June 9, 2011, at 4 (Order No. 744).

¹⁰⁵ See 39 U.S.C. § 3641(b)(1)(B).

Postal Service provides discounted rates for nonprofit rate categories in Standard Regular Mail and Standard Enhanced Carrier Route Mail,¹⁰⁶ as well as Periodicals, Media Mail/Library Mail. In addition, the Postal Service provides free postage for blind and disabled persons, as well as free balloting materials under the Uniformed and Overseas Citizens Absentee Voting Act. If these discounted rates were not offered, the rates for these mail pieces would be higher, resulting in a loss of volume and, consequently, lower costs. The Estimated Revenue Not Received is calculated as the difference between a higher level of revenue generated at the higher price and a lower level of costs incurred by these mail pieces due to the decline in volume associated with the higher price. This approach is often referred to as the “net revenue” or “profitability” method.

The CPI cap constraint imposed by the PAEA makes it difficult for the Postal Service to fully recover the cost of Periodicals through rate increases. Therefore, it is assumed that, if not for the price cap, the Postal Service would raise Periodical rates to the level necessary to cover its attributable costs. The effect on volume would be built into the determination of the necessary size of the rate increase, but the net effect would be to fully eliminate the loss. Table IV-2 compares the Estimated Revenue Not Received from FY 2009 to FY 2013 as a result of discounts on nonprofit mail and losses on Periodicals.

Table IV-2. Estimated Revenue Not Received, FY 2009 to FY 2013 (\$ Millions)

Element B USO Components	FY 2013	FY 2012	FY 2011	FY 2010	FY 2009
Nonprofit mail discounts net of costs	1,130	974	1,329	1,284	1,322
Losses on Periodicals	521	670	609	611	642
Total	1,651	1,644	1,938	1,895	1,964

NONPROFIT MAIL DISCOUNTS NET OF COSTS

Although nonprofit mail discounts declined significantly in FY 2012, the USO cost of these discounts appears to have returned to a higher level, more in line with FY 2009 to FY 2011.¹⁰⁷ The attributable costs of nonprofit products were not readily available to the Commission this year,¹⁰⁸ so it used a different method to develop these costs than in previous years. However, in developing the estimate for FY 2013, concerns arose about the accuracy of this method. Given these concerns and the absence of previously available data, the Commission plans to explore ways to improve the accuracy of estimated nonprofit attributable costs in the coming year.

¹⁰⁶ The Postal Service also provides discounts to nonprofit Periodicals. However, the losses from all Periodicals are included in the losses from Market Dominant products and not included in the estimate of the cost of discounts for nonprofit mail.

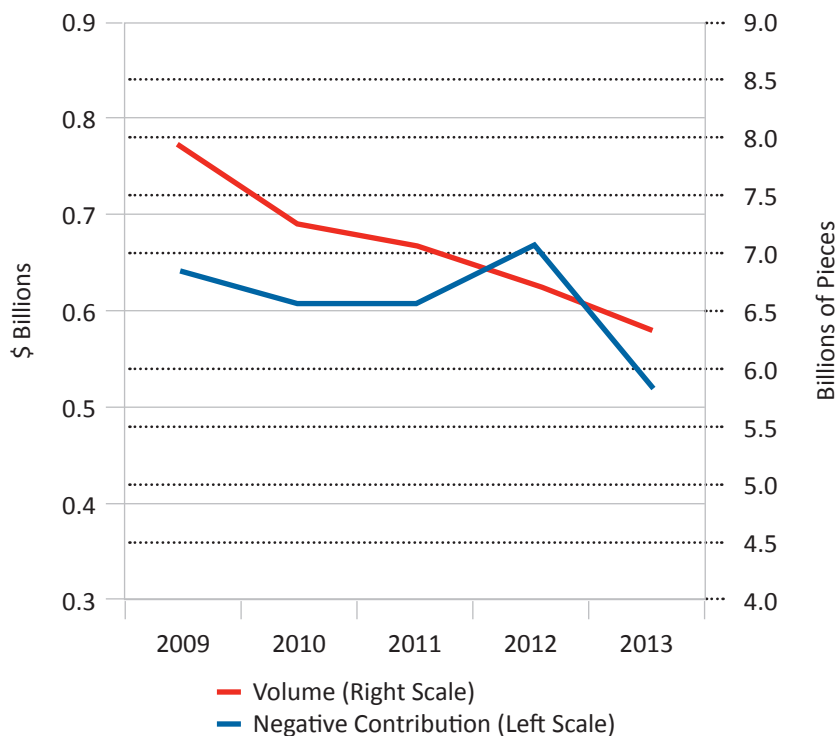
¹⁰⁷ See the FY 2012 *Annual Report* at 30 for a discussion of factors that could be responsible for last year’s decline.

