ANNUAL COMPLIANCE DETERMINATION REPORT

Fiscal Year 2010

U.S. POSTAL REGULATORY COMMISSION

March 29, 2011

Ruth Y. Goldway
Chairman

On behalf of the Postal Regulatory Commission, I am pleased to present this Annual Compliance Determination (ACD) reviewing the performance of the U.S. Postal Service for Fiscal Year (FY) 2010.

This is the fourth annual ACD prepared by the Commission since enactment of the Postal Accountability and Enhancement Act (PAEA). Taken together, these reports portray a Postal Service that has made major reductions in costs and progress in utilizing flexibilities given it by the PAEA. The Commission approved a variety of Postal Service pricing initiatives, including seasonal pricing, designed to spur increased First-Class and Standard Mail volume, several experimental product tests, and 127 Negotiated Service Agreements, roughly twice as many as last year. Nevertheless, it is clear that the Postal Service is on a downward financial path and faces structural problems that have eroded its financial stability and placed its ability to fulfill its universal service obligation at risk.

Under the PAEA, price increases for market dominant products are restrained by a CPI price cap. Postal management and employees have done a commendable job in effectively adjusting to sudden volume declines due to the recent recession. The Postal Service used about the same number of workhours in FY 2010 as it did in FY 1977, while delivering 85 percent more volume to almost 50 percent more delivery points. First-Class Single-Piece mail service performance has remained steady.

The PAEA requires, however, that service performance be measured and reported for all market dominant products to ensure that the discipline of the CPI price cap system is not offset by deterioration in service. The Commission agreed in 2007 to a Postal Service request to mitigate its costs by allowing bulk mail to be measured using internal service measurement systems based on the Intelligent Mail barcode (IMb) in lieu of an external measurement system. However, persistent data errors, insufficient customer IMb usage, and a lack of product specific documentation have impeded PAEA objectives.

Service measurement results for bulk First-Class Mail, Standard Mail, Packages and Periodicals remain deficient. Currently, as was true in the first ACD, only the Postal Service external tracking system for First-Class Mail Single-Piece products is sufficient to meet the service performance tracking objectives of the PAEA. The Postal Service must vigorously address these problems to achieve full compliance with all service performance reporting requirements.

Part of the Postal Service's financial problem lies in structural pricing imbalances. The Commission identified 10 market dominant products and services with revenue that did not cover attributable costs in FY 2010, totaling $1.7 billion in negative contribution. For the first time in an ACD, the Commission finds rates for a market dominant product, Standard Mail Flats, not in compliance with the statute. The Postal Service has repeatedly failed to utilize existing pricing options to address the growing Standard Mail intra-class cross subsidy. It is directed to take appropriate action to end the intra-class cross subsidy

as soon as practicable. No other product is found to be out of compliance, although the Commission finds that the Postal Service should continue using available pricing and costing options to address problematic areas.

Closing its pricing gap, however, will not be sufficient to stem the Postal Service's financial decline. Commission analysis confirms that the Postal Service's cash flow problem and the primary cause of its liquidity crisis is related to an overly ambitious requirement for the Postal Service to prefund its future retiree health benefit premiums. Over the past four years, the Postal Service has paid $21.9 billion to prefund these benefits. Without the prefunding requirement, the Postal Service would have achieved a small net profit over that time. The Postal Service is mandated to make an additional $5.5 billion prefunding payment this year.

FY 2010 marked the fourth consecutive fiscal year the Postal Service has posted a net financial loss. The $8.5 billion loss for FY 2010 follows losses of $5.4 billion in FY 2007, $2.8 billion in FY 2008, and $3.8 billion in FY 2009 and brings the total cumulative losses for the four years to $20.2 billion. During this period, the Postal Service increased its debt by nearly $10 billion and is approaching the limit of its statutory borrowing authority. The Postal Service is at risk of insolvency and projects in its Integrated Financial Plan for FY 2011 that it could end the year with a negative cash balance of $2.7 billion. This is the preeminent challenge facing the Postal Service.

The Commission currently is reviewing the operation of the PAEA, as mandated by the Act, to submit a report this year recommending to the President and Congress legislation or other ways to improve the effectiveness or efficiency of the United States postal laws. We look forward to working with the Postal Service and Congress to address the challenges and opportunities that are identified in that report, this ACD and through the daily oversight activities of the Commission to promote a healthy viable universal mail system for the Nation.

I want to thank Vice Chairman Mark Acton, and Commissioners Langley, Blair, and Hammond for their valuable work and contributions to this report. On behalf of my fellow Commissioners, and with great gratitude, I acknowledge Commission staff for their unstinting dedication and hard work in compiling this report while dealing with a record workload and some of the most challenging issues ever faced by the Commission.

Ruth Y. Goldway

TABLE OF CONTENTS

Chapter VII — Market Dominant Products

Chapter VIII — Competitive Products

Chapter IX—Nonpostal Services

Chapter I

Executive Summary

This report reviews the Postal Service's performance in Fiscal Year 2010, fulfilling the Commission's responsibilities to produce an annual assessment of Postal Service rates and service. 39 U.S.C. 3653. It is based on information the Postal Service is required to provide within 90 days after the close of its most recent fiscal year and on comments the Commission received subsequently from the public.

Principal Findings

In FY 2010, the Postal Service's financial situation continued to deteriorate. Cumulatively, it has lost over $20 billion since FY 2007, including $8.5 billion in FY 2010. These continuing losses, which are projected to persist in future fiscal years, jeopardize the Postal Service's ability to provide postal services to the nation as required by 39 U.S.C. 101.

The Postal Service's financial difficulties stem from two principal causes. First-Class Mail volumes and revenues continue to decline, falling by 5.5 billion pieces (or 6.6 percent) from FY 2009. First-Class Mail revenues fell by more than $1.8 billion (or 5.2 percent.). These decreases, while less precipitous than FY 2009, continue a long-term, persistent decline in First-Class Mail volumes, which since FY 2001 have dropped by 25.7 billion pieces or more than 25 percent. This mail is particularly susceptible to electronic diversion; thus, the downward trend is projected to continue.

The current structure of the retiree health benefit fund payments imposes a substantial strain on Postal Service finances. While the Postal Service made the required $5.5 billion payment for FY 2010, it projects that it will have insufficient resources, including borrowing authority, to satisfy all its FY 2011 financial obligations.

For the first time in a compliance determination, the Commission finds rates for a market dominant product not in compliance with the statute. It directs the Postal Service to eliminate the intra-class cross subsidy for Standard

Mail Flats over time. While a specific timetable is not imposed, the Commission expects the Postal Service to correct the inequity as promptly as practicable.

No other rate or service is found to be non-compliant. While the Commission does identify certain rate and service issues, it finds that actions the Postal Service has taken, principally in the most recent price adjustment proceeding, obviate the need for further remedial action at this time. It is imperative, however, that the Postal Service continue its commendable efforts to reduce costs and increase efficiency.

Financial and Pricing Results

Financial

The Postal Service was able to meet all of its obligations in FY 2010, ending the year with $1.2 billion in cash; however, it anticipates a $2.7 billion negative cash balance at the end of FY 2011. Also Total Factor Productivity increased 2.2 percent, as the Postal Service reduced workhours by 75.1 million, saving an estimated $3.6 billion.

Factors contributing to the Postal Service's $8.5 billion loss include:

- Ten market dominant products failed to generate revenues sufficient to cover attributable costs, losing in the aggregate $1.7 billion, including:
  - $611 million from Periodicals,
  - $577 million from Standard Mail Flats, and
  - $172 million from Standard Mail Parcels/Not-Flat Machinables;
- Total volume declined by 3.5 percent, or more than 6 billion pieces;
- Total expenses increased by 5.1 percent;
- Total revenues declined by 1.5 percent; and
- The payment structure of the $5.5 billion payment into the Retiree Health Benefit Fund.

Pricing

- The Commission finds that Standard Flats prices are not in compliance with the statute, specifically section 101(d) which requires a fair and equitable apportionment of the cost of postal operations;
- 39 workshare discounts exceeded avoidable costs; none requires action at this time;
- Competitive products, as a whole, made a positive contribution to institutional cost, amounting to 7.1 percent, which exceeded the required 5.5 percent share; and
- Three international competitive products and one new, competitive, domestic special services product failed to cover attributable cost, with an aggregate loss of $74 million.

Service Performance

- The Commission is concerned with the Postal Service's ability to report service performance measurements for market dominant products as required by the PAEA by the filing date of the FY2011 Annual Compliance Report; and
- Significant issues continue to hinder the Intelligent Mail barcode system from fulfilling its potential as a useful component of service performance measurement.

Filing Requirement

- Contrary to the Commission's rules, which require that the Postal Service's Annual Compliance Report be submitted based on existing, approved

costing methodologies, the Postal Service filed certain cost avoidance estimates based on proposed methodical changes pending before the Commission; and

- Future Annual Compliance Reports must adhere to the Commission's rules as specified in 39 CFR part 3050.

Revisions of Revenue, Pieces, and Weight Report

- The Postal Service's unilateral revisions to FY 2009 RPW data are based on a methodological change not applicable to that year, and the figures relied upon in the FY 2009 ACD remain valid.
- Unless expressly authorized otherwise, changes in methodology are to be applied prospectively only. (See Appendix B for more discussion)


Disaster Relief

Chapter II

Background

Introduction

Statutory Context

Ongoing, systematic reporting and assessment of the financial and operational performance of the United States Postal Service are mandated by two provisions of the Postal Accountability and Enhancement Act of 2006 (PAEA). The first provision, 39 U.S.C. 3652, requires the Postal Service to file certain annual reports with the Commission, including an Annual Compliance Report (ACR). *See* 39 U.S.C. 3652(a) and (g). The second provision, 39 U.S.C. 3653, provides for the Commission's review of these annual reports, including an Annual Compliance Determination (ACD) regarding the compliance or non-compliance of various rates and service standards.[1] Together, these provisions establish the ACD and the ACR as integrated mechanisms for achieving the PAEA's objective of ongoing accountability, transparency, and oversight.

Timeline and Review of Report

The Postal Service's ACR is to be filed no later than 90 days after the end of each fiscal year, which ends September 30. The Commission's ACD is to be completed within 90 days after receipt of the ACR. The Postal Service filed its 2010 ACR on December 29, 2010. Thus, the Commission's ACD must be issued no later than March 29, 2011.

Focus of the ACR

In accordance with section 3652, the ACR must provide analyses of costs, revenues, rates, and quality of service sufficient to demonstrate that during the reporting year all products complied with all applicable requirements of title 39. Additionally, for market dominant products, the ACR must report product information, mail volumes, and measures of quality of service, including speed of delivery, reliability, and degree of

1 Common abbreviations and acronyms are identified in Appendix D.

customer satisfaction. For market dominant products with workshare discounts, the ACR must report the per-item cost avoided by the Postal Service by virtue of such discount, the percentage of cost avoided that the per-item workshare discount represents, and the per-item contribution to institutional costs. 39 U.S.C. 3652(a) and (b).

Other Reports

In conjunction with its filing of the ACR, the Postal Service must also file its most recent comprehensive statement on postal operations, mandated by 39 U.S.C. 2401(e), and its performance plan and program performance reports, mandated by 39 U.S.C. 2803 and 2804, respectively. *See* 39 U.S.C. 3652(g).

Commission Responsibilities

Under section 3653, the Commission's corresponding responsibilities include providing an opportunity for comment on the Postal Service's submission, making a written determination as to whether any rates or fees were not in compliance with applicable provisions of chapter 36 of title 39 or related regulations, and whether any service standards were not met. If no instance of non-compliance is found, the determination is written accordingly. 39 U.S.C. 3653 (a) (c). If a determination of non-compliance is made, the Commission is directed to take such action as it deems appropriate. The Commission is also required to evaluate annually whether the Postal Service has met the goals established under sections 2803 and 2804, and may make recommendations to the Postal Service related to the protection or promotion of public policy objectives of title 39. 39 U.S.C. 3653(d).

Procedural History

On December 29, 2010, the Postal Service filed its FY 2010 ACR, covering the period October 1, 2009 through September 30, 2010. In accordance with section 3652(g), concurrently the Postal Service also filed its FY 2010 Comprehensive Statement on Postal Operations.[2] The Comprehensive Statement included the Postal Service's 2010 Annual Performance Report and 2011 Performance Plan required by the Government Performance and Results Act, P.L. 103-62.

The ACR includes an extensive narrative discussion and a substantial amount of detailed public and non-public information contained in library references. The library references include the Cost and Revenue Analysis, the International Cost and Revenue Analysis, cost models supporting workshare discount analysis, and billing determinant information. Library Reference USPS-FY10-9 serves as a roadmap that summarizes other materials in the submission and discusses methodology changes. It also includes a section in response to Commission rule 3050.12 regarding data obsolescence.

The Postal Service also filed its annual report to the Secretary of the Treasury regarding the competitive products fund required by section 2011(i) of title 39 as part of USPS-FY10-39 in conjunction with the other Competitive Products Fund materials required to comply with 39 CFR 3060.20 through 3060.23.

On January 4, 2011, the Commission issued an order providing notice of the Postal Service's filing, establishing Docket No. ACR2010 as a formal docket to consider the filing, appointing a Public Representative to represent the interests of the general public, and providing an opportunity for public

[2] FY2010 Comprehensive Statement on Postal Operations, December 29, 2010 (Comprehensive Statement). This document was filed as Library Reference USPS-FY10-17.

comment.[3] It established February 2, 2011, as the deadline for comments and February 17, 2011, as the deadline for reply comments.

Methodology Changes

The Postal Service reports that the scope of methodologies has been reduced because of its heavy reliance on replicating the methodologies most recently used by the Commission. It states, however, that several methodological changes are reflected in the ACR. It identifies and discusses these issues in a separate section of the roadmap document and in the prefaces to the appended materials. Additionally, the Postal Service filed proposals to change analytical principles since the filing of the FY 2009 ACR. It summarizes fourteen proposals and proposed changes that were pending resolution as of the date of the filing, which have been incorporated into the 2010 ACR. Proposals Nine through Twelve and Proposals Thirteen and Fourteen are still pending before the Commission, having been submitted shortly before the FY 2010 ACR on December 20, 2010, and December 22, 2010, respectively.

Product Analysis

The Postal Service provides a detailed analysis of each market dominant product, including domestic negotiated service agreements entered into during FY 2010. It also presents information on workshare discounts responsive to 39 U.S.C. 3652(b). The Postal Service presents a product-by-product analysis of competitive products and discusses available FY 2010 data regarding conformity with 39 U.S.C. 3633. Further, the Postal Service provides information on the two market tests conducted during FY 2010, and on nonpostal services. It explains that the Commission rule requiring the ACR to include information on costs, volumes and revenues regarding nonpostal services was not adopted until late in FY 2009. As a result, the Postal Service states that it has attempted to improve its reporting of data in this ACR.

Confidentiality

In FY 2009, the Commission adopted rules governing the treatment of commercially sensitive information.[4] These rules require the Postal Service to apply for non-public treatment when it considers information required in periodic reports to be commercially sensitive. Its application must specify reasons for concluding the particular information is commercially sensitive and in need of non-public treatment, and describe with particularity the nature of the competitive harm that public disclosure is likely to cause. Accordingly, the Postal Service accompanied its 2010 ACR with an application for non-public treatment of certain competitive product information, including its supporting rationale.

Requests for Additional Information

On January 14, 2011, the first Chairman's Information Request (CHIR) was issued directing the Postal Service to provide additional information to clarify estimates in the ACR. Four additional CHIRs were issued during the course of this proceeding. The Postal Service responded to all information requests. In addition, the Postal Service subsequently filed supplemental information to support its responses. The Commission appreciates the Postal Service's responsiveness to the information requests.

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3 *See* Notice of Postal Service's Filing of Annual Compliance Report and Request for Public Comments, January 5, 2011 (Order No. 636); *see also* 76 FR 1471 (January 10, 2011).

4 *See* Docket No, RM2008-1, Order No. 225 Final Rule Establishing Appropriate Confidentiality Procedures, June 19, 2009.


Disaster Relief

Chapter III

Legal Issues

Introduction

In this year's ACR, the Postal Service asserts that "[a] significant question regarding the requirements of title 39 arises with respect to cost coverage shortfalls." FY 2010 ACR at 7. The Postal Service questions whether repeated cost coverage shortfalls can be addressed effectively within the PAEA's price cap mechanism, given the disposition of the recent exigent rate request and concern that efficiency enhancements cannot close the coverage gap. Another aspect of the question pertains to the Commission's interpretation of the term "product" as it relates to section 3622(c)(2), which provides, among other things, that each class or type of mail service bear the direct and indirect postal costs attributable to it.[1]

Questions also arise about the role of section 101(d) in non-compliance determinations and the relationship of section 3622(c)(2) to the price cap in the statutory pricing hierarchy and related Commission regulations.

The Postal Service's ability to address cost coverage shortfalls under the PAEA

The Postal Service asserts that its recent exigent rate request included a plan to address systemic cost coverage shortfalls, and that the Commission's denial of that request means the plan is no longer workable.[2] *Id.* at 8.

1 For ease of discussion, the Commission uses the phrase "attributable cost floor" in lieu of repeating the language in section 3622(c)(2). Commenters use the phrase attributable cost floor as shorthand to indicate the pricing standard referred to in section 3622(c)(2). *See, e.g.*, MPA *et al.* Comments at 1, Appendix A *passim*; PR Reply Comments at 2-3; and MPA *et al.* Reply Comments at 2, 8.

2 In the FY 2009 ACD, the Commission identified fourteen market dominant products and services that had failed to cover attributable costs; said the aggregate loss was $1.7 billion, and found that most of the loss ($1.5 billion) was associated with Periodicals ($642 million), Standard Flats ($616 million), and Standard NFMs/Parcels ($205 million).

The Postal Service further states that it has indicated to the Commission over the course of the joint effort on the Periodicals Study that even with the most optimistic enhancements and annual rate increases within the statutory cap, it does not foresee that Periodicals, Standard Flats, and Standard NFMs/Parcels will reach full attributable cost coverage. *Id.* The Postal Service concludes:

> …[I]t seems impossible for the Postal Service, acting with the powers granted to it and within the constraints imposed by title 39, to present any realistic plan that would result in these products fully covering their attributable costs, much less making any contributions to institutional costs. Therefore, it seems most appropriate for the Commission to determine whether it can exercise any of its powers to remedy the cost coverage shortfall of the products in question.

Id.

The Postal Service observes that parties commenting on last year's ACR advocated that the Commission possesses such powers (citing the Public Representative and the Greeting Card Association) and says it therefore would be useful for the Commission to determine "exactly what the contours of its powers are under title 39." *Id.*

Commission Analysis

The Commission disagrees with the Postal Service's conclusion that denial of the exigent rate request deprives the Postal Service of any ability to devise realistic plans, within statutory constraints, to achieve full cost coverage for Periodicals and certain underwater products. Moreover, to the extent the Postal Service's reference to "fully covering … attributable costs" means immediately moving certain classes or products to full coverage, the Commission rejects that point. The Commission's consistent position has been that a statutorily-consistent course of action, in some instances, is meaningful progress toward improved cost coverage.

The Commission's disposition of the exigent request does not foreclose the Postal Service's ability to use its pricing flexibility to address intra-class shortfalls (as in Standard Mail) or to pursue cost-reduction efforts directed at underwater classes or products or an overall reduction of overhead costs. While the statutory price cap may limit pricing-related progress on an annual basis, the Commission does not accept the premise that the existence of the price cap thwarts the Postal Service's ability to effectively address the pricing issues it identifies.

In fact, the Postal Service's pricing approaches for Package Services (which is a class that did not cover costs in FY 2010) and Standard NFMs/Parcels (a product with a reported 77.2 percent cost coverage) in Docket No. R2011-2 (filed shortly after this year's ACR) show that pricing flexibility can be usefully employed to move some classes and products toward improved cost coverage. What is absent on this record is a convincing showing that pricing flexibility has been applied appropriately for Standard Flats and that cost-reduction efforts are receiving adequate, targeted, and sustained attention, especially in Periodicals. This makes the Postal Service's failure to utilize that flexibility to address Standard Mail Flats cost coverage all the more unfounded. The suggestion that the Commission explore its options, including piercing the price cap, also departs from the Postal Service's longstanding position on the status of the price cap mechanism in the statutory pricing hierarchy.[3]

[3] Docket No. RM2007-1, Initial Comments of the United States Postal Service (April 6, 2007), at 16; 21-23.

Standard Mail Flats

Pursuant to 39 U.S.C. 3652(a)(1), the Postal Service is required, among other things, to "demonstrate that all products during such year complied with all applicable requirements of [title 39]." In this ACR, the Postal Service does not attempt to make that showing, simply noting that "the Flats product had a cost coverage of 81.6 percent in FY 2010." FY 2010 ACR at 31.

The Postal Service expressly recognizes that pricing and efficiency measures need to be taken to ensure that the Flats product covers its costs and makes an appropriate contribution toward institutional costs. *Id*. It suggests, however, its plans were nullified by the Commission's denial of its exigent rate request. In its most recent price adjustment proceeding, Docket No. R2011-2, the Postal Service reverted to the previous pattern of below-average price increases for Flats it followed in the prior two price adjustment proceedings under the PAEA.

In its review of the Postal Service's ACR, the Commission must determine "whether any rates or fees in effect for such year (for products individually or collectively) were not in compliance with applicable provisions of [chapter 36 of title 39] (or regulations promulgated thereunder)." Among the provisions of chapter 36 is 39 U.S.C. 3622(c)(14), which as part of the modern system for regulating rates and classes for market dominant products, requires the Commission to take into account "the policies of this title as well as other factors as the Commission determines appropriate." While many of the section 3622(c) factors were simply imported from former 39 U.S.C. 3622(b), section 3622(c)(14) represents a synthesis of former section 3622(b) language that the Commission's recommended rates be "in accordance with the policies of this title" and section 3622(b)(9) that in addition to the eight enumerated factors, the Commission could also consider "such other factors as the Commission deems appropriate" in making its rate recommendations.

Thus there is symmetry between both the Postal Service's obligations under section 3652 to demonstrate that all products complied with the applicable provisions of title 39, and the Commission's review under section 3653 which takes into account, among other things, the policies of title 39. Moreover, this reading is consistent with pricing under the PAEA which contemplates both ex ante and ex post review of prices.

Postal Service proposed price adjustments are subject to ex ante review by the Commission, including whether planned price changes are consistent with the policies of title 39. Commission determinations as to the lawfulness of such planned changes are, with notable exceptions, "provisional and subject to further review." *See* CFR 3010.13(j) and 39 CFR 3010.44(c). That further, ex post, review occurs in the ACD.

Standard Mail, as a class, covers attributable costs and makes a substantial contribution to institutional costs. However, FY 2010 ACR results show that the Standard Flats product does not cover costs, and therefore does not make a contribution to institutional costs. FY 2010 ACR at 31.

Beginning as early as the FY 2008 ACD and reiterated in subsequent proceedings, the Commission expressed concern that Standard Mail Flats do not cover costs and, as a consequence, impose a disproportionate institutional cost burden on other

Standard Mail products, particularly Letters. FY 2008 ACD at 61; *see also* FY 2009 ACD at 86; Docket No. R2009-2, Order No. 191 at 52-53, and Docket No. R2010-2, Order No. 675 at 31. Since FY 2008, that burden has worsened. Flats' contribution per piece was negative 2.2 cents in FY 2008, growing to negative 8.2 cents in FY 2010. In contrast, the FY 2008 per-piece contribution from Standard Letters was a positive 9.0 cents and in FY 2010 was a positive 8.6 cents.[4] Despite the Commission's repeated suggestions that Flats be priced above cost (*see, e.g.*, Order 191 at 53), the Postal Service has persisted in proposing below-average price increases for this product, including in its most recent price adjustment proceeding, Docket No. R2011-2.

In this proceeding, three commenters (L.L. Bean, Valpak, and the Public Representative) address the Postal Service's repeated below-cost pricing strategy for Standard Flats (outside of the exigent case), including its most recent proposal in Docket No. R2011-2; discuss the ensuing harm, and point out the intra-class subsidy. They claim that the intra-class subsidy, amounting to $1.4 billion over the last three years, including $577 million in FY 2010, violates 39 U.S.C. 101(d), which provides that postal rates "shall be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis." The Commission agrees and concludes that the Standard Flats product is not in compliance with this important policy of title 39. The Commission does not take this step lightly.[5] As discussed in Chapter VII, the Postal Service is directed, pursuant to section 3653(c), to take remedial action as promptly as practicable to effectively address the unfair and inequitable apportionment of costs.[6]

Periodicals

The Postal Service reports that Periodicals has not been covering its attributable costs, and that cost coverage (at 75.5 percent) declined slightly in FY 2010.[7] FY 2010 ACR at 35. The situation in Periodicals is admittedly different from that posed by Standard Flats, as both of the products that comprise this class also have reported cost coverage shortfalls. This means a rebalancing pricing strategy, which keeps the overall price cap intact at the class level, is not feasible.

Two commenters (Valpak and the Public Representative) assert that a non-compliance determination for this class is warranted on the basis of the repeated cost coverage shortfall and violation of section 101(d). Valpak also invokes instances of non-compliance with respect to other statutory pricing factors and objectives.

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4 An alternate way of viewing the burden is to compare the difference in unit contribution. In FY 2008, the difference in unit contribution was 11.2 cents, growing to 16.8 cents in FY 2010.

5 In discussing this product in its FY 2008 ACD, the Commission noted that "[t]he lack of a sufficiently high cost coverage directly implicates the requirement of section 101(d), which directs the Postal Service to apportion the costs of the Postal Service on a fair and equitable basis and section 3622(b)(5), which requires that rates must be set to ensure adequate revenues to maintain financial stability." FY 2008 ACD at 61 (footnote omitted).

6 Although Standard Parcels/NFMs do not cover costs, that product is easily distinguishable from standard Flats. In each general price adjustment proceeding under the PAEA, the Postal Service has proposed substantially above-average price increases Standard Parcels/NFMs. *See, e.g.*, Order No. 191 at 43 (16.425 percent for Parcels/NFMs compared to 3.781 percent for the class on average). Moreover, in Docket No. MC2010-36 the Postal Service proposed and the Commission conditionally approved the transfer of commercial Standard Parcels to the competitive product list.

7 This percentage and the percentages for the Within County and Outside County products that comprise this class are based on the Postal Service's initial filing. Based on revision, these percentages changed slightly.

Time, MPA/ANM/ABP and Condé Nast claim that there is no justification for a non-compliance determination with respect to Periodicals. Moreover, Time and MPA/ANM/ABP challenge the use of section 3622(c)(2) as a rationale for non-compliance determination. Their positions are based on a reading of the statute, legislative history, and recent Order No. 536, which they say place the price cap at the top of the statutory pricing hierarchy. Time Comments at 12-14 and MPA/ANM/ABP Reply Comments at 2. MPA/ANM/ABP, for example, assert that section 3622(c)(2) is not an absolute requirement, but one of a number of factors and objectives. As such, they claim it is subordinate to the price cap and the two other quantitative requirements the Commission identified in Order No. 536. MPA/ANM/ABP Reply Comments at 2. MPA/ANM/ABP also maintain that section 101(d) is a policy within chapter 1 of title 39, so has no bearing on a determination that is to be based on chapter 36 considerations. *Id.* at 3.