¹⁰⁸ Docket No. RM2014-2, Order Granting Waiver of Filing FY 2013 Alternate CRA, December 18, 2013 (Order No. 1913).

LOSSES ON PERIODICALS

Table IV-2 suggests that the loss on Periodicals has remained relatively constant from FY 2009 to FY 2012, ranging from a low of \$609 million in FY 2011 to a high of \$670 million in FY 2012, yielding an average annual loss of \$633 million. However, the loss on Periodicals in FY 2013 was \$521 million, the smallest since FY 2008, when its revenue was \$437 million below attributable cost. Figure IV-1 shows the trend of losses and volumes of Periodicals from FY 2009 to FY 2013. The losses have generally declined as volumes have decreased by approximately 20 percent during this period. In spite of the continued volume decline, losses increased in FY 2012. This was largely due to a nearly 4 percent increase in Periodicals unit cost. The unit cost decreased by a similar amount in FY 2013, and the losses reverted to the longer-term downward trend.

Figure IV-1. Periodicals Losses of Contribution and Volume



Source: FY 2008 to FY 2013 Annual Reports.

Element C: Other Public Services or Activities

Element C consists of the costs the Postal Service incurs in providing “other public services or activities which, in the judgment of the Postal Regulatory Commission, would not otherwise have been provided by the Postal Service but for the requirements of law.”¹⁰⁹ The components of Element C include the cost of maintaining Six-Day Delivery and the estimated lost revenue from unzoned rates in Package Services mail and First-Class Mail. Other public services or activities may be included

¹⁰⁹ 39 U.S.C. § 3651(b)(1)(C).

in future reports. However, the Commission established a Public Inquiry docket to consider whether other activities the Postal Service performs constitute universal service costs, and solicited comment on these activities and methods by which they might be estimated.¹¹⁰

DOCKET NO. PI2014-1

In the FY 2013 *Annual Report*, the Commission noted that the current interpretation of Element C may be too narrow.¹¹¹ It explained that a more comprehensive interpretation could also include the estimated net cost of activities such as the Inspection Service or the Postal Service Office of Inspector General, as well as services such as the addressing system or emergency response activities.¹¹² The Commission stated that it would review the issue of cost estimate refinements for Element C in FY 2014.¹¹³

To examine these issues, the Commission established Docket No. PI2014-1 to seek public comment on the universe of “other public services or activities” that the Commission should include under Element C.¹¹⁴ The Postal Service submitted an analysis of activities that could qualify for reporting under Element C.¹¹⁵ Interested persons were asked to submit comments on this analysis.¹¹⁶

The Commission received five comments

and two reply comments; it is considering these to determine which “other public services or activities” should be included under Element C and how to estimate their cost.¹¹⁷

SIX-DAY DELIVERY COST

The cost of maintaining Six-Day Delivery is measured as the estimated savings that would be achieved by providing residential delivery service 5 days a week instead of 6 days a week. For FY 2008 and FY 2009, the cost of Six-Day Delivery was based on the *Study on Universal Postal Service and the Postal Monopoly*, conducted at the Commission’s request by the School of Public Policy at George Mason University. Beginning in FY 2010, the method of estimating the cost of Six-Day Delivery has been updated to reflect the Commission’s findings in Docket No. N2010-1. The main effect of these updates is to include the cost of additional Postal Service operations (e.g., mail processing and transportation) incurred by the obligation to provide Six-Day Delivery.¹¹⁸ The new method also includes other refinements, such as more accurate wage calculations, overhead costs, and more disaggregated methods of estimating mail processing, transportation, and delivery costs.

The estimated reduction in the fixed costs of delivery associated with eliminating the obligation to provide Six-Day Delivery is the primary source of the costs for all three components of Six-Day Delivery mail distribution and delivery. Table IV-3 shows the cost of Six-Day Delivery from FY 2009 to FY 2013.