As discussed in Chapter VII, the Commission concludes that the rates for Periodicals do not satisfy section 3622(c)(2), but it does not find FY 2010 Periodicals rates out of compliance with applicable provisions of chapter 36 or regulations promulgated thereunder. A finding that a product (either individually or collectively) fails to satisfy a provision of title 39 does not compel a finding of non-compliance. In making its determination, the Commission must take into account numerous sometimes conflicting considerations.

The situation in Periodicals is distinguishable from that of Standard Flats. First, concerns about Periodicals cost coverage existed in the years prior to the PAEA; they are not a recent development. Second, unlike Standard Mail, Periodicals as a class fails to cover costs. While this is a concern, there is no suggestion that the Postal Service has ignored its pricing flexibility under the PAEA with respect to Periodicals products. Lastly, management has not yet fully brought to bear efficiency enhancements, network adjustments, and related changes which could alter the attributable cost picture for Periodicals. The Commission believes it is appropriate to allow time for these measures to be implemented and take hold. Given these considerations, the Commission need not address the scope of remedial powers under section 3653.

Pricing Products Below Cost

The Postal Service reads Order No. 536[8] as suggesting that pricing standards apply at the class level, not the product level. FY 2010 ACR at 8. It states:

> It is not clear to the Postal Service how to reconcile this conclusion with the Commission's statements regarding cost coverage shortfalls the FY 2009 ACD. If the Commission's statements in [Order No. 536] regarding products mean that cost coverage shortfalls are acceptable at the product level so long as there is full attributable cost coverage and appropriate institutional cost contribution at the class level, then Commission action to remedy product-level cost coverage shortfalls may not be necessary.

FY 2010 ACR at 9.

While the Commission rejected the Postal Service's contention that the term "product" is the only appropriate level at which pricing standards apply, it did not rule out the possibility that certain pricing standards would apply at that level. Order No. 536 at 24-27. In this proceeding, consistent with prior

[8] Order No. 536, Docket No. RM2009-3, Order Adopting Analytical Principles Regarding Workshare Discount Methodology, September 14, 2010.

ACDs, the Commission has appropriately applied the pricing standard at the product level.

In Order No. 536 the Commission observed that the terms the PAEA uses to indicate the level at which its various pricing standards apply are non-restrictive ("mail," "service," "class or type," "subclass," and "category.") The Commission noted that many of the PAEA's pricing standards use language that is broad enough to include products, but does not restrict the application of the pricing standard to products. The Commission found this to be true of the ceiling on workshare discounts imposed by section 3622(e). In explaining why it arrived at that conclusion, the Commission discussed the terms used in other pricing provisions to indicate the level at which each provision should be applied. It noted with respect to the language section 3622(c)(2) uses to indicate the level at which the attributable cost floor applies:

> The attributable cost floor applies to each 'class or type of mail [service].'. While this phrase is broad enough to include an individual 'product,' it is not confined to an individual product.

Order 536 at 26.

Order No. 536 also makes the point that section 3622(c)(2) is similar to section 3622(e) in that it uses expansive language to avoid dictating to the Commission or the postal community at what level the standard should be applied. The level at which those two pricing standards should be applied is to be determined by the purpose underlying each standard.

Section 3622 Hierarchy

The Public Representative reasons that the statutory price cap and the attributable cost floor provision in section 3622(c)(2) are on equal footing. This is based on the contention that section 3622(c)(2) is a quantitative requirement, notwithstanding its location with the cluster of statutory factors the Commission identified, in Order No. 536, as qualitative. PR Reply Comments at 2-3. Time and MPA/ANM/ABP assert that the price cap has primacy over the attributable cost floor provision. They point, among other things, to language in the PAEA which establishes the price cap as a requirement of the modern system of rate regulation, and contrast this with the standing the PAEA accords the statutory objectives and factors. Time Reply Comments at 7-14 and MPA/ANM/ABP Reply Comments at 2.

The focus in this case on section 3622(c)(2)'s standing within the statutory pricing hierarchy occurs mainly in the context of (i) the Postal Service's suggestion that the Commission explore its remedial options, including whether these options include piercing the price cap; and (ii) two proposals which not only would exceed the Periodicals price cap, but exceed it by a significant degree. Valpak proposes two successive increases of 16 percent; the Public Representative proposes an 8 percent hike. The Public Representative's proposal tracks the Postal Service's Periodicals proposal in the exigent rate filing.

Section 3622 creates a hierarchy based on "requirements," sections 3622(d) and (e), "objectives," section 3622(b), and "factors," section 3622(c).[9] With the exception of an exigent rate request and use of banked pricing authority, the PAEA's price cap mechanism in section 3622(d)(1)(A) takes precedence over the statutory pricing objectives and factors in sections 3622(b) and (c), even if some of these can be considered quantitative. Therefore, to the extent an objective or factor with a quantitative

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[9] Other provisions of title 39 would qualify as requirements. *See* 39 U.S.C. 3626 and 3627.

component can be seen as competing with the price cap, the price cap has primacy.

In bills that became the PAEA, the price cap was understood as a feature that would focus management's attention on cost control. There is also an indication, in the section 708 directive for a joint Postal Service/Postal Regulatory Commission study of Periodicals costs and efficiency practices, that legislators were aware that the attributable cost floor provision would pose special challenges for any class that had experienced difficulties in satisfying former section 3622(b)(3) under the Postal Reorganization Act of 1970 (PRA).

The PAEA, in section 3622(a), required the Commission to establish a modern system for regulating rates and classes for market dominant products within a relatively short time after enactment. It further provided, in section 3622(d)(1)(A), that an annual limitation [cap] on rates was a requirement of that system. With this cap in place, the Commission was directed to design the system to achieve certain objectives set out in section 3622(b)(1) through (9). And, in establishing or revising the cap-based system, the Commission was directed to "take into account" the factors set out in section 3622(c)(1) through (14).[10] The Commission understands this directive as one which clearly calls for the application of its considered judgment.

The price cap is the signal feature distinguishing the modern system from the cost-of-service approach under the PRA. Many of the statutory objectives the cap-based system is to be designed to achieve, and the factors that are to be taken into account, are expressed in language similar to the ratemaking considerations under the old system, and present familiar challenges in terms of achieving an appropriate balance; however, none has precisely the same standing under the PAEA as they did under the PRA. Instead, the objectives and factors, including those that can be regarded as quantitative operate within the context of the price cap; they are not on an equal footing with it. However, giving precedence to the price cap does not render the attributable cost floor provision inconsequential. It advances the section 3622(b)(5) objective of assuring adequate revenues to maintain financial stability and promotes the recognition of other objectives and factors. Consequently, the Commission will continue to press for meaningful cost-reduction efforts, examination of costs, and use of pricing flexibility to promote PAEA policies.

[10] Section 3622(e) addresses workshare discounts. The Commission has incorporated this provision into regulations implementing the modern rate regulation system.


Disaster Relief

Chapter IV

Postal Service Financial Goals

Introduction

By law, the Postal Service is "to be operated as a basic and fundamental service" whose "basic function is the obligation to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people." 39 U.S.C.101(a). The PAEA established a modern system for regulating rates requiring, among other things, that rates be established to "assure adequate revenues, including retained earnings, to maintain financial stability." Declining mail volumes, especially in First-Class, and the PAEA mandated pre-funding requirements for the retiree health benefits fund, as currently structured, could impede the Postal Service's ability to meet these requirements of title 39. In this chapter, the Commission provides an overview of postal finances and discusses liquidity, the Retiree Health Benefits Fund, the pension overfunding issue, class/product revenue and cost data, mail volumes, workhours, and productivity.

Overview

FY 2010 marked the fourth consecutive fiscal year the Postal Service has posted a net financial loss. The $8.5 billion loss for FY 2010 follows losses of $5.4 billion in FY 2007, $2.8 billion in FY 2008, and $3.8 billion in FY 2009 and brings the total cumulative losses for the four years to $20.2 billion. These losses, coupled with the expected continued losses in ensuing fiscal years[1] threaten the Postal Service's ability to fulfill its statutory mandate. As Table IV-1 shows below, the financial losses over the past four years have severely eroded the Postal Service's retained earnings and have caused an increase in total debt that threatens to reach the statutory limit of $15 billion in the near future.

[1] The Postal Service's FY 2011 Integrated Financial Plan at page 2 estimates a loss in FY 2011 of $6.4 billion.

Table IV–1
Financial Position of USPS FY 2006–2010
($ in Millions)

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Net Income (Loss) before RHB and Workers Comp Adj.	$900	$3,216	$3,211	$(1,051)	$(505)
Payments to Retiree Health Benefits Fund	-	8,358	5,600	1,400	5,500
Workers Comp Liability Adj.	-	-	417	1,343	2,500
Net Financial Loss	900	(5,142)	(2,806)	(3,794)	(8,505)
Retained Earnings	6,276	1,134	(1,672)	(5,413)	(13,873)
Total Debt	**2,100**	**4,200**	**7,200**	**10,200**	**12,000**

Source: USPS Financial Statements, FY 2006–2010

Liquidity Issues – Continued

In the FY 2008 ACD, the Commission expressed concern about the Postal Service's continuing financial decline and the "…very real possibility that the Postal Service will not be able to pay some of the large year-end payments for the retiree health benefits fund and workers compensation. **The Commission is concerned about the Postal Service's liquidity in the near future."** (Emphasis Added).[2]

In FY 2009, Congress deferred the required annual payment into the Postal Service Retiree Health Benefits Fund (RHBF) by $4 billion, allowing the Postal Service to finish FY 2009 with a cash balance of $4.1 billion instead of $78 million. This allowed the Postal Service to hold off a cash deficiency crisis in the beginning of FY 2010 and to continue to provide service consistent with sections 101 and 3622(b)(5) of title 39. The Commission noted in the FY 2009 ACD that the Postal Service was on a financial path that would put its section 101 mandates at risk and that the Postal Service should, with all the available resources under current law, address the sources of financial instability sooner rather than later.[3]

In FY 2010, despite better than expected operating results and continued cost reductions, the Postal Service continued to experience significant financial losses as the economic recovery failed to completely restore lost volumes. As the economy improved, volumes, particularly in Standard Mail, began to increase in the final fiscal quarter of the year. However, unit revenues from Standard Mail provide less net contribution than First-Class mail, which continued to show significant volume declines.[4] Consequently, the increases in Standard Mail volume were not sufficient to make up for the losses in net revenue from First-Class Mail. Despite this, before the workers compensation adjustment of $2.5 billion, the Postal Service net loss was about $1.8 billion less than the initial operating plan. This additional net revenue (actual vs. planned) enabled the Postal Service to make the full $5.5 billion payment into

2 Postal Regulatory Commission FY 2008 Annual Compliance Determination at 25.

3 Postal Regulatory Commission FY 2009 Annual Compliance Determination at 19-20.

4 It takes about three pieces of Standard Mail to recover the net revenues from the loss of one First-Class Mail piece.

the RHBF and also end the year with a cash balance of $1.2 billion. Additionally, the Postal Service only increased its total debt by $1.8 billion, instead of using the full allowable increment of $3 billion. Total debt increased to $12 billion. Because of the better than expected operating results, the Postal Service was able to meet the Section 3622(b)(5) objective, *i.e.*, revenue adequacy.[5]

Total mail volumes continued to decline in FY 2010, though at a much slower rate than in FY 2009. Total volumes dropped by 3.5 percent, or over six billion pieces, in FY 2010, as compared with a 12.7 percent decline in volume in FY 2009. All but one class of market dominant mail experienced continued declines. Only Standard Mail volumes, which began to improve substantially after the first quarter, showed a small increase of 0.1 percent over last year.

Revenues also were less than last year, declining 1.5 percent or over $1 billion from last year. First-Class mail revenues were the primary reason for the decline in total revenues, dropping over $1.8 billion from last year. Standard Mail revenues were almost the same as last year while revenues increased for other mailing services[6] and Shipping Services which include Priority Mail, Express Mail, and Parcel Select.

Total expenses in FY 2010 were 5.1 percent higher than last year with the primary contributors to the increase being the RHBF payment and a non-cash adjustment to the workers compensation liability. Most of the other categories of expenses – compensation and benefits, transportation, and other expenses – showed decreases. Compensation and Benefits expenses were reduced by almost $1.8 billion, primarily through the reduction of 75 million workhours.

Table IV–2
Mail Volumes
($ in Millions)

	FY 2010	FY 2009	Increase or (Decrease)	% Change
First-Class	78,203	83,766	-5,563	-6.6%
Periodicals	7,269	7,901	-632	-8.0%
Standard Mail	82,525	82,448	77	0.1%
Package Services	658	731	-73	-10.0%
Other	499	517	-18	-3.5%
Total Mailing Services	169,154	175,363	-6,209	-3.5%
Total Shipping Services	1,420	1,381	39	2.8%
Total Mail	170,574	176,744	-6,170	-3.5%

Source: USPS FY 2010 Form 10-K at 14

Table IV–3
Mail Revenues
($ in Millions)

	FY 2010	FY 2009	Increase or (Decrease)	% Change
First-Class	34,026	35,883	-1,857	-5.2%
Periodicals	1,879	2,038	-159	-7.8%
Standard Mail	17,331	17,345	-14	-0.1%
Package Services	1,516	1,684	-168	-10.0%
Other	3,619	2,886	733	25.4%
Total Mailing Services	58,371	59,836	-1,465	-2.4%
Total Shipping Services	8,681	8,254	427	5.2%
Total Mail	67,052	68,090	-1,038	-1.5%

Source: USPS FY 2010 Form 10-K at 15

[5] For this ACD only, revenue adequacy is viewed as having sufficient cash to meet all obligations. In other regulatory arenas and under better economic conditions, revenue adequacy might be held to a more rigorous standard.

[6] Other Mailing Services include Ancillary Services such as Registry, Certified, and Insurance along with special services such as Money Orders and Post Office Boxes.

Table IV–4— Total Expenses–FY 2010
($ in Millions)

	FY 2010	FY 2009	Change in Amount	Percent Change
Compensation & Benefits	$52,601	$53,154	$(553)	-1.0%
Retiree Health Expenses	7,747	3,390	4,357	128.5%
Transportation	5,878	6,026	(148)	-2.5%
Supplies & Services	2,236	2,321	(85)	-3.7%
Depreciation and Amortization	2,469	2,270	199	8.8%
Other Expenses	4,495	4,669	(174)	-3.7%
Total Operating Expenses	$75,426	$71,830	$3,596	5.0%
Interest Expense	156	80	76	95.0%
Total Expenses	**$75,582**	**$71,910**	**$3,672**	**5.1%**

The cost increases for retiree health benefits offset the reductions in other expenses. The Postal Service made the full $5.5 billion payment in FY 2010 which was $4.1 billion higher than the adjusted payment of $1.4 billion made in FY 2009.

The large adjustment to workers compensation resulted from changes to the discount rates that are used to estimate the present value of the workers compensation liability. Workers compensation costs increased by $1.3 billion over last year. The discount rates are based on a market basket of Treasury securities with maturities that correspond to the expected duration of future cash payments. As interest rates on these securities declined during the year, adjustments were made to the workers compensation discount rates which increased the liability. The changes to the liability are charged to the income statement as expenses. During FY 2010, the expense adjustment due to discount rate changes amounted to over $2 billion, while actuarial estimate changes accounted for an additional $483 million, amounting to a total $2.5 billion adjustment to the workers compensation liability.

While the Postal Service was able to meet all of its obligations in FY 2010, its financial challenges continue. The Postal Service's FY 2011 Integrated Financial Plan projects that the total financial loss will be $6.4 billion. Even with no unexpected adverse financial events, the Postal Service estimates that there will be insufficient cash to meet all of its financial obligations, primarily the required $5.5 billion payment into the RHBF. During FY 2011 the Postal Service expects that it will use $6.7 billion in net cash during the year. With a beginning cash balance of $1 billion and available borrowing authority of $3 billion, the expected cash balance at the end of FY 2011 is expected to be a **negative** $2.7 billion.[7]

The Postal Service has taken several actions over the last three years to try to maintain service while reducing costs. Reducing workhours by almost 250 million, renegotiating supply and service contracts, adjusting transportation requirements, and adjusting city carrier routes with the assistance and support of the city letter carriers union, have enabled the Postal Service to save over $12 billion in the last three years.

[7] Postal Service FY 2011 Integrated Financial Plan at 6.

Additionally, the Postal Service has developed a 10-year action plan which addresses ways to increase revenues and control costs over the long run.[8]

The Postal Service is also reviewing the current management structure for opportunities to reduce the ranks of management and administrative personnel by almost 7,500, saving an annualized estimate of over $700 million beginning in FY 2012.[9] This is in addition to the over 40 million planned workhour savings for FY 2011.[10] However, while these actions will reduce the costs of the Postal Service, they will not provide the $4-$5 billion annual cost savings necessary to bring the Postal Service long term financial solvency and stability. The Postal Service stresses that timely Congressional action is needed to address the main contributors to the financial and liquidity problems; the overfunding of the pension obligations and the current method of funding retiree health benefits. USPS 10-K at 27-28.

Retiree Health Benefits Fund

The Commission's majority decision on the Postal Service's exigent rate request, Docket No. R2010-4, noted that the primary cause of the liquidity crisis is the "overly optimistic RHBF prefunding schedule."[11] In this ACR, the Public Representative reiterates the Commission's comments and notes that because of the required payments into the RHBF, operating profits have been transformed into significant losses, which have had to be financed by using significant amounts of debt. Public Representative Comments at 3-4.

Valpak has also commented that the funding for retiree health benefits needs permanent reform, not one-year deferrals, and that the

> "…aggressive funding schedule can be viewed as constituting an extraordinary requirement insofar as no other federal, state, or local government is required to prefund any of their retiree health care benefits." Valpak Comments at 17-18.

The Commission extensively discussed the effects of the retiree health benefits funding on the Postal Service's liquidity in Order No. 547, denying the Postal Service's request for exigent rate increases. The Commission stated that, but for the retiree health benefit funding requirements, the Postal Service would have had sufficient reserves over the past three years to carry the Postal Service through the worst of the past recession, with only minimum, if any, reliance on long-term debt. Table IV-5, below, is an updated version to the Table 5 in Order No. 547 at 77, which shows that the Postal Service would have had a positive cash balance of over $11 billion by the end of FY 2010.

The PAEA requires that information on the funding status of the retiree health benefit liability be provided every year in the annual USPS Form 10-K statement. This information, compiled and developed by the Office of Personnel Management (OPM), shows the obligations, costs and funding status of the RHBF. OPM uses several assumptions regarding the future costs of medical benefits, interest rates, and demographics to develop the estimates of the funding and funding requirements of the RHBF. Over the past two years, OPM has altered the methodology to include changes, albeit at a much more conservative pace, to assumptions regarding medical benefits

8 Ensuring a Viable Postal Service for America: An Action Plan for the Future, March 2, 2010. *See also http://www.usps.com/strategicplanning/futurepostalservice.htm*

9 USPS Form 10-Q, Quarter 1, FY 2011 at 29.

10 *Id.* at 23.

11 PRC Order No. 547 at 68.

Table IV–5
Forecasted USPS Cash Flow Without RHBF Payments
($ in Millions)

	FY 2007	FY 2008	FY 2009	FY 2010	Est. FY 2011
Net Income/(Loss)	(5,142)	(2,806)	(3,794)	(8,505)	(6,400)
Less: Statutory RHBF Payments	8,358	5,600	1,400	5,500	5,500
Adj. Net Income/(Loss)	3,216	2,794	(2,394)	(3,005)	(900)
Non-Cash items and Other Cash Flows	2,539	2,367	5,367	5,213	1,000
Cash Flows from Investing Activities	(2,458)	(1,938)	(1,806)	(1,323)	1,300
Cash Flows from Financing Activities					
Increase (decrease) in debt	2,100	0	0	0	0
Payments for Capital Leases	(19)	(29)	(46)	(47)	(49)
U.S. government appropriations–expensed	(76)	(61)	(64)	(63)	(63)
Net Cash (Used) provided by financing activities	2,005	(90)	(110)	(110)	(112)
Net Increase/(Decrease) in Cash	5,302	3,133	1,057	775	1,288
Cash Balance BOY	997	6,299	9,432	10,489	11,264
Cash Balance EOY	6,299	9,432	10,489	11,264	12,552
Debt Outstanding	4,200	4,200	4,200	4,200	4,200

Sources: USPS Annual Reports FY 2007 through FY 2010; USPS FY 2011 Integrated Financial Plan at 6

which were recommended by the Commission in a July 30, 2009, report presented to the Subcommittee on Federal Workforce, Postal Service, and the District of Columbia, Committee on Oversight and Government Reform, U.S. House of Representatives. That report recommended, among others things, that a graduated medical benefits inflation factor rather than a static factor be used to estimate the RHBF liability.

Pension and Benefit Funding Issue

The Postal Service Inspector General (OIG) released a white paper on January 20, 2010, claiming that the Postal Service's pension liability for Civil Service Retirement System (CSRS) employees has been overfunded by $75 billion. Subsequent to that report, on March 16, 2010, the Postal Service requested that the Commission conduct a review of the methodology determining the Postal Service's liability for CSRS pensions as determined by OPM pursuant to Section 802 of PAEA.

As required by law, the Commission retained the services of an independent actuarial firm, the Segal Company, to assess OPM's calculation of the Postal Service's share of the CSRS pension assets and liabilities, which included a review of the methodology proposed in the OIG white paper. Segal met with OPM, the OIG, and the Postal Service and conducted reviews of the methodologies utilized by all the parties independently.

On June 29, 2010, the Commission issued the report prepared by the Segal Company. The report suggested that the methodology for determining the Postal Service's share of the CSRS pension fund does not follow current private sector accounting standards for recognizing pension costs, assets, and liabilities.

The report laid out the methodologies that could be used based on current practices of accounting and actuarial standards. Segal estimated that if the Postal Service's share of the CSRS assets were recalculated based on these current practices, the Postal Service's share of the CSRS assets was understated by $50-$55 billion.

The President's FY 2012 Budget Proposal would change the financing of the RHBF by accelerating the provision in PAEA that requires the Postal Service to begin paying the normal cost of retiree health benefits for current employees in FY 2011 instead of FY 2017, and provides that the RHBF would begin paying the premiums for current retirees instead of being paid by the Postal Service. The proposal maintains the current pre-funding payments embodied in PAEA but would defer $4 billion of the FY 2011 payment. The Administration also proposes to return the $6.9 billion Federal Employment Retirement System (FERS) surplus estimated by OPM to the Postal Service over 30 years, with the first payments of $550 million payable in FY 2011 and FY 2012.

Additionally, the proposal contains a provision where the current "stream of payments" required by the PAEA would be adjusted to account for the difference between the normal cost of future benefits for current employees, which will be paid by the Postal Service, and the cost of health benefit premiums for current retirees, which will be paid by the RHBF. The Commission has estimated that the effect of these budget proposals would reduce the Postal Service estimated net loss for FY 2011 by $4.6 billion.

Table IV–6
Effect of FY 2012 U.S. Budget Proposals on USPS FY2011 Finances

	$ in Billions	
Current FY2011 Net Loss Estimate		($6.40)
Elimination of PAYGO retirement premiums	2.43	
Retiree Health Benefits Payment Relief	4.00	
Addition of RHB Cost	(3.00)	
Refund of FERS Surplus	0.55	
Difference between Normal Cost and Retiree Premiums	0.61	
Net effect of FY2012 Budget Proposals	4.59	
Revised Estimate of FY2011 Net Loss		(1.81)

Financial Reporting Requirements

Title 39, Section 3654 requires the Postal Service to file with the Commission certain reports that conform to the Securities and Exchange Commission (SEC) regulations.[12] The reports to be filed with the Commission are the annual Form 10-K, the quarterly Form 10-Q and Form 8-K.

The Form 10-K is an annual report which contains a comprehensive summary of a company's performance, including the audited financial statements. The report also includes information regarding the executive compensation policies of the company, and detailed information of the compensation and benefits packages of all senior executive officers. This report is due to the Commission within 60 days of the end of the reportable fiscal year.

The Form 10-Q is a similar report to the Form 10-K, but filed on a quarterly basis. The Form 10-Q provides quarterly financial reports and a

[12] This requirement is also embodied in the Commission's Rules of Practice and Procedure under Section 3050.40. *See* PRC Order No. 203, April 16, 2009.

management discussion on operations and finances, including management's assessment of the outlook for the rest of the year. The Form 10-Q is required to be filed with the Commission within 40 days of the end of the fiscal quarter.

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

The Postal Service filed the required FY 2010 Forms 10-Q in February 2010 (Quarter 1), May 2010 (Quarter 2), and August 2010 (Quarter 3). All filings were within the specified 40-day time frame. The Form 10-K for FY 2010 was filed on November 15, 2010, well within the 60-day filing requirement.

During FY 2010 the Postal Service also filed three Form 8-K's, notifying the Commission of senior executive personnel changes and publicly reported financial results. They were all filed within the three business day time limit.

Summary by Product

Table IV-7 summarizes the Commission's analysis of the financial performance of all products (market dominant, competitive, domestic, and international) and all negotiated service agreements (NSAs) for FY 2010.[13] Chapter VII presents the financial analysis and performance for each market-dominant class, for market-dominant NSAs, and for market-dominant international products. Chapter VIII presents the analysis of the financial results for competitive products and NSAs.

Table IV-7 shows the volumes, revenues, attributable costs, contribution to institutional costs and cost coverages for postal products, reflecting the current mail classification. Table B-1 in Appendix B presents the same financial information by subclass, reflecting the previous mail classification, and thus allowing comparison of FY 2010 with financial results from previous fiscal years.

The Revenue, Pieces, and Weight (RPW) system and the billing determinants are the main sources for volumes and revenues in Table IV-7. Report B of the Postal Service's Cost Model is the source of the attributable (variable and product specific) costs for domestic mail. The International Cost and Revenue Analysis (ICRA) is the source document of the attributable costs for international mail.[14] As in the three previous compliance determinations, the Commission has used "booked" revenues and expenses in the analysis of the financial results for postal products and NSAs. Thus, the revenues and expenses used in the Commission's financial analyses

13 For a detail presentation of the financial performance, *see* public library reference PRC-ACR2010-LR1 (which covers only market-dominant products and NSAs) and nonpublic library reference PRC-ACR2010-NP-LR1 (which covers market-dominant and competitive products and NSAs).

14 In the ACR proceeding for FY 2010, as in previous ACR dockets the volume, revenue, and weight figures submitted by the Postal Service were not internally consistent. As documented in Library Reference PRC-ACR2010-NP-LR-1, there are instances in the Postal Service's FY 2010 CRA where volume revenue and weight figures do not precisely match the corresponding figures in the relevant source documents, such as the RPW system and the billing determinants. The lack of internally consistent figures adds to the difficulty of validating the Postal Service's numbers within the time constraints of the ACR proceedings.

are consistent with the Postal Service's audited financial statements.