¹¹⁰ Docket No. PI2014-1, Notice Establishing Docket Concerning the Scope of Public Service or Activity Cost Reporting Under 39 U.S.C. § 3651(B)(1)(C), August 20, 2014. Order No. 2156, Order Approving Changes in Rates of General Applicability for Priority Mail, August 15, 2014.

¹¹¹ FY 2013 *Annual Report* at 31.

¹¹² *Id.*

¹¹³ *Id.*

¹¹⁴ Docket No. PI2014-1, Notice Establishing Docket Concerning the Scope of Public Service or Activity Cost Reporting under 39 U.S.C. § 3651(b)(1)(C), August 20, 2014 (Order No. 2163).

¹¹⁵ *Id.* at 2.

¹¹⁶ *Id.* at 3.

¹¹⁷ *Id.* at 1.

¹¹⁸ The Commission has recalculated the estimated cost of Five-Day Delivery on rural routes from FY 2010 to FY 2012, and used the appropriate variables in its FY 2013 estimate. For this reason, the Six-Day Delivery cost estimates for these years may not match those presented in earlier annual reports.

Table IV-3. Other Public Services or Activities that Would Not Be Provided Absent the Requirements of Law (\$ Millions)

Element C USO Components	FY 2013	FY 2012	FY 2011	FY 2010	FY 2009
Six-Day Delivery	2,212	2,240	2,250	2,248	2,080
Unzoned Media Mail/Library Mail rates	70	71	115	98	96
Unzoned First-Class Mail rates	109	117	122	78	81
Total	2,391	2,428	2,487	2,424	2,257

Statements by the Postal Service indicate that if the obligation to deliver 6 days a week were lifted, it would discontinue delivery of letters and flats on Saturdays, but retain Saturday delivery service for parcels.¹¹⁹ This suggests that it may no longer be appropriate to assume that the Postal Service would discontinue all Saturday delivery service if the obligation to maintain Six-Day Delivery were lifted.

LOST REVENUE FROM UNZONED RATES

Rates for Media Mail/Library Mail are required to be uniform with respect to distance.¹²⁰ The Commission estimates the cost of the distance component by assuming that without this constraint, this mail would produce the unit contribution of a proxy, Bound Printed Matter, which does not have this restriction. Multiplying the unit contribution of Bound Printed Matter by the volume of Media Mail/Library Mail produces an estimate of \$70 million for the distance component. Table IV-3 shows that this cost has been declining in recent years, and that this trend continued in FY 2013. As volume declines, so does the cost of the distance obligation.

The combined costs of Elements A, B, and C comprise the cost of the USO. Table IV-4 shows the cost of the USO from FY 2009 to FY 2013. From FY 2009 to FY 2011, the cost of the USO increased by approximately 5.3 percent. The trend then reversed, decreasing by approximately 12.6 percent from FY 2011 to FY 2013. As explained above, the most likely explanation for this change is a combination of cost-cutting measures and efficiency improvements by the Postal Service, along with volume reductions in Market Dominant products.

Table IV-4. Estimated Cost of the USO (\$ Billions)

Elements A, B, and C	FY 2013	FY 2012	FY 2011	FY 2010	FY 2009
Services to all areas of the Nation	0.48	0.74	0.74	0.71	0.69
Estimated revenue not received	1.65	1.64	1.94	1.90	1.96
Other public services or activities	2.39	2.43	2.49	2.42	2.26
Total	4.52	4.81	5.17	5.03	4.91

¹¹⁹ United States Postal Service Form 10-Q, Quarter 3, FY 2014, August 11, 2014, at 30.

¹²⁰ 39 U.S.C. § 3683.

Value of the Postal Monopoly

The Commission updates the combined and mailbox monopoly values for FY 2013 using the assumptions and methodology outlined in the *Report on Universal Postal Service and the Postal Monopoly*.¹²¹ The Postal Service has a mailbox monopoly that restricts the placement of objects in mailboxes and a letter monopoly that places restrictions on the types of messages a competitor may deliver. The value of the postal monopoly is an estimate of the profit that the Postal Service would lose if these monopolies were lifted and potential competitors were allowed to compete with the Postal Service. The Commission separately estimates the value of the mailbox monopoly, but not the letter monopoly, because the United States is the only country with a mailbox monopoly. Calculating the value of the mailbox monopoly separately allows the Commission to evaluate this unique monopoly on its own.¹²²

The model's "base case" assumes that a potential competitor will "win" or "skim" all of the contestable mail on a route if the revenue it would earn from these mail volumes is greater than the fixed and attributable costs related to the volumes. Generally, mail is considered to be contestable if it is dropshipped to the processing facility or delivery unit closest to its destination, because the competitor would need to perform little or no mail processing to prepare it for delivery. To focus on the most profitable delivery routes and avoid the need for

the significant capital to establish a processing and transportation network, the competitor would deliver only local and regional mail.

Even with the monopolies in place, there are competitors that deliver material (e.g., newspapers' weekly advertising supplements) that might otherwise be sent by mail. If the mailbox monopoly alone were lifted, mail that is not directed to a specific person or address could be captured by an entrant, but the monopoly on the delivery of letters [as defined in 39 C.F.R. 310.1(a)] would prevent the capture of mail that is directed to a specific person or address, such as First-Class Presort Letters/Cards and Standard Mail Letters. If the letter monopoly were also lifted, this restriction would not apply.

The value of the letter monopoly alone (retaining the mailbox monopoly) is not estimated. Given the overlap in contestable mail and the different frequencies of delivery by the competitor, a simple subtraction of the value of the mailbox monopoly from the value of the combined monopoly does not yield the value of the letter monopoly. Moreover, without access to a designated receptacle, it is unlikely that an entrant could successfully compete for the delivery of mail directed to a specific person.

The key parameters to the estimate of the value of the monopoly are delivery frequency, the cost of entry to competitors, the rates charged by competitors, and the volume of contestable mail. In the *Report on Universal Postal Service and the Postal Monopoly*, three cases with different assumptions for the key parameters were evaluated. The "base case" assumed the

¹²¹ Report at 143-52.

¹²² GMU Study, Appendix, Section IV at 3.

entrant delivered 3 days a week, while the “low” scenario assumed it delivered 6 days a week.¹²³

The model also assumes that a competitor is 10 percent more efficient, but needs to offer a 10 percent discount to entice customers to switch from the Postal Service. Because the competitor’s efficiency advantage is offset by its discount requirement, reducing delivery frequency is its only means of achieving a delivery cost lower than the Postal Service’s lowest delivery cost.¹²⁴ If a competitor’s revenues from a route are greater than the sum of its fixed and attributable costs, it will obtain all of the contestable mail on that route.

The general method employed to estimate the value of the monopolies is similar to the method used for FY 2012. The Commission’s model estimates the value of the monopoly as the difference between the Postal Service’s profits before entry and after entry. This method is often referred to as the “profitability approach.” Table IV-5 shows both the “base” and the “low” case for FY 2013 and previous years.¹²⁵ The increase in the estimated value of the postal monopoly from FY 2012 is largely due to increases in the unit contribution of many of the contestable products. Higher unit contributions increase the number of routes the entrant can profitably capture and the amount of contribution the Postal Service loses when contestable mail is captured.

Table IV-5. Value of the Postal Monopoly (\$ Billions)

Type of Monopoly	FY 2013	FY 2012	FY 2011	FY 2010	FY 2009
Mailbox monopoly	0.81	0.70	0.91	0.69	0.79
Combined monopolies – base case	3.93	3.28	3.34	3.33	2.93
Combined monopolies – low case	2.40	1.80	1.66	1.55	2.11

The Commission has identified several areas in which it seeks to improve its estimates of the value of the monopoly. The model currently evaluates entry for each route regardless of the extent of route clustering, although an entrant’s fixed costs would be reduced if it focused on routes in the same cluster or area.¹²⁶ The model assumes that the entrant does not incur mail-processing costs and, therefore, does not reflect the cost of sorting to Carrier Routes that would be required for capture mail presorted to the 5-digit level. The model also does not account for mailers’ switching costs or brand loyalty. In addition, bulk parcels, which are Competitive products, are considered to be contestable. It may be appropriate to re-examine whether potential revenue losses from Competitive products should continue to be included in the value of the monopoly. The Commission continues to review these issues internally and in collaboration with the Postal Service and others through vehicles such as the PI2014-1 Docket.