In response to a Commission inquiry, the Postal Service stated that effective January 2010, it implemented the Foreign Post Settlement (FPS) system for international mail. Under the FPS system, revenues and expenses will be based on actual inbound and outbound international mail volumes, current international mail rates, and currency exchange rates in effect during the period.[15]

Table IV-7 shows that in FY 2010, Postal Service attributable costs totaled $41.576 billion, or 55.0 percent of its total costs, leaving $34.006 billion of institutional (or overhead) costs to be recovered from product revenue contributions. Because of mail volume declines and the lack of a market dominant price adjustment, the revenue generated from the sale of postal products contributed only $25.386 billion to the recovery of institutional costs; leaving a loss of $8.620 billion. The loss was reduced by $89 million of Congressional appropriations and $25 million of investment income, leaving the Postal Service with a net loss of $8.505 billion for FY 2010.

In FY 2010, four competitive (domestic and international) mail products and ten market-dominant domestic products and services did not generate sufficient revenue to cover their attributable costs and thus their contribution to institutional costs was negative. The total negative contribution from the four competitive products was $74.039 million. The competitive products as a group, however, contributed more than the required 5.5 percent of institutional costs, generating a net income before tax of $550 million.

The total shortfall from the ten market dominant products with negative contribution amounted to $1.669 billion. Following is the list of market dominant products and services with negative contributions to institutional costs.

List of Market Dominant Products and Services with Respective Negative Contribution to Institutional Costs ($ in Millions)

1	First-Class Inbound International Single-Piece Mail	(53.208)
2	Standard Flats	(576.986)
3	Standard Not Flat-Machinables and Parcels	(172.455)
4	Periodicals, Within County	(24.194)
5	Periodicals, Outside County	(586.810)
6	Package Services, Single-Piece Parcel Post	(133.628)
7	Package Services, Bound Printed Matter Parcels	(26.705)
8	Package Services, Media and Library Mail	(89.190)
9	Special Services, Address Management Services	(3.499)
10	Special Services, Stamp Fulfillment Services	(2.710)
Total		**(1,669.384)**

Source: Library Reference PRC-ACR2010-LR1

The negative contributions of two of the products, Standard Flats and Outside County Periodicals, amounted to $1.164 billion or about 70 percent of the total shortfall.

As in previous years, in FY 2010, First–Class Presort Mail and Cards was the most successful postal product financially. Its volume was the second largest – 46.2 billion pieces or 27 percent of total volume. It generated the largest amount of revenue – $16.058 billion or 27 percent of total revenue. It also made the largest contribution to institutional costs – $10.659

[15] *See* response to CHIR No. 1, Question 22, January 24, 2011. According to the Postal Service, the FPS system will provide international mail accounting accruals for use in the Postal Service's audited financial statements and the ICRA. In effect, this replaces the "imputed" method previously used to develop revenues and expenses.

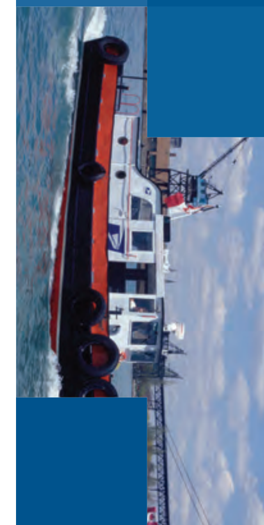
Table IV–7—Fiscal Year 2010 Volume , Revenue, Cost and Cost Coverage by Class Current Classification (Products)

	Volume (000)	Revenue ($000)	Attributable Cost ($000)	Contribution to Institutional Cost ($000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
Competitive Mail								
Express Mail	42,553	827,898	495,560	332,338	1,945.571	1,164.571	781.000	167.1%
Priority Mail	809,471	5,656,639	4,246,634	1,410,005	698.807	524.619	174.189	133.2%
Parcel Select and Parcel Return Service (PRS)	296,824	568,756	419,897	148,859	191.614	141.463	50.150	135.5%
Competitive International Mail	270,737	1,480,530	967,055	513,475	546.853	357.194	189.658	153.1%
Competitive Domestic Services	82,675	135,018	115,681	19,336	163.312	139.923	23.388	116.7%
Competitive International Services	1,261	8,267	12,056	(3,790)	655.757	956.366	(300.609)	68.6%
Total Competitive Mail and Services	**1,419,584**	**8,677,108**	**6,256,884**	**2,420,224**	**611.243**	**440.755**	**170.488**	**138.7%**
Market Dominant Mail								
First-Class Mail								
Single-Piece Letters and Cards	28,584,912	12,815,796	7,775,442	5,040,354	44.834	27.201	17.633	164.8%
Presort Letters and Cards	46,225,386	16,058,305	5,398,847	10,659,458	34.739	11.679	23.060	297.4%
Flats	2,483,992	3,122,695	2,147,953	974,741	125.713	86.472	39.241	145.4%
Parcels	574,429	1,133,763	1,132,418	1,345	197.372	197.138	0.234	100.1%
Outbound Single-Piece Mail Intl	334,404	690,377	362,959	327,418	206.450	108.539	97.911	190.2%
Inbound Single-Piece Mail Intl	34	204,587	257,795	(53,208)				79.4%
Standard Mail								
High Density & Saturation Letters	5,428,043	741,537	348,528	393,009	13.661	6.421	7.240	212.8%
High Density & Saturation Flats & Parcels	11,363,444	1,853,432	825,827	1,027,605	16.310	7.267	9.043	224.4%
Carrier Route	9,473,617	2,240,712	1,567,192	673,520	23.652	16.543	7.109	143.0%
Letters	48,508,586	9,294,785	5,127,431	4,167,353	19.161	10.570	8.591	181.3%
Flats	7,067,654	2,592,242	3,169,228	(576,986)	36.678	44.841	(8.164)	81.8%
Not Flat-Machinables and Parcels	682,403	607,701	780,156	(172,455)	89.053	114.325	(25.272)	77.9%
Inbound NSA Mail Intl	1,061	473	150	322				
Periodicals								
Within County	695,455	74,301	98,495	(24,194)	10.684	14.163	(3.479)	75.4%
Outside County	6,574,014	1,804,533	2,391,343	(586,810)	27.449	36.376	(8.926)	75.5%

Table IV–7—Fiscal Year 2010 Volume, Revenue, Cost and Cost Coverage by Class Current Classification (Products)—Continued

	Volume (000)	Revenue ($000)	Attributable Cost ($000)	Contribution to Institutional Cost ($000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
Package Services								
Single-Piece Parcel Post	61,408	615,241	748,869	(133,628)	1,001.885	1,219.490	(217.605)	82.2%
Inbound Surface Parcel Post (at UPU Rates)	1,089	17,029	11,460	5,569	1,563.959	1,052.518	511.441	148.6%
Bound Printed Matter Flats	229,752	191,328	129,358	61,970	83.276	56.304	26.972	147.9%
Bound Printed Matter Parcels	244,736	322,544	349,249	(26,705)	131.793	142.705	(10.912)	92.4%
Media and Library Mail	122,322	369,361	458,551	(89,190)	301.958	374.872	(72.914)	80.5%
Inbound NSA Mail Intl	48	106	7	99				
U.S. Postal Service Mail	431,206							
Free Mail	67,214		66,303	(66,303)		98.645		
Total Market Dominant Mail	**169,154,120**	**54,750,848**	**33,147,563**	**21,603,285**	**32.367**	**19.596**	**12.771**	**165.2%**
Market Dominant Services								
Ancillary Services								
Certified Mail	268,725	752,429	634,691	117,738	280.000	236.186	43.814	118.6%
COD	834	6,522	8,246	(1,724)	781.562	988.125	(206.563)	79.1%
Insurance	39,146	125,567	98,624	26,944	320.764	251.936	68.828	127.3%
Registered Mail	2,967	47,806	42,567	5,239	1,611.492	1,434.887	176.604	112.3%
Stamped Envelopes		14,029	3,717	10,311				377.4%
Stamped Cards		879	646	233				136.1%
Other Ancillary Services	1,605,496	807,076	494,109	312,966				163.3%
Money Orders	123,405	183,153	126,339	56,814	148.416	102.378	46.039	145.0%
Post Office Box Service		813,186	674,892	138,295				120.5%
Caller Service		93,921	30,621	63,300				
Other Special Services		35,671	29,946	5,726				
International Services	2,032	28,920	27,402	1,518				105.5%
Other Income		625,262		625,262				
Total Mail and Services	**170,573,704**	**66,962,376**	**41,576,247**	**25,386,129**	**39.257**	**24.374**	**14.883**	**161.1%**
Institutional Costs			34,005,721					
Appropriations: Revenue Forgone		88,877						
Investment Income		25,326						
Total Revenues		67,076,580						
Total Costs			75,581,968					
Net Income (Loss)		(8,505,388)						

Source: Library Reference PRC-ACR2010-LR1



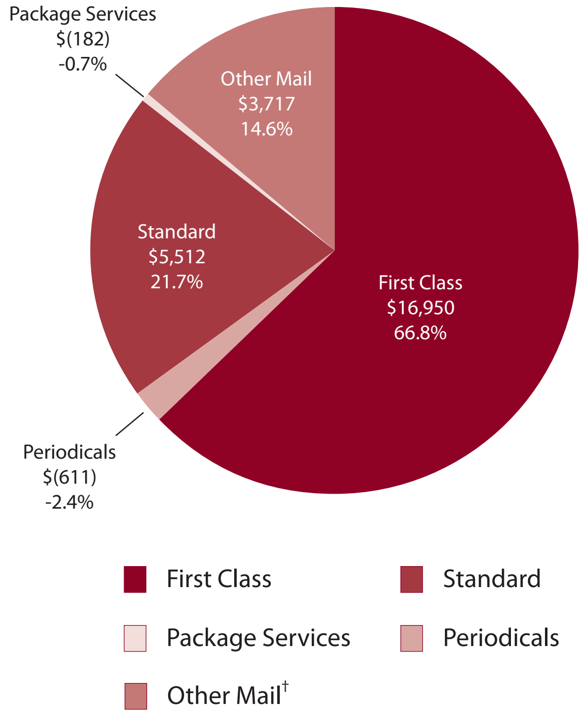
billion or about 42 percent of the total contribution from all mail and services. Its per-piece contribution was 23.060 cents, which is about 2.7 times higher than the per-piece contribution made by Standard Letters. Its cost coverage of 297.4 percent was second only to special service Stamped Envelopes.

It is also interesting to note in Table IV-7 that First-Class Flats and Bound Printed Matter (BPM) Flats made positive per-piece contributions of 39.241 cents and 26.972 cents respectively, whereas Standard Flats made a negative per-piece contribution of 8.164 cents. Table IV-7 also shows that the average revenues for First-Class Flats and BPM Flats were 3.4 and 2.3 times higher, respectively, than Standard Flats. These findings point to the chronic underpricing of Standard Flats.

Finally, the following breakdown of contributions to institutional costs is derived from Table IV-7. In FY 2010, domestic products accounted for 96.9 percent of the total contribution to institutional costs. Of this share, 89.4 percent came from market-dominant products and 7.5 percent came from competitive products. International products accounted for the remaining 3.1 percent of the total contribution to institutional costs, with 1.1 percent coming from market-dominant products and 2.0 percent from competitive products.

Figure IV-1 presents the contribution to institutional (or overhead) costs by mail class. In FY 2010, First-Class Mail paid $17 billion or 67 percent of the Postal Service's overhead. First-Class volume, however, is the most adversely affected by Internet technologies such as electronic mail, online bill payment and presentment, and online banking. In the last 10 years, First-Class Mail lost 25.7 billion pieces or 28.5 percent of its volume, in significant part due to increased adoption of these technologies. In light of this dependency on First-Class Mail, the Postal Service is vulnerable to the continued spread and improvement of Internet services, which threaten the financial sustainability of the Postal Service.

Figure IV–1—Fiscal Year 2010 Contribution to Institutional (Overhead) Costs by Class (Dollars in Millions)



† Includes Express Mail, Priority Mail, Parcel Select, Parcel Return Service, International Competitive Mail, Free Mail, Special Services and Other Income.

Mail Volumes

Figure IV-2 shows annual mail volume changes for the past ten years. While the recent economic recession ended in June 2009,[16] the effects of the economic slowdown and the rate at which mail is migrating from traditional postal hard copy services to electronic

[16] 2010 Business Cycle Dating Committee, September, 2010, National Bureau of Economic Research.

Figure IV–2—Total Mail Volume Annual Growth Rates Fiscal Years 2001–2010

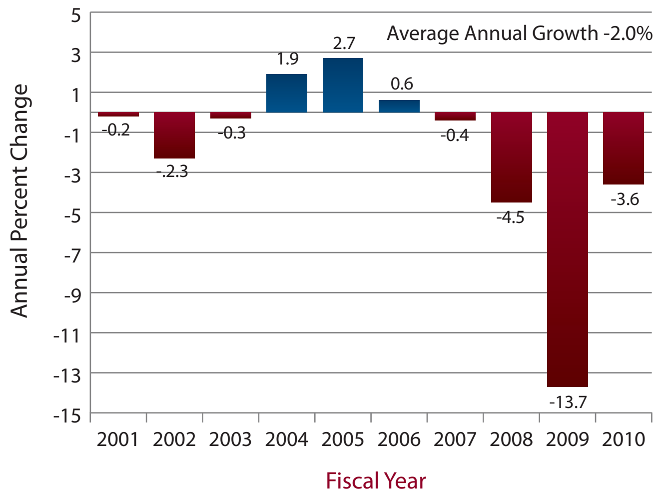
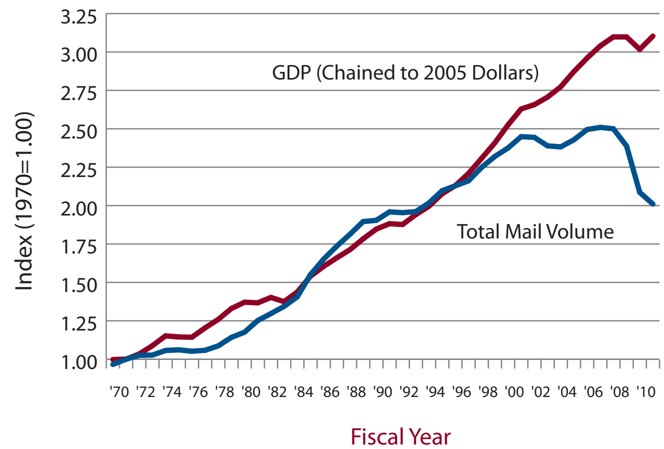


Figure IV–3—Gross Domestic Product (GDP) and Total Mail Volume Growth Fiscal Years 1970–2010



media continue to negatively impact mail volume. Although the rate of decline diminished in 2010, total volume continued its downward trend with a decrease of 6.2 billion pieces or 3.6 percent from 2009 to 2010. In the last three years (2008-2010) the Postal Service lost 41.7 billion pieces or about 20 percent of its volume.

During the past decade, the Postal Service experienced volume reductions in seven years and volume increases in three years. The volume declined at an average annual rate of 2.0 percent. In contrast, the mail volume grew at an average annual rate of 2.0 percent during the 1970's, 4.9 percent during the 1980's, and 2.2 percent during the 1990's. At the end of FY 2010, mail volume was 170.6 billion pieces and stood at about the same level as in FY 1993.

The volume increases in FYs 2004, 2005 and 2006 coincide with the formation of the "housing bubble" which generated an unusually high demand for mail-based advertising regarding mortgage financing and refinancing and credit card issuance. Figure IV-3 depicts the growth of total mail volume along with the growth of U.S. Gross Domestic Product (GDP) over the past 41 years.

From 1970 to 1999, the growth of mail volume closely matched the pace of the U.S. economic growth. In fact, during the last 30 years of the 20th century, GDP and mail volume grew at an average annual rate of 3.1 percent and 3.0 percent, respectively. Since 2000, however, this close relationship of GDP and mail volume growth has ceased to exist. During the first 11 years of the current century, GDP grew at an average annual rate of 1.9 percent whereas volume declined at an annual rate of 1.5 percent. This created a gap of 3.4 percentage points between the average changes of the two measures. In other words, over the past 11 years, GDP continued to grow at a rather steady rate, with the exception of a 2.7 percent decline in 2009 due to the economic recession, while mail volume stagnated or declined, with the exception of a healthy growth of 3.1 percent in FY 2000 and the short period of growth in the fiscal years 2004 through 2006.

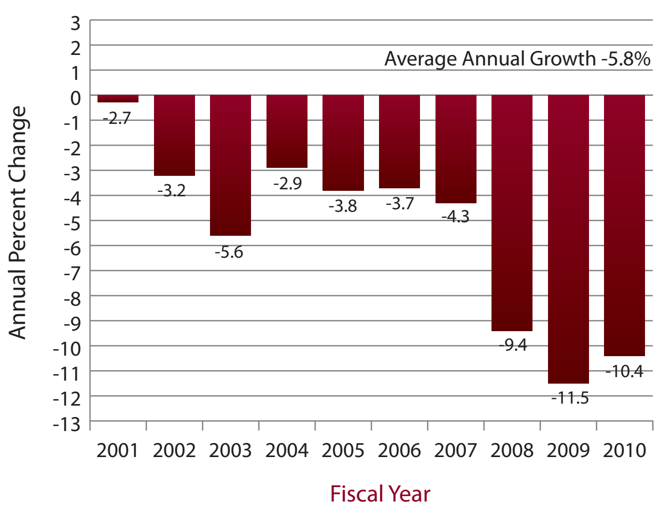
In FY 2010, volume declined 3.6 percent whereas GDP grew 2.8 percent; this created a record gap of 6.5 percentage points between the two measures. This recent and pronounced divergence between the growth patterns in mail volume and GDP is expected to continue in the future. The Postal Service cannot rely on benefiting significantly from a rebound in the economy. Consequently, the Postal Service's financial sustainability is at greater risk than in the past.

First-Class Single-piece Mail

As shown in Figure IV-4, First-Class single-piece mail volume continues its long and progressive decline. In FY 2010, First-Class single piece lost 3.4 billion pieces, or 10.4 percent of its volume. Over the past 10 years, the average annual decrease in First-Class single-piece volume was 5.8 percent. As a result, First-Class single-piece mail lost 24.1 billion pieces or about half of its volume over this period.

One of the major contributors to this decline is the increasing use of the internet for messaging, online bill payment and banking.

Figure IV–4—First-Class Single-Piece Volume Annual Growth Rates Fiscal Years 2001–2010



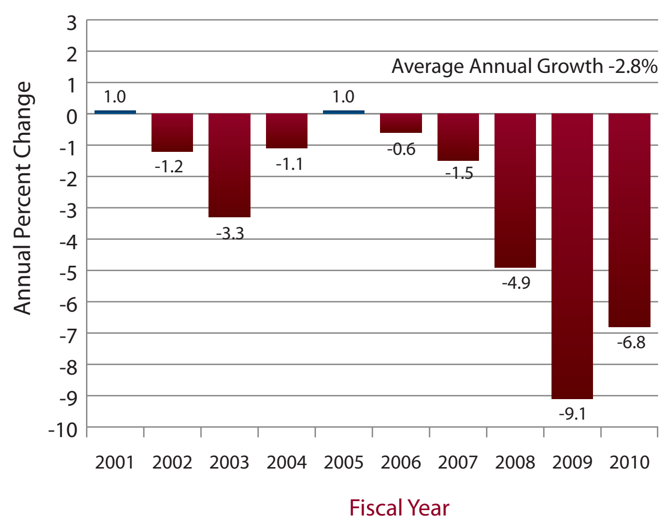
Source: Postal Service Revenue, Piece, and Weight (RPW) reports.

First-Class Presorted Mail

The volume for First-Class presorted mail, the growth of which in the past mitigated the volume declines in single piece, continues declining with year-over-year reductions of 1.6 percent in FY 2008, 7.4 percent in FY 2009 and 4.3 percent in FY 2010. The decline in presort volume can be attributed to electronic presentment of bills and financial statements, and the economic slowdown which has adversely affected the financial industry.

Figure IV-5 below shows the annual growth rates for total First-Class mail over the past 10 years.

Figure IV–5—Total First-Class Mail Volume Annual Growth Rates Fiscal Years 2001–2010



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

In FY 2010, total First-Class volume decreased 6.8 percent or 5.5 billion pieces. The volume decline continued a downward trend that started in 2002. For the past decade, First-Class Mail declined at an average annual rate of 2.8 percent. As a result, First-Class Mail lost 25.7 billion pieces or about one-fourth of its volume over a ten-year period. At the end of FY 2010, First-Class volume was 77.9 billion

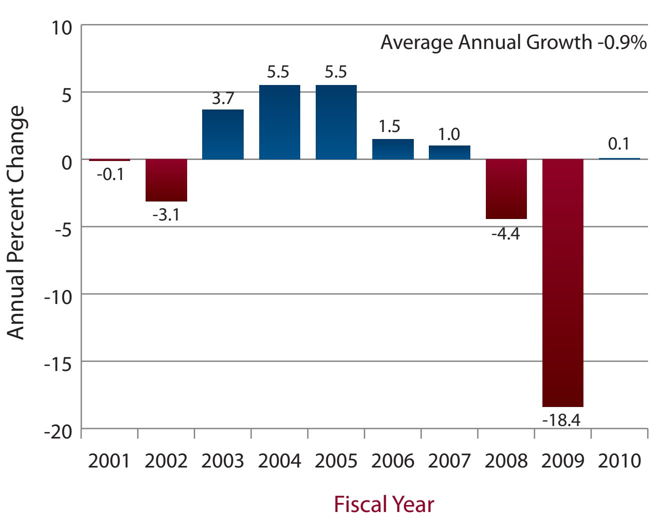
pieces, about the same level as in FY 1987, 24 years ago.

Most of the First-Class volume losses are due to electronic diversion and these pieces are most likely permanently gone. The permanent loss of First-Class Mail is particularly troubling because revenue from this type of mail contributes substantially to the funding of the Postal Service's overhead costs. To compensate for the lost contribution of one piece of First-Class Mail, Standard Mail must increase by three pieces.

Standard Mail

Standard Mail is the largest class by volume; totaling 48.4 percent of all mail pieces delivered by the Postal Service. Figure IV-6 below presents the annual growth rates for Standard Mail during the last decade. Signs of economic recovery can be seen in the reversal of Standard Mail volume declines in FY 2010. Compared to the same period last year, it grew 4.6 percent in quarter III and 8.9 percent in quarter IV. As a result, Standard Mail volume remained essentially flat in FY 2010, with an annual increase of 0.1 percent. Standard Mail volume of 82.5 billion pieces in 2010 represented 79.7 percent of its peak of 103.5 billion pieces in 2007, a decrease of almost 21 billion pieces. Over the past decade Standard Mail volume declined at an average annual rate of 0.9 percent.

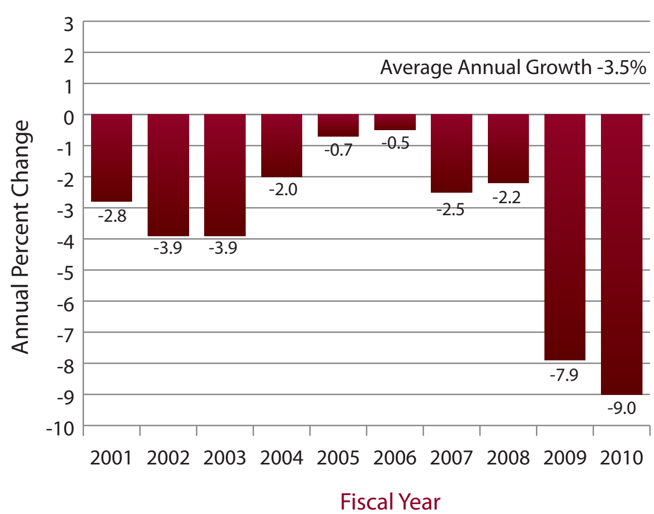
Figure IV–6— Standard Mail Volume Annual Growth Rates Fiscal Years 2001–2010



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

Generally, direct mail has been a major contributor to the overall revenue growth of the Postal Service. Since FY 2005, Standard Mail volume has exceeded First-Class Mail volume every year, except for FY 2009. However, because of the disparity in contribution per piece between First-Class and Standard Mail, this long-term volume shift towards Standard Mail has unfavorable implications for the Postal Service's finances.

Figure IV–7—Periodicals Volume Annual Growth Rates Fiscal Years 2001–2010



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

Periodicals

Figure IV-7 presents the annual percent changes in Periodicals volume for the past ten years. In FY 2010, Periodicals volume decreased by 9.0 percent. This is

the tenth consecutive annual volume decline and the largest ever for Periodicals.

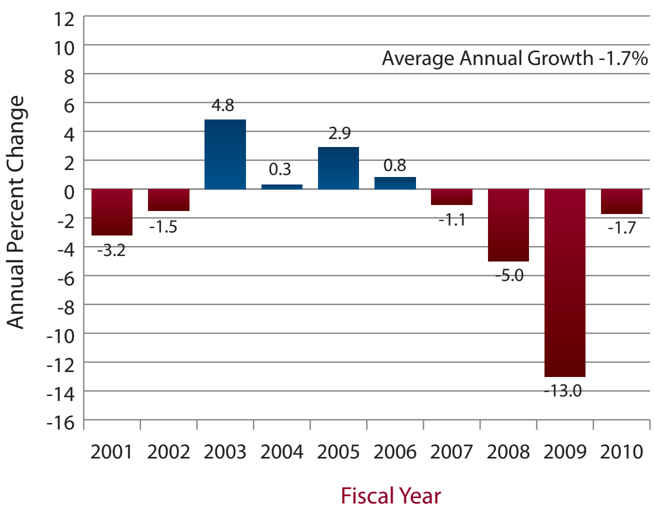
During the past decade, Periodicals volume has declined by about one-third. The average annual decrease in Periodicals volume was 3.5 percent. It is expected that the Periodicals class will continue losing volume in the future.

Package Services

Package Services products face considerable market competition from private parcel carriers. At the same time, they serve a growing market as consumers increasingly use the Internet for shopping online. Figure IV-8 below shows the annual percent changes in Package Services volume during the past decade. The economic recovery helped Package Services volume, reducing the volume losses to 1.7 percent in FY 2010. For the decade, Package Services declined at an average annual rate of 1.7 percent.

The growth rates presented in Figure IV-8 were calculated by aggregating the volumes of four market dominant and two competitive products in order to maintain continuity with prior years. Table VI-8 below presents the growth rates for FY 2010 of all six products included in the Package Services growth rate calculations.

Figure IV–8— Package Services Volume Annual Growth Rates Fiscal Years 2001–2010



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

Table IV–8
Package Services Products
FY 2010 Annual Growth Rates

	Percent Change
Market Dominant Products	
Single-Piece Parcel Post	-27.3
BPM Flats	-3.9
BPM Parcels	-10.1
Media and Library Mail	-13.6
Market Dominant Products	-10.4
Competitive Products	
Parcel Select	18.5
Parcel Return Service	44.4
Competitive Products	20.8
All Products	-1.7

Source: Postal Service RPW report

The economic recovery had a significant positive impact on Parcel Select volume. In 2010, Parcel Select volume increased by 18.5 percent, more than offsetting its decline of 10.6 percent in 2009. Parcel Return Service (PRS) volume continues its unparalleled growth, with year-to-year increases of 44.4 percent in 2010 and 44.8 percent in 2009. The significant growth is a result of the Postal Service's successful effort to develop partnerships with private parcel carriers, to use aggressive pricing, and to leverage the first-mile pickup network. In FY 2010, the Postal Service expanded PRS partnerships begun in 2009 with both FedEx and UPS, in addition to continuing a long-standing relationship with Newgistics.

Workhours

In FY 2010, responding to lower mail volumes, the Postal Service cut 75.1 million workhours (or 6.2 percent) saving $3.6 billion in labor costs. This workhour decrease was equivalent to a reduction of about 42,000 full-time postal employees. Moreover, it followed year-over-year reductions of 115.3 million workhours in FY 2009 and 50 million workhours in FY 2008. Table IV-9 below shows the reduction in the Postal Service's workhours and savings in labor compensation by craft in FY 2010.

Table IV–9—FY 2010 Change in Workhours and Labor Compensation by Craft ($ in Millions)

	Workhours		Nominal Compensation Change
	Change	Percent Change	
Supervisors	(4.5)	-6.9%	(246.4)
Clerks & Mail Handlers	(43.4)	-11.0%	(2,099.2)
City Carriers and Vehicle Drivers	(16.2)	-4.0%	(767.7)
Rural Carriers	(3.9)	-2.2%	(152.2)
Other Employees	(7.0)	-3.9%	(376.80)
Total	**(75.1)**	**-6.2%**	**(3,642.3)**

Source: USPS Annual Tables, FY 2010 TFP

In FY 2010, there were reductions in the workhours of all crafts. As in the previous year, clerks and mail handlers experienced the greatest reduction, with a decrease of 43.4 million workhours, or 11 percent. In 2009, the Postal Service consolidated carrier routes, eliminating over 11,000 routes, with an additional 1,100 routes eliminated in 2010. Over the two years, it also reduced the fleet of postal-owned vehicles by more than 3,000. The net result of these actions was a significant reduction in the workhours of both city and rural carriers. City carrier and vehicle driver hours decreased by 16.2 million, or 4.0 percent, and rural carrier hours fell by 3.9 million, or 2.2 percent. Supervisor workhours decreased by 6.9 percent.

Table IV-10 presents the cumulative change in workhours and labor compensation over the past 10 years.

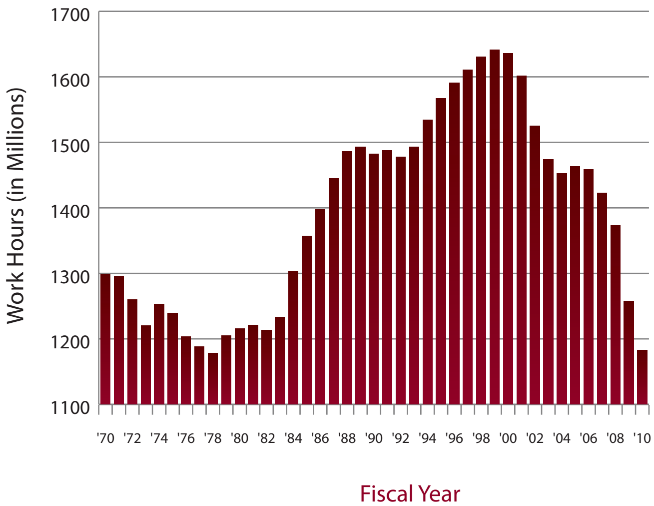
Table IV–10 Change in Workhours and and Compensation by Craft Over Ten Fiscal Years 2001–2010 ($ in Millions)

	Workhours		Nominal Compensation Change
	Change	Percent Change	
Supervisors	(23.4)	-31.7%	(1,117.1)
Clerks & Mail Handlers	(319.3)	-61.9%	(12,536.3)
City Carriers and Vehicle Drivers	(96.85)	-21.9%	(3,940.6)
Rural Cariers	7.02	4.0%	137.1
Other Employees	(20.55)	-11.1%	(981.33)
Total	**(453.1)**	**-32.4%**	**(18,438.2)**

Source: USPS Annual Tables, FY 2010 TFP

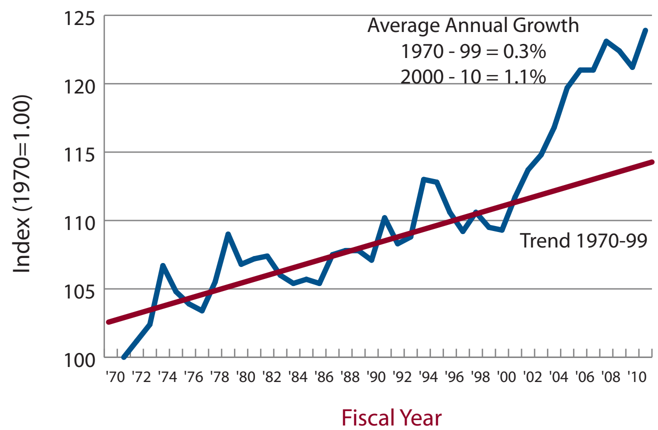
Over the past decade, the Postal Service eliminated 453.1 million workhours, or 32.4 percent, and saved about $18.4 billion in labor costs. The reduced workhours are roughly equivalent to 253,000 employees. Clerks and mail handlers experienced the greatest reduction, losing 319.3 million workhours, or 61.9 percent. The workhours of supervisors and city carriers decreased by 31.7 percent and by 21.9 percent, respectively. During this period, only the workhours of rural carriers increased by 4 percent.

Figure IV–9—U.S. Postal Service Work Hours Fiscal Years 1970–2010



Source: U SPS Annual Tables, FY 2010 TFP

Figure IV–10—U.S. Postal Service Total Factor Productivity (TFP) Fiscal Years 1970–2010



Source: USPS Annual Tables, FY 2010 TFP

Figure IV-9 depicts the annual number of workhours used by the Postal Service over the past 41 years. In FY 2010, the Postal Service delivered 170.6 billion pieces of mail to 130.4 million delivery points using 1,183 million workhours, about the same level of workhours as in FY 1977 when the volume delivered was only 92.3 billion pieces and the number of delivery points was 77.1 million. In other words, in 2010 the Postal Service was able to deliver 85 percent more volume to 69 percent more delivery points than in 1977, using the same workhours.

Productivity

The Postal Service uses Total Factor Productivity (TFP) to measure changes in postal efficiency. TFP measures the change in the relationship between outputs (workload processed) and inputs (resource usage) over a period of time. Workload consists of weighted mail volume, miscellaneous output and the expanding delivery network. Resources consist of labor, materials (including purchased transportation), and deployed capital assets. Workload growth minus the growth of resources used equals TFP growth.

Figure IV-10 presents the TFP growth over the past 41 years.

The Postal Service is a labor intensive organization, with 77 percent of the value of its inputs consisting of labor.[17] From 1970 to 1999, the Postal Service was unable to restrain the growth of its labor input despite heavy capital investments in automation. As a result, over this period, TFP growth fluctuated between short periods of productivity increases and productivity declines, creating a trend of insignificant gains in postal efficiency. From FY 1971 through FY 2000, the Postal Service's productivity increased 9.3 percent, resulting in an average annual TFP growth of 0.3 percent. By decade, the average annual TFP growth rates were: 0.7 percent during the 1970's; 0.0 percent during the 1980's; and 0.2 percent during the 1990's.

[17] Source: Postal Service Annual Tables, FY 2010 TFP. The value of labor includes all wages and benefits for all employees and retirees, including craft employees, professional, administrative, and technical personnel.

From 2000 to 2010, the Postal Service managed to cut its labor force aggressively as its workload remained flat or declined. As a result, the Postal Service's efficiency improved dramatically from 2000 through 2007. During this eight-year period, TFP grew at an average annual rate of 1.5 percent, five times faster than during the last thirty years of the last century. After achieving eight consecutive years of productivity increase, the Postal Service registered TFP declines of 0.5 percent and 1.0 percent for 2008 and 2009, respectively. The large drop in mail volume in FY 2008 and the record decline in FY 2009 made it difficult for the Postal Service to achieve productivity growth. In FY 2010, TFP increased 2.2 percent. Over the past 11 years, TFP grew at an average rate of 1.1 percent annually.

In its 2010 Annual Performance Report and 2011 Annual Performance Plan, the Postal Service announced that it plans to introduce Deliveries-per-Work-Hour as a substitute measure of productivity. According to the Postal Service, this new efficiency measure "compares the number of deliveries of all types (city, rural, highway contract route, Post Office Box, and Caller Service) with the total number of work hours used by all employee categories, including all field and headquarters managers, executives and officers – even the postmaster general."

Although the Commission recognizes the Postal Service's authority to choose the performance indicators for its programs, it is concerned with the proposal to replace TFP with Deliveries-per-Work-Hour as a performance indicator.

Deliveries-per-Work Hour does not recognize a major workload component, the collection, processing, transporting and sequencing for delivery of mail. It erroneously considers the servicing of the expanding delivery network as the only component of postal workload. TFP recognizes both mail volume and delivery points as components of the postal workload and assigns about 80 percent weight to mail volume and 20 percent to delivery points. Moreover, before merging mail volume with delivery points to calculate workload, TFP weights the volume of various postal products to account for variations in work content of mail pieces due to factors such as size, weight, preparation, and mode of transportation. Weighting pieces of mail to reflect their unequal work content allows them to be compared on a consistent basis, as "apples to apples."[18] Finally, unlike TFP, the Deliveries-per-Work-Hour measure considers workhours (*i.e.*, labor) as the only input in postal production ignoring capital inputs and materials.

[18] Weighting of mail volume to account for variations in work content is crucial to obtaining a balanced measure of productivity, because of the accelerating trend away from single piece letter mail with heavy workload content toward bulk, presorted mail with light workload content.


Disaster Relief

Chapter V

Performance Plans & Program Performance Reports

Introduction

The PAEA requires the Commission to review the performance goals established in the Postal Service's 2010 Annual Performance Report (Report) and 2011 Annual Performance Plan (Plan). The Commission must evaluate whether the Postal Service has met the goals in the Report and Plan. It may also provide recommendations to the Postal Service related to protecting or promoting public policy objectives in title 39. 39 U.S.C. 3653(d).

Overall, the Report and Plan is an improvement over the performance reports and plans the Postal Service has provided in past years. Importantly, the Report and Plan adhere more closely to statutory requirements, which addresses the Commission's concerns from the FY 2008 and FY 2009 ACDs. The Plan, however, does not cover each program activity set forth in the Postal Service's budget. *See* 39 U.S.C. 2803(a). In its analysis, the Commission makes suggestions for improving future annual performance reports and plans.

To facilitate analysis and discussion, this chapter is divided into the following sections: Statutory Requirements, Performance Indicators, Strategic Initiatives, Comments, Compliance with Report and Plan Requirements, and Review of Performance Goals.

Statutory Requirements

Statutory requirements for the Plan and Report are codified in 39 U.S.C. 2803 and 2804.[1] Section 2803(a) requires the Postal Service to "prepare an annual performance plan covering each program activity set forth in the Postal Service budget…." The Plan must:

- Establish performance goals defining the level of performance achieved by a program activity;
- Express such goals in an objective, quantifiable, and measurable form;
- Describe the operational processes, skills and technology, and other resources needed to meet these goals;
- Establish performance indicators to measure the relevant outputs, service levels, and outcomes of each program activity;
- Provide a basis for comparing actual program results with established performance goals; and
- Describe the means used to validate measured values.

Sections 2803(b) enables the Postal Service to express performance goals for a particular program activity in an alternative form if the Postal Service determines that it is not feasible to express these goals in an objective and quantifiable manner. The alternative form must describe "minimally effective" and "successful" programs.

Section 2803(c) allows the Postal Service to aggregate, disaggregate, or consolidate program activities when preparing the Plan. However, the Postal Service may not omit or minimize the significance of any program activity that is a major function or operation. Section 2803(d) enables the Postal Service to prepare a non-public annex to the Plan under certain circumstances.

39 U.S.C. 2804 codifies requirements for the Report. Section 2804(a) requires the Postal Service to prepare a report on program performance for each fiscal year. Section 2804(b) requires that the Report set forth the performance indicators established in the Plan, along with the actual performance achieved compared to the performance goals. If the Postal Service specifies performance goals in an alternative form by describing minimally effective and successful program activities, it must provide program results relating to those categories.

Section 2804(d) requires the Report to review the success of achieving the FY 2010 performance goals, evaluate the Plan relative to the performance achieved towards the FY 2010 goals, and include summary findings of program evaluations. If a performance goal has not been met, the Postal Service must explain and describe why the goal was not met and plans and schedules for achieving the goal. If the performance goal is impractical or infeasible, the Postal Service must explain why that is the case and recommend a course of action.

The Report and Plan are consolidated into one document that is included with the 2010 Comprehensive Statement on Postal Operations (Comprehensive Statement).[2] The Postal Service submits the Comprehensive Statement to Congress each year. 39 U.S.C. 2401(e). Among other things, the Comprehensive Statement must address postal

[1] The Postal Service is required to provide the Commission with copies of its most recent comprehensive statement under section 2401(e), performance plan under section 2803, and program performance reports under section 2804. 39 U.S.C. 3652(g). Chapter 28 of title 39, which includes sections 2803 and 2804, was added pursuant to the Government Performance and Results Act of 1993, Pub. L. No. 103-62, 107 Stat. 285 (1993).

[2] Library Reference USPS-FY10-17.

operations generally, including data on the speed and reliability of service provided for the various classes of mail and types of mail service, mail volume, productivity, trends in postal operations, and analyses of how internal and external factors impact the Postal Service.[3]

Performance Indicators

The Report and Plan are part of the Postal Service's annual performance management process. This process establishes performance targets and measures results from the past fiscal year against those targets. The annual performance management process focuses on the Postal Service's three corporate strategic goals: Improve Service, Improve Employee Engagement, and Improve Financial Performance.

To evaluate its progress towards achieving these goals, the Postal Service developed 10 performance indicators, which are described in more detail below. The Postal Service has the authority to establish performance indicators for each program activity in the Postal Service's budget. *See* 39 U.S.C. 2803(a)(4). For each performance indicator, the Postal Service sets an annual target to allow management to focus on near-term priorities and current conditions. These targets are published in the Plan, which explains how results will be measured and describes any indicator or measurement changes from prior years. Report and Plan at 1.

The Report provides results against the prior year's targets and serves as a baseline for establishing new targets. Once the Postal Service establishes annual targets, it deploys resources and assigns accountability, implements actions to achieve results, and monitors performance against the targets. It also makes resource adjustments throughout the year. *Id.*

Table V-1 shows seven out of the ten performance indicators currently used by the Postal Service to evaluate performance towards achieving its three strategic goals of Improve Service, Improve Employee Engagement, and Improve Financial Performance. Not shown are performance indicators for Express

[3] Products and Services, Operations, Customer Programs, and Workforce are discussed in Chapters 2-5 of the Comprehensive Statement.

Table V–1 — Comparison of Actual and Target Performance for Postal Strategic Goals

Strategic Goal	Performance Indicator	FY 2008 Actual	FY 2009 Actual	FY 2010 Plan	FY 2010 Actual	FY 2011 Plan
Improve Service	**First-Class Single-Piece Mail** Overnight	96.5%	96.2%	96.6%	96.36%	96.65%
	2 Days	94.1%	93.7%	94.1%	93.71%	94.15%
	3-5 Days	92.7%	92.2%	92.8%	92.44%	92.85%
Improve Employee Engagement	OSHA Illness and Injury Rate	5.74	5.62	5.52	5.49	5.39
	Voice of the Employee Survey Rate	63.7	64.0	63.8	62.3	64.5
Improve Financial Performance	Total National Revenue ($ billions)	$74.9	$68.1	$65.9	$67.1	N/A
	Total Factor Productivity	(0.5%)	(0.9%)	1.2%	2.2%	N/A
	Operating Income ($ billions)	N/A	N/A	N/A	N/A	(0.9)
	Deliveries per Work Hour	N/A	N/A	N/A	N/A	40.4

Source: Report and Plan at 2. Footnotes have been omitted from the original table.

Mail, Priority Mail, and Parcel Select, which are competitive products that are not publicly reported. Table V-1 also lists Operating Income and Deliveries per Work Hour (DPWH), two new performance indicators for FY 2011.

For each performance indicator, the Postal Service provided actual results for fiscal years 2008, 2009, and 2010, as well as targets for fiscal years 2010 and 2011. Of the 10 performance indicators, six support Improve Service, two support Improve Employee Engagement, and two support Improve Financial Performance. In the discussion that follows, each performance indicator is discussed in relation to the strategic goal it supports.

Improve Service

The six performance indicators that support Improve Service are First-Class Single-Piece Mail Overnight, First-Class Single-Piece Mail 2 Days, First-Class Single-Piece Mail 3-5 Days, Express Mail, Priority Mail, and Parcel Select. The Postal Service sets targets and measures results based on service performance scores in these categories.

In FY 2010, service performance scores for First-Class Single-Piece Mail fell slightly below national targets in all three categories (Overnight, 2 Days, and 3-5 Days). The Postal Service explains that service was affected by unusually severe weather-related issues. However, service performance scores in FY 2010 improved over FY 2009 scores because of an increase in process improvements and actionable data at all levels of operations. *Id.* at 3. For a more detailed discussion of First-Class Single-Piece Mail performance, please see Chapter VI on Service Performance.

The Report and Plan did not list service performance scores for Express Mail, Priority Mail, and Parcel Select. Because these products are competitive, performance targets and results are not publicly reported. *Id.*

The Postal Service measures and reports other categories of mailing services, which include Presort First-Class Mail and Standard Mail, Periodicals, Package Services, and Special Services. While these categories also have service standards and goals, the Postal Service did not use their service performance scores as performance indicators because they have not gone through the annual performance management process described above. The Postal Service states that it may include these other categories of mailing services in future performance reports and plans once more reliable diagnostic data is available. *Id.* at 4.

Improve Employee Engagement

To evaluate Employee Engagement, the Postal Service relies on two performance indicators: the Occupational Safety and Health Administration (OSHA) illness and injury rate and the Voice of the Employee (VOE) survey index.

The OSHA illness and injury rate measures the number of injuries and illnesses that occur per 100 employees. This rate dropped from a high in FY 2008 of 5.74 to 5.49 in FY 2010. The target for FY 2011 is 5.39.

The Postal Service tracks employee engagement using an index developed from the VOE survey.[4] The survey has 33 questions, not including demographic and environmental questions. Most of them ask employees to evaluate certain statements, such as "My job

[4] Library Reference USPS-FY10-44.

makes good use of my skills and abilities." For most questions, employees choose from five answers, ranging from "Strongly Agree" to "Strongly Disagree." In other questions, answers range from "Very Good" to "Very Poor" or "Yes," "No," or "Not Sure." *Id.*

The Postal Service groups the survey questions into eight categories: strategic direction, trust, contribution to Postal Service growth, communication, diversity and respect, employee commitment, personal safety, and work effort and quality.[5] The performance indicator for the VOE survey is an index score based on the average number of favorable employee responses to one question from each category. Report and Plan at 5.

The Postal Service states that survey results are used to identify organizational issues and establish improvement strategies.[6] In FY 2009, the actual VOE survey index score was 64. In FY 2010, the actual score was 62.3, falling short of the target by 1.5 points. The FY 2011 target is 64.5.

Improve Financial Performance

Currently, the Postal Service measures financial performance using total national revenue and total factor productivity (TFP) as performance indicators. Total national revenue includes all postage, fees, and other funds obtained from selling products and services. From FY 2008 to FY 2010, total national revenue declined from a high of $74.9 billion in FY 2008 to a low of $67.1 billion in FY 2010. However, actual FY 2010 revenue was higher than target by $1.2 billion. Report and Plan at 2.

TFP compares outputs, such as deliveries made, with resources used, including capital, labor, and materials at the corporate level. From FY 2008 to FY 2010, TFP improved from a low of (0.5) percent to a high of 2.2 percent. *Id.*

FY 2011 Financial Performance Indicator Changes

In FY 2011, the Postal Service plans to change the financial performance indicators by discontinuing its use of total national revenue and TFP. It proposes replacing total national revenue with operating income, which is net of total operating revenues less total operating expenses. Operating expenses include all expenses other than the prefunding of the Retiree Health Benefits Fund (RHBF) and adjustments to Workers Compensation liabilities that may result due to changes in discount rates. The Postal Service contends that adding operating income as a performance indicator will focus attention on the importance of profitability and cash flow within management's control. *Id.* at 6-7.

In FY 2010, the Postal Service had an operating loss of $0.5 billion. For FY 2011, the target is a loss of $0.9 billion.

The Postal Service proposes to replace TFP with DPWH as a financial performance indicator in FY 2011. DPWH is an efficiency measure comparing the total number of deliveries of all types with the total number of work hours used in all employee categories. It is calculated by multiplying the number of delivery points (approximately 151 million) by the number of delivery days (303). The result (45,753 million deliveries per year) is divided by the total number of work hours used in all employee

[5] Response to CHIR No. 4 at 39.

[6] http://www.usps.com/strategicplanning/cs09/CSPO_09_103.htm.

categories, including managers and executives (1,134 million).[7]

In FY 2010, the actual DPWH were 38.6 deliveries. In FY 2011, the target is 40.4. The Postal Service asserts that increasing DPWH requires increasing automation, implementing process improvements in all areas, consolidating facilities, and reducing work hours. The Postal Service contends that DPWH is a better measure of productivity than TFP, which is solely an aggregate measure that is not as useful for managing and motivating performance. *Id.*

Strategic Initiatives

In the FY 2008 and FY 2009 ACDs, the Commission asked the Postal Service to produce annual performance plans and reports adhering more closely to the requirements of 39 U.S.C. 2803 and 2804. Responding to the Commission's request, the Postal Service introduced and described nine strategic initiatives in an appendix to the Comprehensive Statement. Comprehensive Statement at 51-53. The Postal Service stated that these initiatives "help clarify the connection between strategic goals and objectives, and the actions necessary to achieve them…." *Id.* at 51.

Each strategic initiative supports one or more of the strategic goals of Improve Service, Improve Employee Engagement, and Improve Financial Performance. Each initiative also has a results indicator used to measure the success of the strategic initiatives in meeting their FY 2011 targets.

The results indicators differ from the 10 performance indicators described above for the Report and Plan. The PAEA requires performance plans to establish performance indicators to be used in measuring or assessing relevant outputs, service levels, and outcomes of each program activity in the Postal Service's budget. 39 U.S.C. 2803(a)(4). Strategic initiatives and results indicators clarify the connection between the performance of individual programs and the three strategic goals of Improve Service, Improve Employee Engagement, and Improve Financial Performance.

Table V-2 displays the nine strategic initiatives, strategic goals supported, results indicators, and FY 2011 targets. A discussion of each strategic initiative follows.

Intelligent Mail

Intelligent Mail is a strategic initiative measuring the percentage of workshared mail containing an Intelligent Mail barcode (IMb). The FY 2011 target is for 90 percent of workshared mail to have either a Full-Service or Basic IMb.[8] The Postal Service states that the 90 percent target assumed that mailers would be required to use IMbs by the end of May 2011 to receive an automation discount. That assumption is no longer valid, and the Postal Service is currently reassessing that target.[9] Table V-3 displays the percentage of Full-Service and Basic IMb-eligible mail that is expected to be IMb compliant by the end of FY 2011, rounded to the nearest tenth of a percent.

The Postal Service reports that as of March 4, 2011, 37 percent of IMb items are Full-Service IMb compliant. This percentage includes both Full-Service

[7] Report and Plan at 7. To the extent that the Postal Service does not deliver to some addresses six days a week, the DPWH calculated value would be overstated.

[8] This measure excludes in-county Periodical volumes. Comprehensive Statement at 53.

[9] Response to CHIR No. 5 at 17.

Table V–2—Strategic Initiatives that Support Strategic Goals

Strategic Initiative	Strategic Goals Supported	Results Indicator	FY 2011 Target
Intelligent Mail	Service Employee Engagement Financial Performance	Increase the percentage of workshared mail containing an IMb. (Full-Service and Basic, excluding Periodicals in-county volumes)	90% by end of year
Flats Sequencing System	Service Financial Performance	Increase the percentage of flat mail in delivery point sequence for delivery zones on FSS that have been in operation at least six months.	72%
Expand Access	Service Financial Performance	Expand share of retail revenue generated by means other than at a postal retail counter.	35%
Optimize Network	Service Financial Performance	Reduce total interior facility space.	Reduce by 2.8 million sq/ft
Flexible Workforce	Service Employee Engagement Financial Performance	Come in below the Integrated Financial Plan average work hour rate. (Bargaining and casual employees, including wages, benefits and existing contractual wage increases. Excludes current and prefunding payments for retiree health benefits.)	$41.69/hour
Reduce Energy Use	Financial Performance	Continue progress toward FY 2015 energy reduction goals.	On target
Reduce Delivery Fixed Costs	Financial Performance	Increase average number of deliveries per route. (combination of city and rural delivery routes)	589 by end of year
Expand Products, Services, and Features	Service Employee Engagement Financial Performance	Create new products, services, and features.	15 new
Address Overfunded Legacy Costs	Employee Engagement Financial Performance	Address legacy cost funding issues.	All three addressed

Source: Comprehensive Statement at 53

Table V–3—FY 2011 Year End IMb Compliance Expectations

Mail Class	Full-Service IMb	Basic IMb
First-Class Mail	50%	23.5%
Standard Mail	36.5%	20.9%
Periodicals	54.6%	42.1%
Package Services	6.3%	0.7%

Source: Response to CHIR No. 5 at 17.

and Mixed Service mailings.[10] Only three percent of Full-Service IMb compliant mail is included in current service performance measurements. *Id.* at 17-18.

The Postal Service plans on taking steps to obtain sufficient Full-Service IMb compliant mail in order to report service performance results for Standard Mail and Presort First-Class Mail in FY 2011. These steps include reducing the complexity of customer supplier agreements and establishing national customer acceptance and critical entry times. The Postal Service states that these steps should significantly reduce the potential for errors and enable an increasing number of mailers and Full-Service IMb pieces to be included in FY 2011 service performance reports. *Id.*

Flats Sequencing System

The flats sequencing system (FSS) is a strategic initiative that increases the percentage of flat mail in delivery point sequence for delivery zones operational on the FSS for at least six months. The FY 2011 target is 72 percent. Comprehensive Statement at 53. The Postal Service explains that this initiative focuses on reducing carrier sortation and associated costs through automated processing of flat mail into delivery sequence. It states that FSS will replicate for flats the benefits achieved by letter sequencing, which will improve service and financial performance. *Id.* at 51.