¹²³ If only the mailbox monopoly were lifted, the entrant is assumed to deliver once a week to reduce its costs. This is consistent with services provided by existing private delivery companies. Report at 149.

¹²⁴ According to the GMU Study, this assumption is consistent with experience in countries that have allowed competitive entry where competitors deliver mail 3 days a week.

¹²⁵ In previous annual reports, the estimated value of the combined monopolies that was presented inadvertently reflected the “low” scenario assumption of Six-Day Delivery by the entrant. Estimates reflecting both the 3-day and 6-day assumption are presented here. Future annual reports will present only the “base case” assumption of 3-day delivery by the entrant.

¹²⁶ The Commission would need to obtain route-level delivery data with 3-digit ZIP Code flags to account for clustering. Further improvements could be made by assuming the entrant could design routes to more efficiently deliver contestable mail; however, this would require information about volume delivered to each stop that is not currently available.



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SERVANT OF PARTED FRIENDS
CONSOLER OF THE LONELY
BOND OF THE SCATTERED FAMILY
ENLARGER OF THE COMMON LIFE

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POSTAL MUSEUM
WILLIAM A. WHEELER
STAMP GALLERY

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NATIONAL
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100 PENNSYLVANIA
BUREAU OF LABOR STATISTICS
BOSTON OFFICE

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Chapter V. Other Proceedings and Actions

The Office of the General Counsel supports the Commission in the timely and efficient resolution of matters falling within practice areas defined by the PAEA. These include rulemakings, complaints, appeals of Post Office closings, review of postal products and services (including market tests) for consistency with statutory criteria, advisory opinions in Nature of Service cases, and related litigation. It also advises the Commission on the conduct of agency business in conformance with the Freedom of Information Act, the Government in the Sunshine Act, government contracting requirements, and other laws.

In FY 2014, the Commission fostered greater transparency and speedier resolution of issues. It initiated rulemaking dockets to clarify its procedures, resolved appeals of Post Office closing cases, assisted with litigation of its orders before the Court of Appeals, participated in research initiatives to clarify key issues related to its work, and served as an adviser on international postal issues.

Rulemaking on Nature of Service Proceedings

The Commission, using comments it solicited on April 10, 2012,¹²⁷ drafted new proposed rules for Nature of Service proceedings. It submitted these rules for public comment in a notice of proposed rulemaking on May 31, 2013.¹²⁸

On May 20, 2014,¹²⁹ the Commission issued an order adopting the amended rules, which address the need to facilitate more timely completion of Nature of Service advisory opinions. The previous rule under 39 U.S.C. § 3661(c) did not stipulate how many days the Commission had to submit an advisory opinion following a Postal Service request for review under 39 U.S.C. § 3661(b). Now, with limited exceptions, the Commission must provide an advisory opinion within 90 days of a Postal Service request under 39 U.S.C. § 3661.

¹²⁷ See Docket No. RM2012-4, Advance Notice of Proposed Rulemaking on Modern Rules of Procedure for Nature of Service Cases Under 39 U.S.C. § 3661, April 10, 2012 (Order No. 1309).

¹²⁸ See Docket No. RM2012-4, Notice of Proposed Rulemaking Regarding Modern Rules of Procedure for Nature of Service Cases Under 39 U.S.C. § 3661, May 31, 2013 (Order No. 1738).

¹²⁹ See Docket No. RM2012-4, Order Adopting Amended Rules of Procedure for Nature of Service Proceedings Under 39 U.S.C. § 3661, May 24, 2014 (Order No. 2080).

In response to input from commenters, the final rules incorporate minor modifications, clarifications, and corrections to the proposed rules. In addition to the 90-day timeline and expedited procedural schedule, the principal changes include:

- The establishment of a pre-filing phase
- A limitation on the scope of the proceeding to the Postal Service’s proposal
- The adoption of expedited deadlines for filing and responding to motions
- Implementation of a mandatory technical conference
- A limitation on the number of interrogatories
- Guidelines for the length of briefs and reply briefs

Post Office Closing Appeals

The Commission issued four decisions concerning Post Office closures in FY 2014. The Postal Service’s final determination to close Downtown Fernandina Beach Station in Fernandina Beach, Florida, was remanded to the Postal Service for further consideration.¹³⁰ The Postal Service’s final determination to close Glenoaks Station Post Office in Burbank, California, was affirmed.¹³¹ The petitions to review the closings of the Climax Post Office in Climax, Georgia, and Downtown Stamford Post Office in Stamford, Connecticut, were dismissed.¹³²

¹³⁰ Docket No. A2013-7, Order Remanding Determination, November 19, 2013 (Order No. 1880).