Expand Access

Expanding postal access is a strategic initiative that increases the proportion of retail revenue generated by means other than a postal retail counter. *Id.* Two examples are self-service kiosks and partnerships with companies such as Office Depot. *Id.* at 26. The FY 2011 target is 35 percent.

Optimize Network

Under this strategic initiative, the Postal Service adapts physical networks to changes in mail volume, mail mix, and customer behavior. The results indicator is to reduce total interior facility space, and the FY 2011 target is a reduction of 2.8 million square feet. The Postal Service explains that this strategic initiative enables it to take advantage of new technologies and improved processes to reduce excess capacity in postal plants, post offices, and delivery units. *Id.* at 52.

Flexible Workforce

Having a flexible workforce is a strategic initiative that addresses labor costs, which compose nearly 80 percent of the Postal Service's total expenses. *Id.* at 44. The results indicator for this initiative is the average hourly rate for bargaining and casual employees, including existing contractual wage increases. It excludes the RHBF obligation, which is not within management's control. The FY 2011 target is to come in below the FY 2011 Integrated Financial Plan average work hour rate of $41.69 per hour. The Postal Service plans to reduce work hours and the cost of the work hours used.

Reduce Energy Use

The Postal Service proposes to reduce energy use each year to meet the FY 2015 energy reduction goals set forth in the Strategic Sustainability Performance Plan. The Postal Service reports that it sets specific targets for the National Performance Assessment Energy Index (NPA Index). If the targets

[10] Mixed Service mailing refers to a situation in which a mailer does not want to prepare a tray with fewer than 150 pieces. The mailer may include the "overflow" pieces in the next tray level. For example, if a mailer has 30 5-digit overflow pieces going to ZIP Code 20260, then those pieces may be added to a qualified 3-digit tray (202), and the overflow pieces will receive the 5-digit rate. Domestic Mail Manual 235.

are achieved, the Postal Service will comply with the goals of the Energy Independence Security Act (EISA) of 2007. The Postal Service states that "EISA requires a 30 percent reduction in facility energy intensity by 2015…and a 20 percent reduction in petroleum-based fuel consumption in postal owned vehicles by 2015…." Response to CHIR No. 5 at 20.

The Postal Services' NPA Index reduction target is 4.1 percent. The NPA Index score is based on achieving in FY 2011 a 4.5 percent reduction in petroleum fuel used in its vehicles and a 3.5 percent reduction in its facility electricity usage. Progress against the NPA Index is published monthly. While the NPA Index reduction target is not included as one of the performance indicators in the Plan, it is included as a compensable indicator for multiple functional managers. *Id.* at 20-21.

The results indicator for this strategic initiative is the continued progress toward meeting FY 2015 energy reduction goals. The FY 2011 target is for the Postal Service to be on track to meet these energy reduction goals.

Reduce Delivery Fixed Costs

The Postal Service states that delivery is the largest cost center and carries the greatest share of fixed costs. Thus, it contends that reducing fixed delivery costs is critical because of declining volume and revenue per delivery point. The results indicator for this strategic initiative is to increase the average number of deliveries per route for city and rural routes combined. The FY 2011 target is 589 deliveries per route by the end of the year. Comprehensive Statement at 52.

Expand Products, Services, and Features

Under this initiative, the Postal Service will provide customers with new mailing and shipping products, services, and features to meet their changing needs. The results indicator is the number of new products, services, and features created. The FY 2011 target is 15. *Id.*

Address Overfunded Legacy Costs

The legacy costs identified are the pension overpayments to the Civil Service Retirement System and the Federal Employee Retirement System. If these overpayments are applied to future RHBF obligations, the Postal Service believes that it could return to a pay-as-you-go method. If it is unable to obtain relief, the Postal Service projects that it may lack sufficient funds to make the required RHBF payment in September 2011. The results indicator for this strategic initiative is "address legacy cost funding issues"; the FY 2011 target is "all three addressed." *Id.* at 53.

Comments

In Order No. 636, the Commission solicited comments from interested persons concerning the Postal Service's progress in meeting its performance goals. Order No. 636 at 6. The Public Representative was the only participant to submit comments on this matter. He praises the progress the Postal Service made towards complying with 39 U.S.C. 2803 and 2804. PR Comments at 17.

The Public Representative applauds the Postal Service for adding the strategic initiatives and clearly defining performance targets for each one. He states that, while long overdue, performance targets will provide a baseline for future performance plans and reports.

However, he cautions that the Postal Service changed its financial performance indicators in FY 2011 to operating income and DPWH. He contends that, while improvements are generally welcome, changes should be limited in number to prevent any disruption in the continuity of measurement over time. *Id.*

Compliance with Report and Plan Requirements

Responding to a FY 2009 ACD recommendation, staff from both the Postal Service and the Commission met to discuss methods of improving Postal Service reporting relative to the requirements of 39 U.S.C. 2803 and 2804. The information provided in the Report and Plan is an improvement over the information provided in past years. By identifying the strategic initiatives, the Postal Service responded to the Commission's request to provide more information on the performance of individual programs and the connection between programs and the three strategic goals of Improve Service, Improve Employee Engagement, and Improve Financial Performance. However, the Plan does not cover each program activity set forth in the Postal Service's operating budget. *See* 39 U.S.C. 2803(a).

Plan Requirements

In FY 2010, the Plan met almost all statutory requirements in section 2803. But the Plan did not "[cover] each program activity set forth in the Postal Service budget…."[11] In the FY 2009 ACD, the Commission determined that "the Postal Service budget" means "the Postal Service operating budget, not some variation of it limited to appropriations." FY 2009 ACD at 43. The operating budget is part of the Postal Service's FY 2010 Integrated Financial Plan.

Covering each program activity set forth in the Postal Service's operating budget is an essential requirement of the Plan. Performance plans must establish performance goals and performance indicators to measure the performance levels and outcomes of each program activity. *See* 39 U.S.C. 2803(a)(1), (a)(4).

The Plan met the other requirements of section 2803. The Plan established performance goals defining the level of performance to be achieved by a program activity. Performance goal means "a target level of performance expressed as a tangible, measurable objective, against which actual achievement shall be compared…." 39 U.S.C. 2801(3). The Plan expressed performance goals as the targets set for each of the 10 performance indicators. These targets are expressed in "objective, quantifiable, and measurable form[s]" such as percentages, rates, and revenue in billions of dollars. *See* 39 U.S.C. 2803(a)(2).

Performance plans must also establish performance indicators, which refer to "a particular value or characteristic used to measure output or outcome[.]" 39 U.S.C. 2801(4). The Postal Service has the authority to choose its own performance indicators. The Plan identified 10 performance indicators to measure or assess relevant outputs, service levels, and outcomes for each program activity. *See* 39 U.S.C. 2803(a)(4). Performance indicators are grouped under the strategic goal they support.

The Plan provided "a basis for comparing actual program results with the established performance goals" by comparing FY 2010 actual to FY 2010 targets for each performance indicator. *See* 39 U.S.C. 2803(a)(5). The Plan also described the

[11] *Id.* Program activity means "a specific activity related to the mission of the Postal Service[.]" 39 U.S.C. 2801(5).

means used to verify and validate measured values by explaining how the Postal Service determines actual and target performance results. *See* 39 U.S.C. 2803(a)(6).

The Postal Service also "briefly describe[d] the operational processes, skills and technology, and the human, capital, information, or other resources required to meet the performance goals[.]" *See* 39 U.S.C. 2803(a)(3). In future performance plans, the Postal Service is requested to provide further detail about the resources needed to meet the performance goals.

Report Requirements

The Report complied with requirements in section 2804. It set forth the 10 performance indicators established in the Plan and compared FY 2010 actual performance results with FY 2010 targets. *See* 39 U.S.C. 2804(b)(1). For each performance indicator, the Report reviewed the Postal Service's success in achieving FY 2010 targets and evaluated the Plan relative to the performance achieved towards the targets in FY 2010. *See* 39 U.S.C. 2804(d)(1), (d)(2).

If the Postal Service did not meet a target, it explained why and described how it would meet that target in FY 2011. *See* 39 U.S.C. 2804(d)(3). For example, the Postal Service explained that First-Class Single-Piece Mail performance fell short of FY 2010 targets because of severe weather-related issues. Report and Plan at 3. Its plan for improving performance includes refining automation and address recognition, eliminating unnecessary handling and processing, improving visibility, and standardizing the use of computerized workforce planning models. *Id.* at 4.

The Report also included summary findings of program evaluations completed during FY 2010.[12]

Review of Performance Goals

The PAEA requires the Commission to evaluate whether the Postal Service has met the performance goals established in the Report and Plan. This review involves comparing FY 2010 results for each performance indicator against FY 2010 targets. The Commission also evaluates the adequacy of the performance indicators and makes specific recommendations. Each performance goal, or target, is discussed below under the strategic goal it supports.

The Commission may provide recommendations to the Postal Service that relate to protecting or promoting the public policy objectives in title 39. Specific recommendations for each target are listed below. In general, the Commission suggests that the Postal Service apply consistent terminology throughout the Report and Plan. For example, "target" and "plan" are used interchangeably. Report and Plan at 3.

The Postal Service should also clearly define "objective." The Postal Service states that it sets a limited number of "high-priority objectives" to advance its three strategic goals of Improve Service, Improve Employee Engagement, and Improve Financial Performance. *Id.* at 1. It explains that the strategic initiatives help "clarify the connection between strategic goals and objectives…." Comprehensive Statement at 51.

However, the Report and Plan do not clearly state whether those objectives are performance indicators, targets, or some other measurement. Because the

[12] Program evaluation means "an assessment, through objective measurement and systematic analysis, of the manner and extent to which Postal Service programs achieve intended objectives." 39 U.S.C. 2801(6).

strategic initiatives are designed to link the strategic goals and objectives, understanding these objectives is important to the Commission's analysis. The Commission recommends that future performance reports and plans identify those objectives unambiguously.[13]

Improve Service

The Postal Service is progressing towards the targets set for First-Class Single-Piece Mail. First-Class Single-Piece Mail service performance scores fell slightly below FY 2010 targets, but by no more than 0.4 percentage points. However, service performance scores in FY 2010 improved over FY 2009 scores. FY 2011 targets are all slightly higher than those set in FY 2010.

The Commission is concerned, however, about the adequacy of the performance indicators that measure service improvements. The Postal Service identified six performance indicators that support its strategic goal of Improve Service. However, these indicators are limited to one market dominant product (First-Class Single-Piece Mail) and three competitive products (Express Mail, Priority Mail, and Parcel Select). Performance for those competitive products is not publicly reported, but the Postal Service provided service performance targets under seal.[14]

The Commission recognizes that the Postal Service may choose its own performance indicators. However, its choice provides an incomplete picture of the measurement systems used to track service performance. Limiting performance indicators to First-Class Single-Piece Mail, which comprises only 17.9 percent of total mail volume,[15] and three competitive products fails to recognize that the Postal Service offers multiple products and services.

The Commission recommends that the Postal Service expand the performance indicators and establish performance goals that include service standard performance scores for other classes of market dominant mail. The Postal Service should also provide a more robust analysis of its competitive products by filing under seal both the targets and actual results. The changes would not unduly burden the Postal Service because it is required to report the service performance of all market dominant products. *See* 39 CFR 3055.1. Also, the Postal Service currently uses service performance measurements to measure the speed of delivery and reliability of market dominant products.[16] Moreover, providing targets and results for each market dominant product would meet the needs of the public, satisfy reporting requirements, and enable the Commission to evaluate the Postal Service's progress in meeting the performance goals that support improving service.[17]

The Commission also recommends that the Postal Service add performance indicators to measure consumer access to postal services. The Postal Service is required to file reports in this area. *See* 39 CFR 3055.91. Consumer access to postal services is a viable method of evaluating and measuring service improvements.

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13 If "objectives" mean the targets set for each performance indicator, the Commission suggests that the Postal Service use "targets" instead of "objectives" to be consistent with service performance reporting.

14 Library Reference USPS-FY10-NP32.

15 FY 2009 Annual Revenue, Pieces, and Weight Report.

16 *See* Chapter VI on Service Performance for further details.

17 Chapter VI contains further discussion on the lack of progress on evaluating service performance for those products measured using the IMb.

Improve Employee Engagement

The Postal Service met the target set for the OSHA illness and injury rate. The Postal Service is governed by the *Occupational Safety and Health Act of 1970* (OSH Act), which was passed to prevent workers from being seriously harmed or killed at work. The OSH Act requires employers to provide their employees with working conditions that are free of known dangers. OSHA sets and enforces protective workplace safety and health standards that require each employer, including the Postal Service, to provide a place of employment that is free from recognized hazards.[18]

Illness and injury records must be kept by employers, and those records are subject to review to ensure that employers comply with the OSH Act. OSHA can assess penalties to employers for violating safety and reporting requirements. *Id.* In FY 2010, the Postal Service paid $478,070 in Civil Penalties and $2,090 in Criminal Penalties to OSHA.[19] It is important to employees that the Postal Service provide a safe work environment and reduce the penalties assessed by OSHA.

The Commission finds that the OSHA illness and injury rate is an appropriate performance indicator for measuring employee engagement. In FY 2010, the actual illness and injury rate of 5.49 per 100 employees improved over the FY 2009 actual and the FY 2010 target. The Postal Service plans to improve its performance in FY 2011 by setting a target of 5.39. Report and Plan at 5.

The other performance indicator measuring employee engagement is the VOE survey index.[20]

The Commission finds that the VOE survey index is acceptable. Although the FY 2010 score of 62.3 fell slightly short of the target, the Postal Service stated that most employees remain positive and have an improved understanding of postal strategies. For FY 2011, the Postal Service increased the target to 64.5. *Id.*

Improve Financial Performance

The Postal Service met the targets set for total national revenue and TFP. Although revenue declined, total national revenue in FY 2010 exceeded the target by $1.2 billion. TFP also increased to 2.2 percent, 1 percentage point above the FY 2010 target.

However, the Postal Service's current financial condition impedes improvements in financial performance. Revenues from FY 2007 to FY 2010 have declined from a high of approximately $75 billion in FY 2007 to a low of approximately $67 billion in FY 2010. From FY 2007 to FY 2010, the Postal Service has experienced total cumulative losses of $20.2 billion.[21] These losses, coupled with projected losses in future years, are threatening the Postal Service's ability to meet its mandate under 39 U.S.C 101 and 3622(b)(5). While the Postal Service was able to meet all of its financial obligations in FY 2010, stakeholders are concerned that it may not be able to do so in FY 2011.

As described in Chapter IV, the Postal Service is continuing to reduce costs. The Postal Service has been decreasing work hours, renegotiating supply and service contracts, adjusting transportation requirements, and revising city carrier routes. In the Postal Service's ten-year plan, the Postal Service

18 *http://osha.gov/workers.html.*
19 National Trial Balance, September 2010.
20 Library Reference USPS-FY10-44.

21 United States Postal Service, 2010 Annual Report at 85.

proposes to continue to control costs and increase revenues over the long run.

As previously mentioned, the Postal Service proposes two new financial performance indicators – operating income and DPWH. Operating income will replace total national revenue as a financial performance indicator in FY 2011. The Postal Service uses the term "operating income" to mean total operating revenues less total operating expenses.[22] The Postal Service contends that using operating income as a performance indicator would enable it to focus on improving profitability and cash flow, which are directly within management's control. *Id.* at 7.

The Commission does not believe that operating income alone will provide a complete and accurate picture of the Postal Service's financial performance. In the FY 2009 and FY 2010 performance plans, the Postal Service used total national revenue and TFP as the performance indicators for improving financial performance. In the FY 2010 Performance Plan discussion, the Postal Service stated that achieving net income is "essential to its continued ability to provide affordable universal service."[23]

Operating income is a better financial performance indicator than total national revenue. However, it could potentially be misleading. Operating income ignores the financial requirement of $5.5 billion to fund future RHBF obligations. It also disregards any changes in Workers Compensation liabilities due to changes in discount rates.

While the Commission agrees that the RHBF obligation is beyond the Postal Service's control, the Postal Service should nonetheless recognize in its performance goals the necessity of generating net income or loss. When setting performance goals, concentrating on just the "controllable" operating income could undermine the goal-setting process. The RHBF expenses must be accounted for as an expense of the organization.

In the normal course of financial reporting, the Postal Service may report a period's financial result in a manner that accurately represents the financial result of the reporting period according to Generally Accepted Accounting Principles (GAAP). GAAP specifies how a company reports non-recurring or extraordinary transactions, but the RHBF payments and Workers Compensation liability adjustments are not non-recurring or extraordinary. The Postal Service may report financial results using "controllable" operating income, and it may report expenses for the RHBF obligation and Workers Compensation liability adjustments separately. However, it should be understood that these expenses are part of the operating expenses of the Postal Service despite the lack of control it may have over them.

The Postal Service also plans to replace TFP with DPWH as a measure of productivity. While the Commission recognizes the Postal Service's authority to choose the performance indicators, the Commission recommends against replacing TFP with DPWH as a performance indicator. DPWH does not recognize major workload components, including collecting, processing, transporting, and sequencing of mail for delivery. It considers the servicing of the expanding delivery network as the only component of postal workload.

22 Operating revenues include all postage, fees, and other funds obtained from the sale of products and services. Operating expenses include all expenses other than RHBF payments and adjustments to Workers Compensation liabilities. Report and Plan at 6.

23 USPS FY 2009 Comprehensive Statement at 61.

By contrast, TFP recognizes both mail volume and delivery points as components of the postal workload and assigns about 80 percent weight to mail volume and 20 percent to delivery points. Moreover, before merging mail volume with delivery points to calculate workload, TFP weights the volume of various postal products to account for variations in work content of mail pieces due to factors such as size, weight, preparation, and mode of transportation. Weighting pieces of mail to reflect their unequal work content allows them to be compared on a consistent basis, as "apples to apples."[24] Finally, unlike TFP, DPWH considers work hours, such as labor, as the only input in postal production, ignoring capital inputs and materials.

The Commission suggests that the Postal Service use TFP, rather than the less robust DPWH, as a financial performance indicator. In addition, the Postal Service must continue to report TFP according to data reporting rules. *See* 39 CFR 3050.60(e).

Strategic Initiatives

The strategic initiatives facilitate the Commission's review of performance goals under 39 U.S.C. 3653(d). The Commission reviews the strategic initiatives as part of its evaluation of whether the Postal Service met the goals established in the Report and Plan. As described above, each strategic initiative supports one or more of the three strategic goals of Improve Service, Improve Employee Engagement, and Improve Financial Performance. Each initiative also has a results indicator and a FY 2011 target.

[24] Weighting of mail volume to account for variations in work content is crucial to obtaining a balanced measure of productivity because of the accelerating trend away from single-piece letter mail with heavy workload content toward bulk, presorted mail with light workload content.

Strategic initiatives were introduced in FY 2011. As such, the Report and Plan have no actual performance results to compare to FY 2011 targets. The Postal Service stated that results will be reported in the FY 2011 Comprehensive Statement. Comprehensive Statement at 51.

In future filings, the Commission recommends that the Postal Service identify the underlying metrics for the Reduce Energy Use strategic initiative. Currently, the results indicator is "[c]ontinue progress toward 2015 energy reduction goals" and the FY 2011 target is "On target[.]" Comprehensive Statement at 53. The underlying metrics would help explain how much the Postal Service should progress to be "on target" to meet its FY 2015 energy reduction goals.

The Postal Service provided some of the underlying metrics in its Response to CHIR No. 5. It quantified the energy use reductions planned for FY 2011 by identifying specific percentage reductions in petroleum fuel and facility electricity usage. Response to CHIR No. 5 at 20. Incorporating these specific reductions into the results indicator and target for the Reduce Energy Use strategic initiative would be beneficial.


Disaster Relief

Chapter VI

Service Standard Performance

Introduction

Under the PAEA, the Commission is tasked with reviewing the Postal Service's quality of service for all market dominant products, including speed of delivery, reliability, and the level of customer satisfaction. The review is undertaken to ensure that quality of service does not deteriorate under the CPI price cap system because of the potential to cut costs by way of service reductions to comply with price cap requirements.

In FY 2010, the Commission issued Order No. 465 which established periodic reporting requirements for service performance measurements and customer satisfaction.[1] In Order No. 465, the Commission required the Postal Service to follow a two step process to achieve full compliance with all reporting requirements by the filing date of the FY 2011 ACR. The first step required the Postal Service to seek semi-permanent exceptions from service performance reporting as allowed by rule 3055.3. The Postal Service sought and was granted multiple semi-permanent exceptions predominantly in the areas of Special Services and negotiated service agreements. The second step required the Postal Service to seek waivers from reporting where more time is needed to fully develop service performance measurement systems. Consideration of these waivers is pending before the Commission.

The semi-permanent exception and waiver process has informed the Commission of the current status of the Postal Service's measurement systems. Based upon the current status, the Commission is concerned with the Postal Service's progress in achieving full compliance with all service performance reporting requirements by

[1] Order Establishing Final Rules Concerning Periodic Reporting of Service Performance Measurements and Customer Satisfaction, May 25, 2010 (Order No. 465).

the filing date of the FY 2011 ACR. For example, the Postal Service does not expect, nor does it have a plan, to report service performance for Standard Mail by product into the foreseeable future.[2]

The PAEA requires the Postal Service to measure the service performance of each market dominant product using measurement systems that are independent of or external to the Postal Service. 39 U.S.C. 3691(b)(1)(D). The Postal Service may seek an exception to this requirement by requesting approval from the Commission to utilize a measurement system under the direct control of or internal to the Postal Service. 39 U.S.C. 3691(b)(2). In November 2008, the Commission granted a Postal Service request to proceed with development of an internal hybrid measurement system based on Intelligent Mail barcodes (IMb) to measure service performance for many of its products.[3]

The IMb system and accompanying electronic documentation now perform a critical role in measuring service performance for the majority of mail. The system is continually being updated and improved by the Postal Service to enable valuable information about mail for the purposes of operations, marketing, and finances. However, significant issues continue to hinder the IMb system from living up to its full potential as a useful component of service performance measurement. The Postal Service has reported problems with data yield, which is the percentage of usable data that may be obtained from IMb measurements. Related problems also have been reported with obtaining an accurate start-the-clock, which is the starting time for all service performance measurements. Furthermore, the current documentation required by the IMb based measurement system does not support reporting Standard Mail by product as required by the PAEA. Further discussion of the IMb based measurement system is found in this chapter in the section titled "Bulk Products: First-Class Mail Bulk Letters/Postcards and Standard Mail."

The remainder of this chapter is divided into three sections: Delivery, Customer Access, and Customer Experience. Delivery discusses speed of delivery and reliability of service based on Postal Service reported performance results. Customer Access discusses retail facilities, wait time in line, and collection boxes. Customer Experience discusses the Postal Service's transformation from the customer satisfaction measurement system to the customer experience measurement system.

Delivery

The Postal Service uses several service performance measurement systems to measure the speed of delivery and reliability of market dominant products. The single-piece components of First-Class Mail Single-Piece Letters/Postcards and Flats are measured using the External First-Class (EXFC) measurement system. The bulk components of First-Class Mail Letters/Postcards and letter and card shaped Standard Mail use an Intelligent Mail barcode (IMb) hybrid measurement system. Parcel shaped mail uses a Delivery Confirmation based system. International Mail uses an International Mail Measurement System (IMMS). Periodicals Mail uses Red Tag and Del-Trak based systems. Finally, Special Services use measurement systems unique to the service being measured. EXFC and IMMS are the only systems that

2 Docket No. RM2011–7, United States Postal Service Request for Temporary Waivers from Periodic Reporting of Service Performance Measurement, February 3, 2011.

3 Docket No, PI2008–1, Order Concerning Proposals for Internal Service Standards Measurement Systems, November 25, 2008.

are fully operational and considered reliable. Service performance results for each product are discussed below.[4]

Single-Piece Products: First-Class Mail Single-Piece Letters/Postcards and Flats

The Postal Service uses the EXFC measurement system to measure the service performance of First-Class Mail Single-Piece Letters/Postcards and the single-piece component of First-Class Mail Flats. The EXFC measurement system is a destination-based system providing quarterly service performance measurement scores at both the area and district level. The system is managed by an independent contractor, IBM.

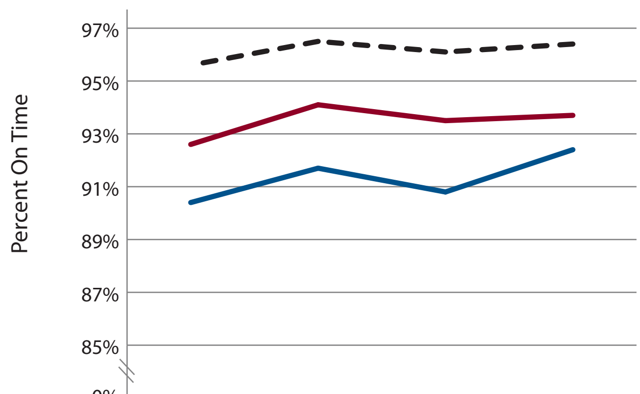
Service performance is measured from the street collection box or lobby chute to the delivery mailbox. Test mailers record the time mailpieces are placed in collection boxes or lobby chutes.[5] These mailpieces are sent to a nationwide panel of receivers. The receivers record when mailpieces are delivered to their homes or business mailboxes.[6] *Id.*

Service performance measurements record the transit-time on the basis of 892 3-digit ZIP Code pairs. Quarterly, the Postal Service provides the most recent results on its website at the area, district, and national level. The annual service performance score is provided at the national level. Measurement of 892 3-digit ZIP Code pairs allows the Postal Service to measure virtually all 3-digit ZIP Code areas in the United States and its territories, including Guam, Puerto Rico and the U.S. Virgin Islands.

The number of EXFC mailpieces sent between locations is proportionate to the actual First-Class Single-Piece Mail volume estimates from ODIS-RPW data between origin and destination locations. For example, if ODIS-RPW data indicate that 10 percent of the overnight mail going to Northern Virginia originates in Richmond, Virginia, the number of EXFC test mailings between these postal areas will correspond to that proportion.[7]

Figure VI-1 provides national level First-Class Single-Piece Mail service performance scores for FY 2007 through FY 2010.

Figure VI–1
Comparison of First-Class Single-Piece Mail Performance for Overnight, 2-Days and 3-5-Days Performance FY 2007 through FY 2010



	FY2007	FY2008	FY2009	FY2010
Overnight	95.6%	96.5%	96.1%	96.4%
2-Days	92.6%	94.1%	93.5%	93.7%
3-5-Days	90.4%	91.7%	90.8%	92.4%

4 Quarterly performance reports are located on the Postal Service's website *http://www.usps.com/serviceperformance/.*

5 Library Reference, USPS-FY10-29, filename: *Service Performance ACR FY2010. doc*

6 IBM uses mail droppers to report the date and time test mailpieces are deposited into the mailstream. Mail reporters report on the date they receive the mailpieces. Order No. 140, Docket No. PI2008–1, Order Concerning Proposals for Internal Service Standards Measurement Systems, November 25, 2008.

7 2009 ACR, Responses of the United States Postal Service to Questions 1-4, 6-11, and 14-25 of Chairman's Information Request No. 3, February 5, 2010.

The Postal Service's focus on improving single-piece performance has resulted in improvements in the overnight, 2-day and 3-to-5-day performance scores when compared to prior years.

Table VI-1 provides a comparison of the FY 2010 actual versus target national service performance for First-Class Single-Piece Mail for overnight, 2-days and 3-5-days. For overnight, 2-days and 3-5-days actual performance was slightly below the overnight target by 0.2 percentage points, and 0.4 percentage points for both the 2-days and 3-5-days performance.

Table VI–1
FY 2010 National First-Class Single-Piece Mail

Delivered On-Time	Overnight	2-Days	3-5 Days
Actual	96.4%	93.7%	92.4%
Target	96.6%	94.1%	92.8%
Difference in percentage points	(0.2) pts	(0.4) pts	(0.4) pts

The Commission finds that these small variations from targeted service performance scores do not raise service performance compliance issues within First-Class Single-Piece Mail.

In FY 2010, the Postal Service began reporting service performance for letters and cards separately from parcels and flats. This facilitates analysis by allowing the Postal Service to focus on the service performance of each shape of First-Class Mail. Flats include Single-Piece and Bulk First-Class Mail flats. Bulk First-Class Mail flats are estimated using the proxy of single-piece flats because there is insufficient Full-Service IMb data available. Parcels include single-piece retail parcels and Bulk First-Class Mail parcels. In FY 2010, 97 percent of the parcels were mailed at First-Class Mail retail rates. Service performance measurement for First-Class Mail retail parcels depends on the customer purchased Delivery Confirmation service and tracking using the internal Product Tracking System (PTS). Parcels do not rely upon IMb for service performance measurement. Service performance comparisons with prior years are not possible because of differences in the data makeup caused by the separate reporting discussed above.

Table VI-2 shows the First-Class Mail flats and parcels service performance results. The Flats and Parcel service performance scores all missed their targets by greater than five percentage points. The Postal Service needs to take steps to improve these service performance scores.

Table VI–2
First-Class Mail Flats and Parcels Service Performance

First-Class Service Performance	National	Target	Variance % Points
Flats			
Overnight	90.7%	96.6%	(5.9) pts
2-Days	85.1%	94.1%	(9.0) pts
3-5-Days	81.6%	92.8%	(11.2) pts
Parcels			
Overnight	91.2%	96.6%	(5.4) pts
2-Days	84.3%	94.1%	(9.8) pts
3-5-Days	87.3%	92.8%	(5.5) pts

Source: 2010 ACR, Library Reference USPS-FY10-29.

International Products: Inbound and Outbound First-Class Single-Piece Mail International

Both Inbound and Outbound First-Class Single-Piece Mail International are measured using the International Mail Measurement System (IMMS). In FY 2010, the Postal Service reported quarterly service performance on a postal administrative area and

national basis. As required by 39 CFR 3055.20(b), the Postal Service provided separate combined scores for Inbound First-Class Single-Piece Mail International as well as Outbound First-Class Single-Piece Mail International. The Postal Service also provided an annual composite measurement that incorporates both inbound and outbound measurements into one value.

IMMS uses an independent (third-party) external sampling system to measure performance for the domestic leg of the transit time for Inbound and Outbound First-Class Single-Piece Mail International letters, postcards, flats and parcels. Inbound First-Class Single-Piece Mail International measurement begins when the mailpiece arrives at the International Mail processing center and ends when it is delivered. Outbound First-Class Single-Piece Mail International is measured from the collection box or mail chute to the destinating International Mail Service Center (ISC) in the United States. IMMS was designed to be similar to the EXFC measurement system. On-time service performance is measured using the same set of service standards as domestic First-Class Single-Piece Mail because the focus is on the domestic leg of transit. Since there is a low proportion of First-Class Single-Piece Mail International flat and parcel volume, and processing is the same for their domestic counterparts, the Postal Service relied on their domestic counterpart from the EXFC (for flats) and Delivery Confirmation (for parcels).

The performance data from letters is combined with the flats and parcel proxy data to measure service performance for all Inbound and Outbound First-Class Single-Piece Mail International. 2010 ACR, Library Reference USPS-FY10-29.

Table VI-3 provides the FY 2010 combined inbound/outbound performance scores for First-Class Single-Piece Mail International as well as the individual inbound and outbound performance scores.

Table VI-3
First-Class Single-Piece Mail International On-Time Service Performance (Inbound and Outbound) FY 2010 Actual versus FY 2010 Target

	FY 2010 Actual On-time	FY 2010 Target	FY 2010 Actual Variance from Target FY 10
Combined In/Outbound	89.4%	94.0%	(4.6) pts
Inbound:			
Overnight	95.5%		
2-day	90.1%		
3-to5-day	88.4%		
Combined	89.6%		
Outbound:			
Overnight	94.1%		
2-day	89.0%		
3-to-5-day	88.2%		
Combined	89.3%		

Source: 2010 ACR, Library Reference USPS-FY10-29 filename: *FY10 ACR First-Class Mail.xls.*

A comparison of the FY 2010 actual and FY 2010 target on-time performance indicates that the Postal Service's actual combined performance was 4.6 percentage points lower than its target.[8] The combined inbound/outbound delivery service performance scores also were below FY 2009 by 0.3 percentage points and below FY 2008 by 4.0 percentage points. Inbound overnight, 2-day

[8] The Postal Service did not establish separate performance targets for inbound and outbound reporting as required by the PAEA. Instead, the service performance target is combined for Inbound and Outbound First-Class Single-Piece Mail International.

Table VI–4
On-time Performance by Shape

	Inbound			Outbound		
	FY 08	FY 09	FY 10	FY 08	FY 09	FY 10
Letters	90.4%	89.2%	90.9%	95.4%	93.4%	90.4%
Flats*	–	83.4%	84.1%	–	84.8%	83.3%
Parcels*	–	84.8%	86.8%	–	84.6%	87.0%
Combined	–	87.8%	89.3%	–	91.7%	89.6%

Source: 2010 ACR, CHIR 5, question 10.
*Domestic service performance measurement scores are used as proxies because there are no service measurements for First-Class Single-Piece Mail International flats or parcels.

and 3-to-5-day scores for FY 2010 were higher than those of FY 2009 by 2.1 percentage points, 2.9 percentage points and 1.8 percentage points, respectively. Outbound overnight and 2-day scores for FY 2010 were lower than those of FY 2009 by 0.8 percentage points and 3.7 percentage points, respectively. FY 2010 outbound service performance for 3-to-5-days was higher than that of FY 2009 by 1.8 percentage points.[9]

The comparison of FY 2010 service performance scores with those of FY 2008 indicates that only the inbound overnight performance score improved. Scores for both 2-day and 3-to-5-day were lower in FY 2010 than in FY 2008 by 0.2 percentage points and 0.7 percentage points, respectively. Comparing FY 2010 with FY 2008 outbound, overnight, 2-day, and 3-to-5-day performance declined by 2.2 percentage points, 7.1 percentage points and 3.9 percentage points, respectively.

The Postal Service contends that the FY 2008 score is not comparable with those of FY 2009 and FY 2010.[10] The Postal Service states that in FY 2008, Inbound and Outbound First-Class Single-Piece Mail International service performance reporting included only letters, not flats or parcels. In FY 2009 and in FY 2010, the performance scores included letters and the proxy scores for domestic parcels and flats.

Contrary to the Postal Service's assertions, the Commission believes that the letter service performance comparison is of interest.

Table VI-4 provides additional on-time performance for Inbound and Outbound First-Class Single-Piece Mail International by shape.

There is a difference in service performance between domestic First-Class Mail and international First-Class Mail. These comparisons are provided in Table VI-5.

The Postal Service reports that the proportion of letters, flats, and parcels for domestic First-Class Mail differs from that of international First-Class Mail with a higher proportion of flats and parcels in the make-up of international mail than in domestic mail. The Postal Service also reports that Inbound and Outbound First-Class Single-Piece Mail International are heavily weighted to 2-day and 3-5-day mail. Furthermore, a higher proportion of international mail is rejected by automation equipment and requires manual processing when compared to its domestic counterpart.[11]

9 Service Performance scores for First-Class Single-Piece Mail International were unavailable for FY 2007. 2010 ACR, CHIR 3, February 7, 2011.
10 2010 ACR, CHIR 5, question 10.
11 2010 ACR, CHIR 5, question 10.

Table VI–5
FY 2010 Proportion of Letter, Flats and Parcels in First-Class Single-Piece Mail International Measurement Versus Domestic First-Class Single-Piece Mail

Shape	Share in International First-Class Single-Piece Mail	Share in Domestic First-Class Single-Piece Mail	Difference in % Points
Letter	71.0%	92.5%	(21.5%)
Flat	15.0%	5.9%	9.1%
Parcel	14.0%	1.5%	12.5%

Source: 2010 ACR, CHIR 5, question 10.
Note: share in Domestic First-Class Single-Piece Mail totals 99.9%

For 2-day and 3-to-5–day mail, the Postal Service postulates that the differences in domestic versus international service performance also may be related to address hygiene. In addition, a large proportion of inbound mail arrives in sacks and bags that require more steps to open, sort and prepare for automation. Finally, when International Mail is released from U.S. Customs to the Postal Service it is presented as large bundles as opposed to being presented as a steady stream. Thus, the inbound international mail also may experience processing delays due to a large volume of mail presented to the Postal Service at one point in time.

A separate measurement system, UNEX, managed by the International Post Corporation (IPC), also exists to measure the service performance of some international mail.[12] UNEX measures the time in transit of test mail pieces from posting in the origin country until delivery in the destination country using Radio Frequency Identification (RFID) technology.[13] Currently, more than 40 postal administrations are participants in the UNEX system. *Id.*

UNEX provides service performance scores relative to a UPU-established annual performance target.[14] For both CY 2009 and CY 2010, the UPU-established target for the U.S. and most industrialized countries was 88 percent. UNEX service performance scores are used to adjust terminal dues payments[15] for inbound letter post from certain foreign postal administrations to the Postal Service pursuant to the UPU's quality of service link to terminal dues, which are the payments between postal operators for the handling and delivery of international mail.[16]

As discussed previously, IMMS reported that the FY 2010 service performance of Inbound First-Class Single-Piece Mail International improved compared

12 Located in Brussels, Belgium, the International Post Corporation works on behalf of postal administrations to improve service quality, promote cooperation and interoperability, and provide intelligence about postal and related markets. For more information, please *see www.ipc.be*.

13 For a more complete description of the UNEX system, *see http://www.ipc.be/en/Services/Technical%20_Platforms/UNEX.aspx*.

14 In response to a Chairman's Information Request, the Postal Service provided (under seal) its UNEX system final and preliminary service performance scores for CY 2009 and CY 2010, respectively. Response to CHIR No. 1, Question 10(a)-(b).

15 Terminal dues refer to payments made between postal operators for the handling and delivery of inbound international letter mail weighing up to 4 pounds.

16 A more complete discussion of the quality of service link to terminal dues can be found in this Annual Compliance Determination in the analysis of Market Dominant International Mail Products under "Quality of Service Link to Terminal Dues."

to FY 2009. Similarly, the UNEX-reported year-to-date (January through November 2010) preliminary service performance for CY 2010 also indicates improvement relative to the final CY 2009 annual service performance. CHIR No. 1, question 19(a)-(b).

As in previous years, however, the Commission notes the comparatively higher service performance reported by IMMS relative to the UNEX system. The UNEX system year-to-date CY 2010 preliminary performance score is less than the combined FY 2010 annual overnight, two-day, and three-to-five-day service performance reported by IMMS for inbound First-Class Mail International.

This difference in service performance is explained in part by the fact that UNEX and IMMS are two different systems.[17] The statistical design of the UNEX system is based upon a calendar year while IMMS measures performance on a fiscal year basis. Most importantly, however, the "start-the-clock" event for measuring service performance differs. Under the UNEX system, measurement begins with the first RFID "read" of a test piece at the point of entry with, or transfer to (after customs clearance), the Postal Service, whichever is later. Under IMMS, measurement begins with the first scan on automated mail processing equipment or entry into the remote barcoding system, whichever comes first.

In addition, the UNEX system service performance scores are based upon results from countries participating in the system while IMMS relies on data from a predetermined set of countries. Moreover, the UNEX system scores are weighted based upon inbound volumes from participating countries and the population of select U.S. metropolitan areas. By contrast, IMMS results for inbound mail are based upon the average mail volume from International Service Centers to destination postal districts.

Despite these differences, both systems reveal improvement in the service performance for inbound First-Class Mail International. The Commission encourages the Postal Service to continue efforts to improve its on-time service performance.

Bulk Products: First-Class Mail Bulk Letters/ Postcards and Standard Mail

Bulk First-Class Mail Letters/Postcards and flat shaped mail, and Standard Mail are measured using a hybrid system based on IMb measurements and a composite last mile factor. The two part hybrid system first measures the plant processing time from the documented entry time in the postal network to the final in plant processing scan using Intelligent Mail barcodes.[18] Then, a last-mile factor is measured, which is the duration from the last plant processing scan to a third-party reporter scan at the final destination. The plant processing time is added to the last-mile factor to provide an end-to-end measurement of service performance.

Bulk First-Class Mail and Standard Mail service performance scores are provided in Table VI-6.

During Quarters 1 through 3, a pilot test for Full-Service Intelligent Mail served as the data source for an external contractor to calculate and compile necessary reports. The system relied upon a small sample of mailers and utilized a start-the-clock proxy which was the first scan in the automated distribution network. Calculations of service performance and the reports were generated from the Intelligent Mail

[17] Response of the United States Postal Service to CHIR No. 2, Question 2(b), Docket No. ACR2008, February 6, 2009.

[18] 2010 ACR, Library Reference USPS-FY10-29, filename: *Service Performance ACR FY2010.doc* at 1.

Table VI–6
FY 2010 Bulk Mail On-Time Service Performance (Actual vs. Targets)

Mail Class	FY 2010 Actual	FY 2010 Targets	2010 Actual Variance from Target
Presorted First-Class Mail			
Overnight	93.4%	96.6%	(3.2) pts
2-Day	92.7%	94.1%	(1.4) pts
3-to-5-Day	88.2%	92.8%	(4.6) pts
Standard Mail			
Destination	83.4%	90.0%	(6.6) pts
End-to-End	59.0%	90.0%	(31.0) pts

Source: 2010 ACR, Library Reference USPS-FY10-29.

Accuracy and Performance System (iMAPS). *Id.* Performance is compared against the First-Class Mail service standard to determine the percent delivered on time. The Postal Service states that the pilot test system is not representative of national performance because it represents a small sample of mailers and the data are not weighted.[19] During the reporting period, only the scores from 12 participating mailers were included in the service performance measurement.

In Quarter 4, service performance measurements were based on data from the Seamless Acceptance and Service Performance (SASP) system, which captures data from Full-Service IMb.[20] The Postal Service had source data from over 500 Full-Service IMb mailers. While 40 percent of the Bulk First-Class Mail was in the Full-Service IMb format, the Postal Service stated that data errors eliminated all but 7 percent of the mail volume from being included in the measurement.[21]

[19] *Id.* at 2.

[20] 2010 ACR, Library Reference USPS-FY10-29, filename: *Service Performance FY10.doc at 2.*

[21] *Id.* at 10.

Standard Mail's service performance (except for parcel shaped Standard Mail) also was measured in Quarters 1 through 3 using pilot data from the IMb system. In Quarter 4, service performance was based on live IMb data. In FY 2010, 256 Standard Mail users participated in Full-Service IMb.[22]

Bulk First-Class Mail's service performance scores were all lower than the corresponding targets. Standard Mail destination entry was below its target by 6.6 percentage points and end-to-end entry was 31.0 percentage points below target.

To be measureable, IMb pieces must be entered as Full-Service IMb mailpieces. At the conclusion of FY 2010, 31.1 percent of Standard Mail volume was entered as fully compliant with Full-Service and Basic IMb. *Id.* In Quarter 4, 19.15 percent of Full-Service IMb Standard Mail was used in evaluating service performance. *Id.* The Postal Service indicated that approximately 28 percent of Bulk First-Class Mail volume was entered as Full-Service IMb. CHIR 5 question 11. The Postal Service provided information on the estimated usage of Full-Service IMb compliant mail as provided in Table VI-7.

At this time, however, the Postal Service indicates a low percentage of usable data is currently being obtained from the IMb system. To improve the percentage of useable data, the Postal Service began certifying customers' electronic documentation to ensure compliance with Full-Service IMb data requirements. Only data from certified mailers is used in the service performance measurement system. Data errors are identified and the information is shared with mailers to facilitate corrections and data inclusion in

[22] *Id.* Response to CHIR 3, question 12.

Table VI–7
FY 2011 Estimated
Full-Service IMb Mail

Mail Class	Full-Service IMb Compliant
First-Class Mail	50.0%
Standard Mail	36.5%
Periodicals	54.6%
Package Services	6.3%

Source: 2010 ACR, CHIR 5, question 12.

the measurement system. The Postal Service describes the certification process as follows:

> The certification process involves two components. The first requires the acceptance clerk to physically sample the contents of mail to ensure mail is prepared per the requirements of Full Service Intelligent Mail. The clerk inspects mailpieces, handling units and containers to ensure these are prepared using Intelligent Mail barcodes, and ensures that the mailer submits electronic documentation with Full Service mailings. The second component involves a comprehensive review of the electronic documentation sent to the Postal Service by the mailer to ensure accuracy of start-the-clock elements.[23]

As more mailers are certified and adopt the Full-Service IMb, service performance reports are expected to improve. In addition, the Postal Service is working with its plants to ensure that capacity issues are addressed and that the network is properly sized for entry volumes. 2010 ACR, Library Reference USPS-FY10-29.

The Postal Service also has indicated that there are placard problems. For example, assume that all trays in a container are properly prepared with a Full-Service IMb. If the container placard has an error, then none of the barcoded mail in the trays is included in the Full-Service IMb measurement system.

The Postal Service responded to Commission questions regarding repeated mailer reasons for not participating in the Full-Service IMb program. In response to the concern that IMb is not useful to mailers, the Postal Service stated that it is working to promote Intelligent Mail by providing full automation visibility to data collected at no additional cost to the mailer. The Postal Service believes that by increasing the value of the program to mailers more will want to participate.

Regarding mailers' comments that the start-up costs of using Full-Service Intelligent Mail are high in relation to the program benefits, the Postal Service comments that it is simplifying the requirements by reducing the complexity associated with the customer supplier agreements (CSAs), streamlining the acceptance of mail and providing more information free of charge to encourage mailer adoption.

Finally, the Postal Service is training its employees to ensure that the Business Mail acceptance and the PostalOne! help desk employees can provide more support to mailers and mail service providers with Full-Service IMb mailings.[24]

In November 2008, the Commission stated that it would be necessary to monitor the IMb adoption rates to ensure reasonably representative and unbiased service performance estimates. Order No. 140 at 15. To date, the adoption and successful completion of Full-Service IMb testing is limited, as evidenced by the limited pilot test data available to evaluate both Bulk First-Class Mail and Standard Mail.

The Postal Service must develop methods that facilitate mailers' correct entry of mail containing Full-

[23] 2010 ACR, CHIR 3, question 6(b).

[24] 2010 ACR, CHIR 3, question 15.

Service IMbs and ensure that all possible Full-Service IMb mail is included in the measurement system. The Commission concludes that given limited data availability, IMb service performance measurements are not an acceptable representative sampling of Bulk First-Class or Standard Mail. The data yield on both Bulk First-Class Mail and Standard Mail is minimal and must be increased to be useful for measurement purposes. Participation rates and compliance must be increased and progress reports made on a monthly basis to the Commission. The Commission will monitor participation rates. Should growth not continue during this fiscal year, the Commission may review its previous decision to allow the Postal Service to proceed with development of an internal IMb based hybrid measurement system.

Periodicals

Periodicals service performance is based on combined data from two external measurement systems, the not-for-profit Red Tag Monitoring Service and the Del-Trak System operated by Time, Inc. Service performance is measured using mailer reported entry times to start-the-clock and external reporter delivery dates to stop-the-clock.[25] The measurement systems include mail entered at destination sectional center facilities or area distribution centers as well as end-to-end mail. Data from both external systems are reviewed, combined and weighted by an independent contractor.

The combined data include information from 39 publications ranging in frequency from daily, weekly, and monthly. Publication circulation ranges from a low of 1,600 to nearly four million. *Id.* at 17. Red Tag and Del-Trak were not designed to be statistically valid service performance measurement systems for the Postal Service; rather, they were designed to meet specific publishers' needs. While flat-shaped Periodicals are measured, there is limited destination delivery unit-entered or Within County Periodicals in either the Red Tag or the Del-Trak measurement system. Given the number of seeded pieces, service performance measurement scores are deemed statistically reliable for each postal administrative area with a maximum of +/-1.8 percent at the 95 percent confidence level.

The start-the-clock measurement begins when the mail is accepted by the Postal Service. However, systems are not fully in place to validate when the mail actually is given to the Postal Service. Almost half of the data's start-the-clock measure is validated by comparing information from the Del-Trak system. *Id.* at 18.

Total Periodicals performance serves as a proxy for both Within County and Outside County Periodicals. Given the types of publications measured using Red Tag and Del-Trak, the majority of the pieces are Outside County Periodicals. Only a few Within County Periodicals mailpieces may be included in the measurement because those pieces generally receive manual postal processing as opposed to being processed on automation equipment.

The Postal Service plans to continue using Red Tag and Del-Trak measurement systems throughout FY 2011. *Id.* at 19. Periodicals on-time service performance was 76.7 percent versus a target of 91 percent.[26] Periodicals FY 2010 annual on-time performance improved 3.0 percentage points over FY 2009 annual performance of 73.7 percent.

25 2010 ACR, Library Reference USPS-FY10-29, filename: *Service Performance ACR FY2010.doc at 16.*

26 http://www.prc.gov/prc-pages/mailing/2010/2010qt4.aspx.

A Postal Service initiative for improving Periodicals service performance is to increase the mail processed on automation equipment. If processed on automation equipment, Periodicals could be measured using IMb. Currently, a large percentage of Periodicals are not processed on automation due in part to its downstream entry into the Postal Service network. The Postal Service indicates it is working to ensure that plant capacity issues are addressed and that off-loading is done in a timely manner and that the network is sized for the volumes entered.[27]

If IMb service performance measurement accurately reports service performance and can be sufficiently representative of the mail entered into the mailstream, the Commission finds that the Postal Service should transition Periodicals service performance measurement to the IMb measurement system environment. This will eliminate subjectivity and provide an improved service performance measurement.

Package Services

Package Services consists primarily of parcels but does include some flats that are too heavy to be mailed as Standard Mail. Package Services includes Single-Piece Parcel Post, Media Mail, Bound Printed Matter Parcels and Bound Printed Matter Flats and Inbound Surface Parcel Post (at UPU rates), which are mailed by households and commercial mailers.

Delivery Confirmation is used to measure the on-time service performance for retail package services. In FY 2010, service performance measurement systems were not in place to measure commercial Package Services, including Bound Printed Matter Parcels. The importance of Delivery Confirmation cannot be overestimated as it remains the sole method of measuring retail package service performance.

When retail clerks receive parcels including Delivery Confirmation service, the Delivery Confirmation barcode is scanned at a point-of-sale terminal or with an Intelligent Mail handheld scanning device to start-the-clock. At the delivery point or attempted delivery, the barcode is scanned again which serves to stop-the-clock. The measurement is treated as representative of Single-Piece Parcel Post and Media Mail/Library Mail. Additionally, the Postal Service considers the retail Single-Piece Parcel Post with Delivery Confirmation as an acceptable proxy for Inbound Surface Parcels at UPU rates. *Id.* at 20-23.

In FY 2010, the Postal Service began reporting performance on a product basis. The annual FY 2010 Package Services service performance scores represent retail Package Services. The FY 2010 Service Performance scores for Package Services are provided in Table VI-8.

All performance scores are below the FY 2010 targets. Single-Piece Parcel Post's actual performance of 80.1 percent is 9.9 percentage points below target. Bound Printed Matter Flats performance of 52.7 percent was 37.3 percentage points below target.[28] Systems were not in place to measure service performance for Bound Printed Matter Parcels. Media Mail/Library Mail's service performance score of 87.7 percent is 2.3 percentage points below its FY 2010 target. Inbound Surface Parcel Post's (at UPU rates) service performance score of 80.1 percent was 9.9 percentage points below target.

In Quarters 1 through 3, Bound Printed Matter Flats were not included in the pilot measurement system.

[27] 2010 ACR, Library Reference USPS-FY10-29, filename: *Service Performance ACR FY2010.doc at 19-20.*

[28] http://www.prc.gov/prc-pages/mailing/2010/2010qt4.aspx.

Table VI–8
FY 2010 Annual Performance for Package Services

Package Services	FY 2010 % On-Time	FY 2010 Target %	Over/ (Under) Target
Single-Piece Parcel Post	80.1	90.0	(9.9) pts
Bound Printed Matter Flats	52.7	90.0	(37.3) pts
Bound Printed Matter Parcels	–	90.0	–
Media Mail / Library Mail	87.7	90.0	(2.3) pts
Inbound Surface Parcel Post (at UPU rates)	80.1	90.0	(9.9) pts

Source: 2010 ACR, USPS-FY10-29, filename: *FY10 ACR Package Services.xls*.

Quarter 4, FY 2010, was the first quarter that Bound Printed Matter Flats service performance measurement used the Intelligent Mail Accuracy and Performance System (iMAPS). Test mailings were limited to a few days during Quarter 4[29] and the measured volumes were entered at either a destination NDC or SCF and covered most Bound Printed Matter Flats entry points. The measurement system used the arrival time at a designated facility to start-the-clock and an IMb scan by an external third-party reporter to stop-the-clock. A limited data sample was available in Quarter 4, but due to mailer data errors and problems with postal verification, the results may not be considered reliable.[30]

The Postal Service claims that it set aggressive service performance targets for all Package Services products and that is why performance was lower than targets. *Id.* at 22. Further, the Postal Service indicates that as process improvements are implemented and the transformation of BMCs into NDCs is completed, unnecessary processes will be removed and service performance should improve.[31] The Postal Service is working to ensure that its plants continue to address capacity issues and that off-loading is done in a timely manner.

The Commission finds that the Postal Service must continue to improve service performance for Package Services to bring all products into compliance with the Postal Service's established targets. Process improvements also may facilitate improvements in performance reporting.

Special Services

In reporting Special Services, the Postal Service provided the information shown in Table VI-9.

The Commission previously focused on Return Receipt and Post Office Box Service because they are relatively high revenue Special Services. Return Receipts (green card) overall service performance is 91 percent. There were 3,793 seeded green return receipts. Of those 83.7 percent were properly completed and returned. Nine percent of the green cards were returned improperly completed and 7.3 percent of the seeded green cards did not have a

[29] Only 3 percent of total Quarter 4 Bound Printed Matter Flats volume qualified for measurement. 2010 ACR, Library Reference USPS-FY10-29,filename: *FY10 ACR Package Services.xls*.