¹³¹ Docket No. A2013-5, Order Affirming Determination, October 31, 2013 (Order No. 1866).

¹³² Docket No. A2013-3, Order Dismissing Appeal Without

Court Appeals

Application of Price Cap Rules

When examining the Postal Service’s proposed price adjustments for Market Dominant products, the Commission found that simultaneous implementation of the Full-Service IMb requirement and the planned price adjustments would cause rates to increase by more than the maximum rate adjustment calculated in accordance with 39 C.F.R. § 3010.20. It determined that implementation of the Full-Service IMb requirement changed the basic characteristics of the mailing, constituting the redefinition of a rate cell. As such, the proposed price adjustments coupled with the IMb requirement for First-Class Mail, Standard Mail, and Periodicals would violate 39 U.S.C. § 3622(d).¹³³

In response to the Commission’s determination, the Postal Service chose to defer implementation of the Full-Service IMb requirement (for access to automation rates) until after 2014.¹³⁴ However, the Postal Service noted that it believed the Commission’s finding oversteps its authority and improperly involves it in the operations of the Postal Service.¹³⁵

On December 20, 2013, the Postal Service filed a petition in the United States District Court of Appeals for the

Prejudice and Requiring Periodic Status Reports, October 22, 2013 (Order No. 1852); Docket No. A2014-1, Order Dismissing Appeal Without Prejudice and Requiring Periodic Status Reports, January 28, 2014 (Order No. 1980).

¹³³ Docket No. R2013-10, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 21, 2013, at 106 (Order No. 1890).

¹³⁴ Docket No. R2013-10, Response of the United States Postal Service to Order No. 1890, November 29, 2012, at 3.

¹³⁵ *Id.*

District of Columbia Circuit for review of this matter; briefs and reply briefs have been filed with the court.¹³⁶ The case is awaiting final resolution by the court.

GameFly Complaint

The Postal Service appealed three Commission orders regarding round-trip DVD mailers to the United States Court of Appeals for the District of Columbia Circuit.

The first (Order No. 1763, Order on Remand, June 26, 2013)¹³⁷ directed the Postal Service to equalize rates for letter-shaped round-trip DVD mailers and flat-shaped round-trip DVD mailers. The order was issued to comply with the decision in *GameFly, Inc. v. Postal Regulatory Commission*, 704 F.3d 145 (D.C. Cir. 2013). The second (Order No. 1807, Order on Reconsideration and Clarification, August 13, 2013) denied reconsideration of Order No. 1763, but granted a Postal Service Request for clarification of the rate cap implications of that order. The third (Order No. 1828, Order Prescribing Remedy, September 4, 2013) prescribed equalized rate levels for Market Dominant letter-shaped and flat-shaped round-trip DVD mail. This part of the order became effective September 30, 2013.¹³⁸

On April 8, 2014, the court issued a decision denying the Postal Service's appeal of all three Commission Orders.¹³⁹

Commission Review of Post Office Closing Appeals

On February 14 and 22, 2012, and March 23, 2012, petitioners filed three petitions for review related to appeals of Post Office closings in the Court of Appeals for the District of Columbia Circuit. The petitioners alleged that they were entitled to judicial review of three of the Commission's Post Office closing appeal decisions and sought reversal and remand of those decisions. The Commission filed motions to dismiss the petitions on the grounds that they were not subject to judicial review. The court consolidated the three cases on August 30, 2012, and deferred consideration of the issues raised by the motions to dismiss to the merits panel.

On July 8, 2014, the court issued its opinion and dismissed the three petitions for review. The court held that for two of the Post Office closings, petitioners were not entitled to judicial review. For the third petition, the court found that it did not have jurisdiction to hear the case on the grounds that it was moot. On August 22, 2014, petitioners filed a petition for rehearing and rehearing *en banc*. The Commission filed a response to the rehearing petition on September 29, 2014. The court denied the rehearing petition on October 20, 2014.