[30] 2010 ACR, Library Reference USPS-FY10-29, filename: Service Performance ACR FY10 at 21, and the Commission's website at http://www.prc.gov/prc-pages/mailing/.

[31] 2010 ACR, Library Reference USPS-FY10-29, filename: Service Performance ACR FY10.doc at 24.

Table VI–9
Special Service Performance Reports

Special Services	Annual Target	Annual % Actual
Ancillary Services	90.0	93.0%
Certified Mail™	–	95.0%
Delivery Confirmation™	–	97.6%
Insurance	–	84.0%
All other Ancillary Services combined	–	86.8%
International Ancillary Services	90.0	99.2%
Address List Services	90.0	100%
Confirm®	90.0	100%
Money Orders	90.0	95.4%
Post Office™ Box Service	90.0	94.3%
Customized Postage	–	–
Stamp Fulfillment Services	–	–

Source: 2010 ACR, Library Reference USPS-FY10-29, filename: *FY10 ACR Special Services.xls.*

signature. The Postal Service indicated that the overall Post Office Box Service met its target 94.3 percent or 4.3 percentage points above target.

In Docket No. RM2010-11, the Commission granted semi-permanent exceptions for annual and periodic reporting of service performance achievements to 24 special services and three negotiated service agreements. The list of semi-permanent exceptions follows:

Semi-Permanent Exceptions

Special Services (the following listed products only)
Ancillary Services (the following listed components of the product only)
Address Correction Service (hard-copy)
Business Reply Mail
Bulk Parcel Return
Certificate of Mailing
Merchandise Return
Parcel Airlift (PAL)
Restricted Delivery
Shipper Paid Forwarding
Special Handling
Stamped Envelopes
Stamped Cards
Premium Stamped Stationary
Premium Stamped Cards
International Ancillary Services (the following listed components of the product only)
International Certificate of Mailing
International Registered Mail (outbound only)
International Return Receipt
International Restricted Delivery
International Insurance (with Inbound Surface Parcel Post (at UPU Rates))
Customs Clearance and Delivery Fee
Caller Service
Change of Address Credit Card Authentication
International Reply Coupon Service
International Business Reply Mail Service
Money Orders (sales aspect of this service only)
Negotiated Service Agreements (the following products only)
The Bradford Group Negotiated Service Agreement
Life Line Screening Negotiated Service Agreement
Canada Post–United States Postal Service Contractual Bilateral Agreement for Inbound Market Dominant Services

Other Measurement Issues

In FY 2010, the Postal Service made changes to the number of days-to-delivery by mail class and by 3-digit ZIP Code pairs. A total of 30,148 3-digit ZIP Code pairs were upgraded and 8,622 were downgraded.

Table VI–10
3-Digit Zip Code Pair Upgrades and Downgrades

Mail Class	Total Upgrades	Total Downgrades	Total Impacted
First Class Mail	874	208	1,082
Standard Mail	11,323	3,371	14,694
Package Services	269	3,349	3,618
Periodicals	17,682	1,694	19,376
Total	30,148	8,622	38,770

Source: 2010 ACR Postal Service response to CHIR 3, question 4.

Overall, the number of 3-digit ZIP Code upgrades exceeded the downgrades, which suggests the Postal Service is reducing the number of days to delivery for more ZIP Code pairs. To be meaningful, the information on the number of 3-digit ZIP Code pairs upgraded and downgraded must be accompanied by the volumes of mail impacted by each. Without volume information, the impact of the changes is unknown.

Customer Access

In compliance with 39 CFR section 3055.91, the Postal Service is required to provide information on consumer access. Customer Access includes evaluation of access to retail facilities, the amount of time a customer has to wait in line to obtain postal services, and the availability of postal collection boxes. The number of delivery points also provides an indication of access to postal services. Post office suspensions are evaluated because of their effect on obtaining postal services. Customer access is important to the Postal Service if it is to stem losses due to volume declines and potential changes in mailer behavior.[32]

Over the years, the Postal Service has changed its network by removing collection boxes, closing postal facilities and changing operating hours. Increased access to postal services, however, appears to be growing through alternative marketing channels. With plant consolidations and continued postal facility closings, it is important that the Postal Service find more methods of providing access to postal products and services.

Retail Facilities

Table VI-11 provides the number of retail accessible postal facilities by type for FY 2007 through FY 2010. Also, the change in the number of retail facilities from prior years is shown.

The Commission observes that the overall number of retail facilities has remained relatively stable with 274 post offices, stations and branches closed in FY 2010. However, there is every indication that the Postal Service will be downsizing its retail facility footprint in the near future.

If and when the Postal Service begins a process to close large numbers of retail facilities, it must provide accurate information to its customers on the status of their postal facilities. The Commission recommends that the Postal Service provide adequate notice and comment period for affected customers to provide input.[33] The importance of adequate notice and a comment period is vital to customer service, if the Postal Service proceeds with future closings.

32 One of the Postal Services FY 2011 strategic initiatives discussed in Chapter V is to expand postal access by means other than a postal retail facility.

33 Docket No. N2009-1, Advisory Opinion Concerning the Process for Evaluating Closing Stations and Branches, March 10, 2010.

Table VI–11
Postal Service Retail Factilities

Postal Factilities	FY 2010	FY 2009	FY2010 Change from FY 2009	FY 2008	FY 2010 Change from FY 2008	FY 2007	FY 2010 Change from FY 2007
Post Offices	27,077	27,161	(84)	27,232	(155)	27,276	(199)
Classified Stations, Branches and Carrier Annexes	5,451	5,501	(50)	5,509	(58)	5,419	32
Contract Postal Units	2,931	3,037	(106)	3,148	(217)	3,131	(200)
Community Post Offices	763	797	(34)	834	(71)	895	(132)
Total Post Offices	36,222	36,496	(274)	36,723	(501)	36,721	(499)

Source: Annual Report 2010 of the Postal Service at 84.

Delivery Points

Table VI-12 provides the number of residential and business delivery points by delivery type for FY 2007 through FY 2010. The change in the number of delivery points in FY 2010 also is shown. The total number of delivery points increased by 739,580 in FY 2010.

Wait Time In Line

In FY 2009, the Postal Service provided the Wait Time In Line measurements that were based on information from mystery shopper reporters, who recorded the actual time they spent waiting in line for service from a postal window clerk. In FY 2010, the Postal Service measured Wait Time in Line in the new

Table VI–12
Postal Service Delivery Points

Residential Delivery Points	FY 2010	FY 2009	FY 2010 Change from FY 2009	FY 2008	FY 2010 Change from FY 2008	FY 2007	FY 2010 Change from FY 2007
City Delivery	80,531,231	80,187,505	343,726	79,848,415	682,816	79,470,894	1,060,337
Rural	38,638,280	38,264,946	373,334	37,684,158	954,122	37,022,488	1,615,792
P.O. Box	15,739,698	15,601,883	137,815	15,639,031	100,667	15,635,480	104,218
Highway Contract	2,607,138	2,576,166	30,972	2,516,783	90,355	2,473,323	133,815
Total Residential Delivery	**137,516,347**	**136,630,500**	**885,847**	**135,688,387**	**1,827,960**	**134,602,185**	**2,914,162**
Business Delivery Points							
City Delivery	7,457,500	7,483,461	(25,961)	7,436,965	20,535	7,411,582	45,918
Rural	1,453,292	1,439,266	14,026	1,407,942	45,350	1,360,478	92,814
P.O. Box	4,355,674	4,489,688	(134,014)	4,587,454	(231,780)	4,548,973	(193,299)
Highway Contract	72,648	72,966	(318)	71,538	1,110	69,304	3,344
Total Business Delivery	**13,339,114**	**13,485,381**	**(146,267)**	**13,503,899**	**(164,785)**	**13,390,337**	**(51,223)**
Total Delivery Points	**150,855,461**	**150,115,881**	**739,580**	**149,192,286**	**1,663,175**	**147,992,522**	**2,862,939**

Source: Annual Report 2010 of the Postal Service at 84.

Table VI–13
Wait Time In Line
Weighted Average

Wait Time In Line	Small/Medium Business	Residential
Less than 1 minute	17%	18%
1–3 minutes	28%	29%
4–5 minutes	23%	23%
Subtotal 5 min. or less	68%	70%
6–10 minutes	17%	16%
11–15 minutes	8%	7%
16 minutes or more	7%	7%
Total	**100%**	**100%**

Source: CEM surveys question 11 and performance of SAS data analysis. Data are based on unweighted tabulations provided in USPS-FY10-38. *See* 2010 ACR, CHIR No. 3, question 17. Large business customers were not asked this question on their version of the CEM survey.

Customer Experience Survey.[34] Survey participants were asked how long they waited in line for a clerk during their last visit to a Post Office. The response categories were: one to three minutes; four to five minutes; six to ten minutes; 11 to 15 minutes; and 16 or more minutes.

The weighted average Wait Time in Line results for customer responses are shown in Table VI-13 and reported by small to medium size businesses and residential customers.[35] Sixty-eight percent of small to medium business customers estimated they waited five minutes or less, and 70 percent of residential customers estimated that they waited five minutes or less. In FY 2009, the Postal Service reported that 83.8 percent of the reported Wait Time in Line scores were less than five minutes. The difference between the FY 2010 Wait Time In Line scores of 68 percent and 70 percent and the FY 2009 score of 83.8 percent may be the result of the customer's perception of how long he or she waited in line rather than a reporter's actual timing of the wait for service. However, it is an important indication of potential problem areas.

In response to CHIR No. 3, the Postal Service reported that in FY 2010, 85.7 percent of its customers waited in line on average 2 minutes and 48 seconds or an improvement of 17 seconds over the prior years' 3 minutes and 5 seconds for the actual national average of 83.8 percent.[36] The improvement in Wait Time In Line while slight is nevertheless important. The Postal Service should continue efforts to decrease the length of time customers wait in line for postal services. Continued reductions in the amount of time spent waiting in line should improve the customers perception of doing business with the Postal Service. Approximately 30 to 32 percent of customers report that they are waiting in line more than five minutes for window service. Fourteen to fifteen percent wait more than ten minutes. Reduced postal wait times will improve the customer's postal shopping experience and potentially draw in more business.

The Commission would find it helpful if the Postal Service were to establish and report national wait time in line service performance goals in next year's ACR. Goals based upon the Postal Service's expertise in customer service can be used as the benchmark for measuring customer satisfaction with this aspect of retail service.

34 2010 ACR, Library Reference USPS-FY10-38, question 11 in residential and small to medium business surveys.
35 Large business customers were not asked that question.

36 2009 ACD at 60 and 2010 ACR, CHIR 3, question 3.

Collection Boxes

Collection boxes are an access channel for First-Class Single-Piece Mail. Table VI-14 provides information on the change in the number of collection boxes from the beginning through the end of FY 2010 and the net difference in the number of collection boxes. The information on the number of boxes removed comes from the Collection Point Management System.

Table VI–14
Number of Collection Boxes Removed

Area	FY 2010 End of Year	FY 2010 Beginning of Year	Net Difference
Capital Metro	14,049	14,111	(62)
Eastern	27,647	28,759	(1,112)
Great Lakes	22,298	22,647	(349)
Northeast	33,258	34,063	(805)
Pacific	20,039	20,349	(310)
Southeast	14,170	15,012	(842)
Southwest	12,018	12,467	(449)
Western	26,641	27,055	(414)
Total	**170,120**	**174,463**	**(4,343)**

Source: 2010 ACR, CHIR No.3, question 2 and CHIR No.5, question 15.

The Postal Service removed a total of 4,343 collection boxes in FY 2010 which was down from the removal of 24,105 in FY 2009.[37] At the end of FY 2010, the Postal Service had 170,120 collection boxes remaining.

In Docket No. N2009-1, the Commission stated that the Postal Service must integrate any plans to remove collection boxes into its overall post office reduction plans to assure continuous and adequate customer access to postal services.[38] The Commission anticipates that the Postal Service will address this issue, along with consideration of other alternative access channels, in future requests for advisory opinions concerning processes and procedures used in reducing the number of Postal Service retail facilities.

Alternative Access

In addition to providing postal products and services at postal retail counters, the Postal Service has expanded postal access through additional marketing channels. For FY 2010, 30.7 percent of retail revenue was generated by means other than a postal retail counter. *Id.* at 25-26.[39]

Table VI-15 identifies the FY 2010 revenue each retail channel generated, the share of total retail revenue each contributed and the percent change in revenue provided in FY 2010 compared with that of FY 2009.

PC Postage and Online Services

PC Postage and digital postage meters allow customers who mail frequently to print postage and shipping labels. For FY 2010, the number of active participants increased eight percent.

Currently, PC Postage vendors are participating in pilot trials to enhance payment options for package returns. Another initiative focuses on qualifying PC Postage systems for federal government entities, which would provide an alternative to using postage meters and a competitive service for expedited shipments.

The *usps.com* website allows customers to purchase stamps and philatelic products and order free shipping supplies. Also, customers may search and pay for a

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37 2009 ACD at 60 and 2010 ACR, Response of the United States Postal Service to the CHIR No. 3, question 2.

38 The Postal Service did not report the number of suspensions at the close of FY 2009 in the FY 2009 ACR. In response to Commission questions, the Postal Service stated that service had been suspended at 248 to 254 post offices as of February 2010. The difference in the two values, 248 and 254, may relate to duplicate reporting of a few post offices in the 254 value. *See* 2009 ACD at 58-59.

39 2010 Comprehensive Statement at 25.

Table VI–15
Retail Revenue by Channel

Services	FY 2010 Revenue ($ Millions)	Share of Total Retail Revenue	FY 2010 Change from FY 2009
Post Offices	$12,133	69.3%	(4.6%)
PC Postage	$2,180	12.4%	17.3%
Stamps only sales by retail partners	$1,143	6.5%	(1.1%)
Automated Postal Centers (kiosks)	$579	3.3%	5.3%
Stamps by Mail/phone/fax	$509	2.9%	(0.7%)
Contract Postal Units	$454	2.6%	0.3%
Usps.com/Click-N-Ship	$423	2.4%	16.2%
Other	$94	0.5%	13.1%
Total	$17,515	100.0%	(1.3%)

Source: 2010 Comprehensive Statement at 24.

P.O. Box as well as manage their P.O. Box accounts online. The FY 2010 revenue generated by the *usps.com* website and Click-N-Ship was $423 million up from the FY 2009 revenue by 16.2 percent.

Retail Partners and Self-Service

The Postal Service has been selling stamp booklets at supermarkets, drug stores, and other commercial outlets since the 1980's. In total, stamps are available at 63,000 such locations and in FY 2010 generated approximately $1.2 billion which represented approximately 14 percent of all stamp booklets sold though this channel.

Contract postal units (CPUs) offer a wider range of postal services than just stamps and are operated by a host retailer. In FY 2010, there were 3,720 operational CPUs. The CPUs generated revenue of $454 million, which was an improvement over FY 2009's revenue by 0.3 percent.

In August FY 2010, the Postal Service partnered with 1,083 Office Depot stores to provide stamps, Express Mail, Priority Mail and other postal services.

An Automated Postal Center (APC) is a self-service kiosk that provides access to common postal services. Nationwide, there are approximately 2,500 APCs located in postal facilities. APCs generated $579 million in revenue in FY 2010 – an increase of approximately five percent over FY 2009.

Strategic Initiative

The Postal Service has set a goal of expanding alternative access to postal products and services by 35 percent.[40] The Postal Service anticipates expanding access in areas where postal customers are already shopping and conducting business whether online or in person.

[40] 2010 Comprehensive Statement at 53.

Post Office Suspensions

In the FY 2010 ACR, the Postal Service stated service was suspended at 184 post offices as of the beginning of FY 2010.[41] By the end of FY 2010, the Postal Service stated it had suspended service at a total of 229 post offices and 137 stations and branches (366 facilities) or an increase of 182 postal facilities from the beginning of FY 2010. It is evident that some post offices have had service suspended for several years.

The Postal Service is continuing to struggle with providing accurate data on facilities with suspended service. For example, for post offices with service suspended for a relatively long period of time, the Postal Service was unable to verify the actual suspension dates of those facilities.[42] The Postal Service must make improvements in its suspended post office record keeping for its own internal purposes and to better inform the Commission of the status of these retail facilities.

The Postal Service states that it is currently redesigning the retail facilities closure procedures that will encompass postal facilities with suspended service, and expects that a request for a related advisory opinion will occur in the near future. The request will be accompanied by a thorough explanation of the approach the Postal Service plans to pursue in either closing a suspended office, reopening it or replacing the facility with some form of expanded alternative access. At the time the request is filed, the Postal Service will provide a public list of the facilities, which will include the suspended offices whose discontinuance will be proposed under the new procedures.[43]

The Commission believes that the redesign of the facilities closing procedure, which will include suspended facilities, is an important step in resolving the status of the many retail postal facilities that have had service suspended. The Commission previously offered many suggestions on Station and Branch closing policies and procedures that may be applicable to closing all types of retail facilities.[44] The Commission hopes that the Postal Service will take these recommendations into consideration in any related requests for advisory opinions. The Commission, in its advisory role, looks forward to working with the Postal Service on this issue.

Customer Experience

The Customer Knowledge Management group in the Postal Service Headquarters Consumer Affairs office is responsible for conducting surveys to measure customer satisfaction with market dominant products. In FY 2010, the Postal Service transitioned from a Customer Satisfaction Measurement (CSM) system administered by The Gallup Organization to a Customer Experience Measurement (CEM) system prepared by Maritz Research. Due to different questions and different response categories, the CEM survey responses cannot be compared with survey responses from the CSM surveys from prior years.

For FY 2010, quarterly surveys were administered to residential, small to medium sized businesses, and large business customers.[45] Participants from all 50 states were selected to respond to the CEM

41 2010 ACR, CHIR 4, question 27.

42 *Id.*

43 *Id.*

44 Docket No. N2009-1, Advisory Opinion Concerning the Process for Evaluating Closing Stations and Branches, March 10, 2010.

45 2010 ACR, USPS-FY10-38, filename: *FY10-38 Preface.pdf.*

surveys. Demographic characteristics were not used in selecting respondents for sampling purposes.[46] Responses to survey questions are based upon self-identified usage of market dominant products. Survey candidates for both the residential and the small to medium sized businesses are randomly selected, without replacement, on a quarterly basis.[47] Residential and small to medium sized businesses have the option of returning the survey by mail or completing it online. Invitations are sent to large business customers to participate in the survey. Businesses that accept the invitation complete surveys online.[48]

Survey response weights are developed on a monthly, quarterly, annual and year-to-date basis. In total, over 6.8 million surveys were sent with 0.7 million useable surveys returned. The residential customer response rate was 14 percent; for both the small to medium sized businesses and the large businesses the response rates were eight percent. Overall, the survey response rate was approximately 10 percent. This appears low assuming that the average response rate to an online survey is 30 percent.[49] Table VI-16 provides the number of surveys sent to each group of respondents and the number of surveys returned.

Table VI–16
Number of Surveys Initiated and Returned (Millions)

Survey Type	Surveys Sent	Surveys Returned	Response Rate
Residential	2,562,293	359,340	14%
Small/ Medium Businesses	4,150,705	345,384	8%
Large Businesses	47,998	3,643	8%
Total	**6,760,996**	**708,367**	**10%**

Source: 2010 ACR, USPS-FY10-38, filename: *FY10-38 Preface.pdf.*

Overall, customer satisfaction with various postal services is provided in Table VI-17.

Table VI-18 provides a summary of the strongly agree responses for both residential and small to medium size businesses.

Reporting the strongly agree responses provides insight into the strength of customers' perception of the Postal Service. For both residential and small to medium sized businesses, the Postal Service's tracking service is effective 52 to 56 percent of the time.[50] Collection Boxes have convenient pickup schedules 46 to 52 percent of the time and are conveniently located 50 to 52 percent of the time. Post Offices are conveniently located 64 to 66 percent of the time and hours of operation are convenient 51 to 55 percent of the time. Having enough lines open to serve postal customers occurs 30 to 35 percent of the time. Twenty-nine to 38 percent of customers report there are enough postal self-service alternatives.

The demographic characteristics of residential postal survey respondents are as follows: 62 percent of the respondents are female and 38 percent are male; 9 percent are 34 years old or less, 29 percent are

[46] While surveys are not mailed to customers on the basis of specific demographic characteristics, the Postal Service does collect select demographic data from questions in the surveys.

[47] Small and Medium Businesses have fewer than 250 employees at one site. Large businesses have more than 250 employees per site. 2010 ACR, Library Reference USPS-FY10-38. For Large Businesses, completion of surveys online has been shown to be the preferable method through previous customer research. *Id.* For simplicity, values are rounded to the nearest whole number.

[48] For Large Businesses, completion of surveys online has been shown to be the preferable method through previous customer research. *Id.*

[49] *See* Instructional Assessment Resources, http://www.utexas.edu/academic/ctl/assessment/iar/teaching/gather/method/survey-Response.php. In a paper on "Measuring Customer Satisfaction: More on Corporate Surveys as Practice," mail survey response rates are considered adequate if 50 percent is obtained; 60 percent is considered good and 70 percent is very good.

[50] For simplicity, values are rounded to the nearest whole number.

Table VI–17
FY 2010 Customer Satisfaction with Market Dominant Products (Mailing Services)

Market Dominant Products (Mailing Services)	Residential % Rated Very/ Mostly Satisfied	Small-Medium Business % Rated Very/Mostly Satisfied	Large Business % Rated Very/ Mostly Satisfied
First-Class Mail	93.7	92.4	90.2
Single-Piece International	85.9	83.2	86.3
Standard Mail	83.3	85.9	84.5
Periodicals	86.1	83.8	82.8
Single-Piece Parcel Post	88.2	87.0	84.6
Media Mail	87.6	86.4	85.6
Bound Printed Matter	85.4	83.4	82.4
Library Mail	86.7	84.9	85.1

Source: 2010 ACR, United States Postal Service FY 2010 Annual Compliance Report at 15.

Table VI–18
Residential and Small/Medium Business Customer CEM Responses Percent Who Strongly Agree

FY2010 Customer Experience Survey Measure	Residential Customer	Small-Medium Business Customer
Letters/packages consistently delivered when expected	63.1%	55.2%
Mail collection boxes conveniently located	52.3%	50.0%
Mail collection box pickup schedule is convenient	52.3%	45.9%
Post Office location convenient	66.5%	64.3%
Post Office hours of operation convenient	55.1%	50.7%
Post Office has enough lines open to serve customers	34.7%	30.3%
Post Office has enough self-service alternatives	38.2%	29.2%
USPS tracking effective (if purchased)	55.7%	52.0%

Source: Postal Service CEM surveys, FY 2010. Unweighted survey data from 2010 ACR, Library Reference, USPS-FY-10-38.

Table VI–19
Large Business Responses to CEM Survey Questions 5 and 6†

Mail Class	Mail Services (a) Very/Mostly Satisfied	Consistently Delivered When Expected (b) Strongly Agree	Postal Service's Tracking Effective (if purchased) (c) Strongly Agree
First Class Mail	90.2%	43.9%	49.5%
SP International Mail	86.3%	43.4%	45.7%
Standard Mail	84.5%	48.1%	50.0%
Periodicals	82.8%	44.2%	44.3%
SP Parcel Post	84.6%	46.6%	48.5%
Media Mail	85.6%	45.4%	44.3%
Bound Printed Matter	82.4%	45.0%	44.3%
Library Mail	85.1%	45.9%	44.7%

Source: (a) at 15 of the 2010 ACR, "Customer Satisfaction with Market Dominant Products Mailing Services FY2010", large business survey responses weighted at the area level to represent the large business population (ChIR.3.Q.17e.ACRFY10.doc). For (b) and (c), percents are based on unweighted survey counts for products and services large businesses used at survey question 4 (from every business day to less than monthly) filed in 2010 ACR, Library Reference USPS-FY10-38, CSM Question Response Counts_FY10.xls.

† Surveys included questions with mulitple parts. 2010 ACR, Library Reference USPS-FY-10-38.

between the ages of 35 and 54 years, and 62 percent are 55 years or older. The education level ranged from having no college education—26 percent, to some college education—32 percent, and 4 or more years of college—42 percent. The majority of residential respondents receives their mail at home and primarily uses the Postal Service to send their packages.[51]

Business information collected on small to medium size business respondents identified that 97 percent had 100 or fewer employees and 3 percent had more than 100 employees; 65 percent used the Postal Service to send their packages and 35 percent used alternative services.

Table VI-19 provides a select summary of the responses to the CEM survey for large businesses.

Satisfaction with mail service ranges from a low of 82 percent for Bound Printed Matter to a high of 90 percent for First-Class Mail.[52] Only 43 to 48 percent of mail for all mail classes was consistently delivered when expected. In addition, only 44 to 50 percent of large businesses indicated that Postal Service tracking service was effective for all mail classes.

The demographic responses from large businesses showed that 77 percent had 500 or fewer employees and 32 percent had more than 500. Eighty-one percent of the large business respondents were neither a mailing house nor a consolidator; 20 percent were. Seventy-seven percent of the respondents indicated

[51] 2010 ACR, Library Reference USPS-FY10-43, filename: *ChIR.3.Q.17b.ACR.FY10.doc.*

[52] For simplicity, percentages are rounded to the nearest integer.

that their personal experiences with the Postal Service were either very important or somewhat important in determining whether or not to use the Postal Service for business purposes.[53]

The Commission commends the Postal Service for developing a new CEM survey. Clearly, the survey seeks more information about customer attitudes with regard to the Postal Service, its products and services. The information gained by the survey allows the Postal Service to follow up on actionable items to the benefit of both it and its customers. In addition, the Postal Service expanded the range of allowable customer responses. Rather than just having a response of "neither agree nor disagree" the customer is given the option of responding to either "somewhat agree" or "somewhat disagree." The additional response categories can facilitate the reduction of potential bias in survey responses, which allows more honest response evaluations.

In the Postal Service's FY 2011 ACR, the Commission recommends that the Postal Service establish FY 2012 targets for improving customer satisfaction in each area measured. Comparing progress in the areas of customer satisfaction will allow the Postal Service to identify problem areas and recognize those areas it may excel in.

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53 2010 ACR, Library Reference USPS-FY10-43, filename: *ChIR.3.Q.17b.ACR.FY10.doc.*

Chapter VII

Market Dominant Products

Introduction

This chapter presents the Commission's analysis, organized by class, of the financial results and rates for each market dominant product, market dominant NSAs, market dominant volume incentives, and market dominant international products. The financial analysis focuses on cost coverage and pricing issues, including whether the class and its products generate adequate revenue to cover attributable costs.