¹³⁶ Case No. 13-1308, *United States Postal Service v. Postal Regulatory Commission*, December 30, 2013.

¹³⁷ All three orders were filed in Docket No. C2009-1R.

¹³⁸ Order No. 1828 at 9.

¹³⁹ See *United States Postal Service v. Postal Regulatory Commission*, 747 F.3d 906 (D.C. Cir. 2014).

ACD Directive on Standard Mail Rates

On April 25, 2014, Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. petitioned the Court of Appeals for the District of Columbia Circuit to review the Commission's FY 2013 ACD regarding Standard Mail rates. Valpak contended that the Commission's order did not sufficiently remedy the noncompliance of Standard Mail Flats pricing.

On September 26, 2014, Valpak filed a motion requesting that the court dismiss its petition; the Commission did not oppose this motion, and the court dismissed the petition on October 9, 2014.

Research Projects

The Commission engages in research projects to enhance its understanding of key economic and policy issues affecting the Postal Service. By sponsoring analysis and sharing the results of these independent investigations with the public, the Commission hopes to foster a discussion with and among postal stakeholders that will lead to more informed Commission policies and decisions, and greater success in achieving the objectives of the PAEA.¹⁴⁰

In 2013, the Postal Service announced plans to discontinue the delivery of letter and flat mail on Saturdays, while retaining Saturday delivery of parcels. The Commission retained Swiss Economics to analyze the potential impact of this change on Postal Service

operations and finances. The analysis employed a new approach that applied a dynamic model to evaluate the potential savings from shorter, parcel-only Carrier Routes on Saturdays. A report summarizing the methodology and results of the analysis is available on the Commission's website, www.prc.gov.

The Commission selected Copenhagen Economics to develop an economic framework for evaluating the current terminal dues system, including identifying a methodology for measuring market distortion that results from the current terminal dues structure. The Commission hosted a public briefing by Copenhagen Economics in early FY 2015, after which it published the report on its website.

The Commission also hired CMPW Partnership to produce three deliverables:

- A white paper on the role of inframarginal costs in pricing and product costing
- A report describing a methodology for estimating inframarginal costs for each product and applying the methodology to estimate the inframarginal costs by cost component for FY 2013
- A report that examines the aggregate ratio of volume variable to total accrued cost to determine why it appears to remain relatively constant over time

The Commission hosted a public briefing by the authors in early FY 2015, after which it published the reports and white paper on its website.

¹⁴⁰ These studies solely represent the views of the authors and have not been endorsed by the Commission.

Commission's Role in International Postal Policy

Section 407 of Title 39 of the U.S.C. mandates that the secretary of state is responsible for formulation, coordination, and oversight of international postal policy, including concluding postal treaties such as those involving the UPU. Headquartered in Bern, Switzerland, the UPU is an international treaty organization tasked to facilitate high-quality universal mail service at affordable rates. The U.S. Department of State exercises primary authority for foreign postal policy, and it requests Commission views on whether any treaty, convention, or amendment that establishes a rate or classification is consistent with the law's modern system of ratemaking for Market Dominant products. The Department of State ensures that relevant U.S. positions in the UPU are consistent with the Commission's view unless there is a foreign policy or national security concern.

In April 2014, the UPU considered 54 proposals to amend the UPU Acts. Five resolutions were also offered

for consideration. The Commission found that none of these proposals or resolutions established rates or classifications for Market Dominant products, and communicated its views to the secretary of state. The Commission also continued its active role in the UPU Letters and Parcels Remuneration Groups on international letter mail and parcel delivery rates, as well as several other UPU project groups. It also chaired the UPU Regulatory Issues Project Group on behalf of the U.S. government.

The Commission worked with Ecuador's postal regulator to organize the 5th Postal Regulatory Dialogue in Quito, Ecuador. The Postal Regulatory Dialogue is an initiative that the Commission launched in 2008 for regulators from around the world to share information and exchange views on best practices in postal regulation. Twenty-seven delegates representing 11 countries participated in this exchange. The Commission also remains an active, contributing member of the Department of State's Federal Advisory Committee on International Postal and Delivery Services and has supported government agencies such as the Office of the U.S. Trade Representative in the negotiation of trade agreements on postal and express delivery services.



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