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

The major findings for FY 2010 are summarized below:

- The Commission identified 10 products and services which generated insufficient revenues in FY 2010 to cover attributable costs. The total shortfall from these products is $1.7 billion. This only represents the amount necessary to reach 100 percent cost coverage; it would not result in any contribution towards institutional costs.
- Two classes of mail fail to cover their attributable cost: Periodicals ($611 million) and Package Services ($182 million).
- Three products account for $1.4 billion of the loss: Standard Flats ($577 million), Standard NFMs/Parcels ($172 million), and Outside County Periodicals ($587 million).
- The Commission finds that the FY 2010 rates for Standard Flats do not comply with section 101(d) of title 39 and directs the Postal Service to take action to eliminate the intra-class cross-subsidy through above average price increases and operational efficiency gains.

- Per-piece revenue from Standard Mail Nonprofit pieces was 61.3 percent of Standard Mail commercial per-piece revenues. However, the price adjustment proposed in Docket No. R2011-2 is expected to produce an average revenue per piece that complies with the statute.
- 39 workshare discounts exceeded avoided costs.
    - 23 discounts qualified for a statutory exception.
    - Seven discounts were adjusted to reflect 100 percent of avoided cost in Docket No. R2011-2.
    - The Commission is unable to determine if six discounts are consistent with section 3622(e) because of problems with the underlying costs.
    - Two discounts satisfy the statute assuming Proposal Nine is approved in Docket No. RM2011-5.
    - The evaluation of one discount has been temporarily suspended pending the outcome of Docket No. RM2011-13.

The Postal Service calculates worksharing passthroughs utilizing methodologies that currently are under review by the Commission. The Postal Service filed two petitions to initiate proceedings to consider these methodologies in late December.[1] The timing of the Postal Service's filing did not afford the Commission or interested persons sufficient time to review the merits of these proposals prior to their incorporation into the ACR. Of these proposals, Proposal Nine, in particular, has significant impact on avoided cost estimates for First-Class Mail and Standard Mail letters. The proposal incorporates new input data and a new bundle sorting cost methodology into the First-Class Mail presort letters and Standard Mail presort letters mail processing cost models. In response to a Chairman's Information Request, the Postal Service provided the cost avoidance estimates which exclude the Proposal Nine changes.[2] The resulting passthroughs vary significantly from the original filing.

Several workshare discounts that exceed avoidable cost in FY 2010 were adjusted to achieve 100 percent passthroughs in Docket No. R2011-2. However, for some of these discounts, the Postal Service relied on avoidable cost estimates from Proposal Nine. While the Commission approved the rates the Postal Service proposed in Docket No. R2011-2, it stated that the discounts are subject to further review pending consideration of the worksharing methodology proposals now before the Commission. Assuming approval of Proposal Nine, the discounts reflect a 100 percent passthrough of avoided costs and comply with section 3622(e).

The practice of using unapproved analytical methods in support of price adjustments and the ACR does not follow accepted procedures. The Postal Service's effort to improve costing by making changes in analytic principles requires proper vetting by the mailing community and the Commission sufficiently in advance of filing price adjustments and ACRs.

National Postal Policy Council (NPPC) is concerned that the Postal Service imposes costs on mailers without considering the price cap ramifications. It distinguishes between mail preparation activities for which mailers receive a discount, *e.g.*, barcoding, and those activities causing mailers to incur "uncompensated compliance costs," *e.g.*, Move Update using

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[1] Docket No. RM2011-5, Petition of the Postal Service Requesting Initiation of a Proceeding to Consider Proposed Analytical Principles (Proposals Nine through Twelve), December 20, 2010. *See also* Docket No. RM2011-6, Petition of the Postal Service Requesting Initiation of a Proceeding to Consider Proposed Analytical Principles (Proposals Thirteen and Fourteen), December 22, 2010.

[2] Responses to questions 1 and 10 of Chairman's Information Request No. 1, issued on January 14, 2011.

NCOALink and the submission of mailing statements. NPPC Comments at 6-7. It argues that, while changes in mail preparation systems and processes may reduce the Postal Service's costs, they "impose new and uncompensated costs" on the mailers which, in effect "constitute 'shadow' rate increases." *Id.* at 6-8.

NPPC suggests that the Commission should initiate a rulemaking to require the Postal Service to: (1) conduct a cost-benefit analysis when contemplating changes in mailing regulations or entry requirements to identify and calculate the uncompensated "shadow" costs incurred by mailers; and (2) estimate the uncompensated costs it imposed on mailers during the year due to shadow rate increases. *Id.* at 9-10.

While the issue NPPC raises has important rate cap implications, the Commission is not persuaded at this time that a rulemaking focusing on requiring the Postal Service to undertake cost-benefit analysis whenever it imposes an operational change that may affect mailing regulations or entry requirements would be productive. Any cost-benefit analysis designed to calculate "uncompensated shadow costs" incurred by mailers would require accurate, detailed information on mailers' costs.[3] Neither the Postal Service nor the Commission has access to such information or a ready means to obtain it. Moreover, mailers, rightfully, may be reluctant to divulge such information.

FIRST-CLASS MAIL

Introduction

First-Class Mail consists of six products, Single- Piece Letters and Cards, Presort Letters and Cards, Flats, Parcels, Outbound First-Class Single-Piece Mail International, and Inbound First-Class Single-Piece Mail International. The class had a volume of 78.2 billion pieces in FY 2010. First-Class Mail accounts for 46 percent of total volume and 67 percent of total contribution. Both volume and contribution decreased from FY 2009 by 6.6 percent and 5.8 percent, respectively.

The principle FY 2010 findings for First-Class Mail are:

- The Commission identifies eight worksharing discounts that exceed avoided cost.
    - » Three comply with the statute
    - » Two comply with the statute assuming Proposal Nine is approved in Docket No. RM2011-5
    - » The Commission is unable to determine if two discounts are consistent with the statute because of problems with the underlying costs
    - » The evaluation of one, the automation Mixed ADC discount, has been temporarily suspended pending the outcome of Docket No. RM2011-13
- Cost coverage of presort parcels increased from a noncompensatory level in FY 2009 to a compensatory level.

Financial Analysis

The FY 2010 First-Class Mail cost coverage was 199.3 percent. As Table VII-1 shows, total First-Class Mail FY 2010 revenue was $34.0 billion, which covered its attributable cost of $17.1 billion and contributed $17.0 billion to institutional cost. First-Class Mail's cost coverage decreased from 199.6 percent in FY 2009 to 199.3 percent in FY 2010.

With the exception of Presort Letters and Cards, increases in unit attributable costs for domestic First-Class Mail products are greater than the 1.685 percent increase in the CPI-U for FY 2010.

[3] NPPC suggests that the analysis "include not only direct costs, but indirect costs and burdens to mailer from the timing of change or otherwise." *Id.* at 9. *See* also GCA Reply Comments.

Table VII–1 — First–Class Mail
Fiscal Year 2010 Volume, Revenue, Cost, Contribution, and Cost Coverage by Product

	Volume (000)	Total Revenue ($000)	Attributable Cost ($000)	Contribution to Institutional Cost ($000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
First–Class Mail:								
Single–Piece Letters	27,147,918	12,396,772	7,376,828	5,019,943	45.664	27.173	18.491	168.1%
Single–Piece Cards	1,436,994	419,024	398,614	20,411	29.160	27.739	1.420	105.1%
Total Single–Piece Letters and Cards	28,584,912	12,815,796	7,775,442	5,040,354	44.834	27.201	17.633	164.8%
Presort Letters	43,293,821	15,419,328	5,161,839	10,257,489	35.616	11.923	23.693	298.7%
Presort Cards	2,931,565	638,977	237,008	401,969	21.796	8.085	13.712	269.6%
Total Presort Letters and Cards	46,225,386	16,058,305	5,398,847	10,659,458	34.739	11.679	23.060	297.4%
Single–Piece Flats	1,813,480	2,552,309	1,713,013	839,297	140.741	94.460	46.281	149.0%
Presort Flats	54,771	59,336	45,718	13,618	108.335	83.472	24.863	129.8%
Total Flats	2,483,992	3,122,695	2,147,953	974,741	125.713	86.472	39.241	145.4%
Single–Piece Parcels	558,387	1,108,904	1,110,137	(1,233)	198.590	198.811	(0.221)	99.9%
Presort Parcels	16,041	24,859	22,281	2,578	154.968	138.899	16.069	111.6%
Total Parcels	574,429	1,133,763	1,132,418	1,345	197.372	197.138	0.234	100.1%
Total Domestic First–Class Mail	77,868,718	33,130,559	16,454,660	16,675,899	42.547	21.131	21.415	201.3%
Total International First–Class Mail	334,438	894,964	620,754	274,210	267.602	185.611	81.991	144.2%
Total First–Class Mail	78,203,156	34,025,523	17,075,414	16,950,109	43.509	21.835	21.674	199.3%

Source: PRC–ACR 2010–LR 1

Compared with FY 2009 the unit attributable cost for single-piece letters and cards increased 3.1 percent; the unit cost for presort letters and cards decreased 0.2 percent; the unit cost for Flats increased 14.8 percent; and the unit cost for Parcels increased 4.6 percent. For FY 2010, First-Class Mail unit attributable cost increased by 1.8 percent on average. Each domestic First-Class Mail product covers its attributable cost in FY 2010.

The Postal Service reports that the cost coverage for Parcels was 99.9 percent in FY 2010. However, the Postal Service's figure does not include fee revenue. When fee revenues are included, Parcels cost coverage is 100.1 percent. The Parcels products consist of single-piece parcels and presort parcels. The cost coverage for single-piece parcels decreased from 102.0 percent in FY 2009 to 99.9 percent in FY 2010. However, the cost coverage of presort parcels has improved for the second year in a row (88 percent in FY 2008 and 92 percent in FY 2009) reaching 112 percent in FY 2010. The low cost coverage of single-piece parcels adversely affects the cost coverage for the Parcels product.

Section 3622(c)(2) requires each class or type of mail service to cover its attributable costs and make a reasonable contribution to institutional costs. In Docket No. R2011-2, the Postal Service proposed an above average increase of 2.57 percent for Parcels. The proposal included a uniform price for parcels weighing up to three ounces. The Postal Service asserts this will improve cost coverage by disincentivizing very light parcels, which are difficult to process on parcel sorting equipment. Docket No. R2011-2, United States Postal Service Notice of Market-Dominant Price Adjustment, January 11, 2011, at 15-16. While this should improve the cost coverage of Parcels, the Postal Service should continue to raise the contribution for Parcels through cost reductions and future rate adjustments to satisfy this requirement as necessary. The Commission notes that the Postal Service has proposed to transfer commercial parcels to the Competitive Products List. If this is approved, it will be important for the Postal Service to account for the transfer in its next price adjustment.

NPPC is concerned that the cost coverage for commercial bulk First-Class letters is too high and may soon be viewed as no longer "just and reasonable" under section 3622(b)(8). NPPC Comments at 4. NPPC observes that Presort First-Class letters pay 5.5 cents more contribution than single-piece letters. It argues that the relatively high markup contributes to the decline in volume of this product. Additionally, NPPC notes that the Postal Service's Customer Experience Measurement (CEM) system survey data show that large mailers expressed the least satisfaction with First-Class Mail. *Id*. at 3-4. NPPC suggests that the Postal Service believes that it will be unable to retain this mail in the future, and in the meantime will try to extract the maximum possible revenue from those pieces that must remain in the system. *Id*. at 5. Accordingly, NPPC asserts that the Commission has authority to prevent the Postal Service from exploiting its pricing flexibility.

At this time the Commission does not find that the cost coverage for Presort First-Class letters violates section 3622(b)(8). The Commission will continue to monitor the cost coverages of products to ensure compliance with the Act. NPPC has not demonstrated that prices are not just and reasonable.

The discussion of international First-Class Mail appears in the section on Market Dominant International Mail at the end of this chapter.

Worksharing

The following eight worksharing discounts exceeded avoided cost: (1) Qualified Business Reply Mail (QBRM) Letters; (2) QBRM Cards; (3) Mixed AADC Automation Letters; (4) Automation AADC Letters; (5) Automation 3-Digit Letters; (6) 3-Digit Automation Cards; (7) ADC Automation Flats; and (8) Automation 3-digit Flats. The avoided cost calculations that form the basis of these passthroughs employ the accepted methodology and thus in the case of letters and cards, do not include the effects of Proposal Nine as discussed in the introduction. Below the Commission discusses passthroughs above 100 percent in the same order as listed above.

QBRM

The discounts for QBRM Letters and Cards passthrough 164.3 percent of avoided cost. *See* Table VII-2. In Docket No. R2009-2, the Postal Service passed through 100 percent of the avoided costs for both QBRM Letters and Cards. A decrease in avoided cost has led to the excessive passthrough.

In Docket No. R2011-2, the Postal Service argued that reducing the discounts may undercut the "Reply Rides Free" program and retaining the current level of discounts would help mitigate the above-average price increase experienced by presort mailers. In Docket No R2011-2, the Commission questioned the Postal Service's attempt to link QBRM and Reply Rides Free. However, the Commission reiterated its concerns that the current costing methodology underestimates the cost avoidance. For this reason, the Commission approved the proposed QBRM discount and it urged the Postal Service to develop a costing proposal and a petition to initiate a rulemaking proceeding as soon as practical. Order No. 675 at 14. Accordingly, no further action is warranted at this time.

Automation Letters

The Postal Service calculates the following passthroughs of avoided costs for automation letters: Mixed AADC, 126.1 percent; AADC, 104.8 percent; and 3-digit, 150.0 percent.

Citing Order No. 536 the Postal Service states that the former single-piece benchmark, Bulk Metered Mail, is obsolete and should no longer be used. ACR at 51. Although the Postal Service calculates a passthrough for Mixed AADC letters, the Postal Service interprets Order No. 536 to mean that the passthrough reported for automation Mixed AADC letters based on the BMM benchmark is not applicable with regard to 39 U.S.C. 3622(e). ACR at 53. NPPC supports this interpretation of Order No. 536. NPPC Reply Comments at 1-5.

APWU claims that the workshare discounts for First-Class Mail Presort Letters/Cards reported by the Postal Service do not comply with the restrictions of 39 U.S.C. 3622(e). APWU Comments at 1. It contends that even if the BMM is not used as the benchmark in this proceeding, there is no reason to believe that the use of any other valid benchmark would affect costs avoided in such a way as to make the current discount for Mixed AADC letters compliant with the law. *Id* at 3. APWU contends that the Postal Service should be required to justify discounts that exceed costs avoided and provide a comprehensive plan for phasing out excess discounts overtime. *Id*.

Additionally, APWU argues that excess capacity in the network can result in increased unit costs and

Table VII–2—First–Class Mail Letters, Flats, and Parcels Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	FY 2010 Year–End Discount (cents)	FY 2010 Unit Cost Avoidance (cents)	FY 2010 Passthrough
First–Class Mail Automation Letters			
Barcoding & Presorting			
Automation Mixed AADC Letters (Bulk Metered Mail (BMM) Letters)	5.8	4.6	126.1%
Automation AADC Letters (Automation Mixed AADC Letters)	2.2	2.1	104.8%
Automation 3–digit Letters (Automation AADC Letters)	0.3	0.2	150.0%
Automation 5–digit Letters (Automation 3–digit Letters)	2.2	2.6	84.6%
First–Class Mail Automation Flats			
Barcoding & Presorting			
Automation ADC Flats (Automation Mixed ADC Flats)	12.2	4.4	277.3%
Automation 3–digit Flats (Automation ADC Flats)	6.1	5.6	108.9%
Automation 5–digit Flats (Automation 3–digit Flats)	16.2	17.4	93.1%
First–Class Mail Presorted/Business Parcels[1]			
Barcoding & Presorting			
Presort 3–digit Parcels (Presort ADC Parcels)	8.6	55.9	15.4%
Presort 5–digit Parcels (Presort 3–digit Parcels)	13.2	36.0	36.7%
First–Class Mail Nonautomation Letters			
Presorting			
Nonautomation Presort Letters (Bulk Metered Mail (BMM) Letters)	2.6	5.1	51.0%
Qualified Business Reply Mail			
Barcoding			
QBRM[2] (Handwritten Reply Mail)	2.3	1.4	164.3%

Source: PRC–ACR2010–LR3.

[1] The parcel cost avoidances presented here are different from the ones in the Postal Service's original filing because the Postal Service inadvertently used the wrong cost avoidances from USPS–FY10–11, "FCM flat costs 2010.xls", tab 'BUNDLE OPS SUMMARY.' *See* response of the United States Postal Service to Chairman's Information Request No. 5, Question 2.

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

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

Type of Worksharing (Benchmark)	FY 2010 Year–End Discount (cents)	FY 2010 Unit Cost Avoidance (cents)	FY 2010 Passthrough
First–Class Mail Automation Cards			
Barcoding & Presorting			
Automation Mixed AADC Cards (Nonautomation Presort Cards)	1.5	2.7	55.6%
Automation AADC Cards (Automation Mixed AADC Cards)	1.0	1.1	90.9%
Automation 3–digit Cards (Automation AADC Cards)	0.2	0.1	200.0%
Automation 5–digit Cards (Automation 3–digit Cards)	1.3	1.4	92.9%
Qualified Business Reply Mail			
Barcoding			
QBRM[1] (Handwritten Reply Cards)	2.3	1.4	164.3%

Source: PRC–ACR2010–LR3.

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

thus even workshare discounts that are set at 100 percent of avoided costs exceed the true cost the Postal Service is able to avoid. APWU Comments at 4. APWU contends that this violates 39 U.S.C. 3622(e)(4)(C) because mailers who do not utilize the discounts are adversely impacted. *Id.* NPPC states that APWU's excess capacity arguments do not justify reductions in worksharing discounts. NPPC Reply Comments at 1-5.

Order No. 536 suspended the evaluation of the automation Mixed AADC letter discount with regard to section 39 U.S.C. 3622(e) pending the outcome of Docket No. RM2010-13, which seeks to determine the appropriate base or reference group from which the costs avoided by worksharing are to be calculated.

The Postal Service failed to justify the AADC and 3-digit automation letters discount, and instead in both Docket Nos. R2011-2 and ACR 2010, the Postal Service calculated cost avoidances using an unapproved methodology. The Postal Service's price increase in Docket No. R2011-2 aimed to realign the discounts with avoided cost. However, the Postal Service calculated First-Class Mail letters and cards cost avoidances assuming approval of methodologies and input data introduced in Docket No. RM2011-5, Proposal Nine. Using this unapproved methodology, the discounts passthrough 100 percent of avoided cost. The Commission finds that no further action is required at this time. The Commission will hold any remedial action on these two discounts in abeyance until the conclusion of Docket No. RM2011-5.

Automation Cards

The discount for 3-Digit Automation Cards has a passthrough of 200 percent of avoided costs. In Docket No. R2009-2, this passthrough was at 100 percent. However, lower avoided costs between FY 2008 and FY 2010 caused this passthroughs to exceed 100 percent, which renders the discount inconsistent with 39 U.S.C. 3622(e). The Postal Service's price change in Docket No. R2011-2 realigns the discount with avoided cost, therefore, no further action is required.

Automation Flats

First-Class Mail Automation Flats passthroughs for ADC Automation Flats and 3-Digit Automation Flats are 277.3 percent and 108.9 percent, respectively. The Postal Service cites a reduction in cost avoidance resulting from FY 2008 methodology changes, as explained in Docket No. RM2008-2, Proposal Eight, as the primary reason ADC and 3-digit flats passthroughs exceed 100 percent. In Docket No. R2011-2, the Postal Service argued that setting all flats worksharing passthroughs at 100 percent will lead to significantly higher rates, which would cause rate shock, 39 U.S.C. 3622(e)(2)(B). ACR at 28 and 29. The Commission found that the planned discounts were justified in Docket No. R2011-2. For these reasons, no further action is required.

The First-Class Mail Incentive Program

The First-Class Mail Incentive Program ran between October 1 and December 31, 2009. Eligible Mailers received a 20 percent postage rebate on qualifying presort letter, flat, and card volumes above a predetermined threshold mailed between October 1, 2009, and December 31, 2009.

The Postal Service reports more than 211 million pieces over volume thresholds were mailed by 170 customers, who earned rebates of $14.6 million. The Postal Service estimates that the program generated over 142 million new pieces, and caused another 4 million to migrate from Standard Mail to First-Class Mail. In the ACR the Postal Service reported that new volume produced approximately $34 million of new contribution, net of rebates paid. ACR at 22.

The Postal Service inadvertently reported an incorrect amount of new contribution in the ACR. The Postal Service's revised data collection report filed on July 29, 2010, shows that using the Postal Service's methodology, it made $34 million in contribution only when treating the contribution from "loyalty volume," as caused by the incentive.[4] According to the Postal Service's calculations, the program generated a $19 million net increase in contribution[5] (contribution from volume generated by the incentive minus discounts awarded to "loyalty volume").

To analyze this program, the Commission uses the accepted methodology that incorporates elasticities, after-rates volume and marginal discounts earned to estimate the incremental volume. It shows that the Postal Service lost $7 million in contribution from the program.[6]

PERIODICALS

Introduction

The Periodicals class includes publications such as magazines, newspapers, journals, and newsletters.

4 Loyalty volume, also referred to as "anyhow volume," is mail that would have been sent without any incentive.

5 First-Class Mail Incentive Program Data Collection Report - Revised Excel Data Files, 7/29/2010, FCM Incentive Analysis.xls

6 First-Class Mail Incentive Program Data Collection Report - Revised Excel Data Files, 7/29/2010, FCM Incentive Analysis.PRC.Meth.xls

Eligibility criteria include a minimum amount of editorial (non-advertising) content.[7] This requirement establishes the Periodicals class as one with educational, cultural, scientific, and informational (ECSI) value provided by Periodicals. Consequently, the Periodicals Mail class is a preferred class of mail and receives several statutory discounts as identified in section 3626 of title 39, United States Code, such as a five percent discount for Non-profit and Classroom publications.

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

The profiles of the two Periodicals products differ significantly in terms of volume and revenue. In FY 2010, approximately 695 million copies of Periodicals were mailed at Within County prices, and generated approximately $73 million in revenue for the Postal Service. In contrast, during the same year, 6.6 billion copies of Periodicals were mailed at Outside County prices, and generated approximately $1.8 billion in revenues for the Postal Service. The Postal Service did not propose any methodological changes to the Periodicals cost model prior to filing its FY 2010 ACR.

The principle FY 2010 findings are:

- Prices were in compliance with the preferred rate requirements identified in Section 3626 of title 39, United States Code.
- Within County attributable costs exceeded revenues by $24 million, producing a cost coverage of 75.4 percent.
- Outside County attributable costs exceeded revenues by $587 million, producing a cost coverage of 75.5 percent.
- Nine workshare discounts exceeded avoidable cost, but need not be adjusted since they qualify for the ECSI exception under section 3622(e)(2)(C).
- Worksharing passthrough percentages (especially carrier route) and price-cost ratios for bundle and containers should be moved towards 100 percent to provide incentives for efficient mail preparation.
- The Commission agrees with the Postal Service that current rates for Periodicals do not satisfy 39 U.S.C. 3622(c)(2). The Commission recommends that the Postal Service pursue the opportunities to be explored in the upcoming Periodicals Study to reduce the costs of handling flats.

Financial Analysis

Background

Table VII-4 provides relevant financial data for Within County, Outside County, and the Periodicals class as a whole. It shows volume, revenue, attributable costs, contribution to institutional costs, and cost coverage for each Periodical product in FY 2010.

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

Table VII–4
Periodicals Fiscal Year 2010 Mail Volume, Revenue, and Cost by Product

Product	Volume (Millions)	Revenue (Millions)	Attributable Cost (Millions)	Contribution (Millions)	Revenue per Piece	Cost Per Piece	Unit Contribution	Cost Coverage
Within County	695.5	$74.3	$98.5	$(24.2)	$0.107	$0.142	$(0.035)	75.44%
Outside County	6,574.0	$1,804.5	$2,391.3	$(586.8)	$0.274	$0.364	$(0.089)	75.46%
Total	7,269.5	$1,878.8	$2,489.8	$(611.0)	$0.258	$0.343	$(0.084)	75.46%

Source: USPS–FY10–1, FY10PublicCRA.xls, and PRC–ACR2010–LR1, 10_Summary_LR1.xlsx

Table VII-4 shows that Periodicals continue to make a negative contribution to institutional costs and continue to have cost coverage below 100 percent.

Comments on Cost Coverage

MPA/ANM/ABM utilizes two analytic coverage methods, or tools, to evaluate cost coverage for Outside County Periodicals. One is to use short-run marginal costs to attribute costs to Periodicals, which it considers appropriate in conditions of excess capacity. The other begins with the premise that Periodicals mailers use other postal products and then concludes that the contribution from those products should be used in combination with Periodicals to asses Periodicals' cost coverage. MPA et al. Comments at 7-13, 15-16, Appendix A, and Reply Comments at 5. Conde' Nast supports these approaches. Conde' Nast Comments at 2.

Valpak opposes use of short-run marginal costs in deriving attributable costs. It claims, among other things, that this approach abandons the Commission's 40-year practice for a new, untried and untested system simply for the benefit of Periodicals cost coverage. Valpak Reply Comments at 19-21.

Valpak disputes the validity of including the contribution of complementary products used by Periodical mailers when analyzing whether its revenue is greater than its attributable costs. It argues that every product makes use of other products, and to count the contribution made by other classes or products would amount to double-counting. *Id* at 14.

Valpak also raises concerns about the losses generated by Periodicals over the last 14 years which amount to $4.3 billion. It observes that an average price increase of 32 percent would be required to bring Periodicals to full cost coverage within one year and 16 percent within two years. Valpak Comments at 32. It urges the Commission to find that the Postal Service's pricing policies violate section 101(d) and order it to move towards cost coverage compliance. *Id.* at 31.

On behalf of Time, Inc., Halstein Stralberg filed an Addendum. The Addendum analyzes the reasons Periodicals have failed to contribute to the recovery of the Postal Service's institutional costs. Stralberg offers both operational and pricing recommendations to improve cost coverage. Stralberg believes substantial efficiencies would be gained if the Postal Service were to improve its network configuration, and make several operational steps it believes would reduce manual sorting, such as ending "Hot2C lists," stop making "heroic efforts" when mailers miss critical entry times (CETs), and define machinability according to the preparation needed for 5-digit barcoded flats to be processed on the AFSM 100. Time Addendum at 8.

The Public Representative (PR) faults the Postal Service for not providing data on 40 Flat Sequencing System (FSS) machines in operation. PR Comments at 18-20. The PR also contends that the annual increase in automated flats mail processing productivity was less than in the previous years. *Id.* at 20. Finally, the PR contends that the share of flat costs incurred in manual sorting operations has been steadily increasing since FY2007, and now nearly one-half of flats costs are incurred in manual sorting operations. *Id.* at 21.

The Postal Service addresses the cost coverage issue by first contending that cost coverage is due to many factors, not only efficient operations. It states that these other factors are responsible for the increase in mail processing costs per piece, and maintains they were outside of its control. Postal Service Reply Comments at 19, 21-23. The Postal Service rebuts the notion that there are significant efficiencies that could be captured if it were to require mailers to meet AFSM100 machinability standards before qualifying for a machinable rate. It states that only 4 percent of non-carrier route Outside County Flats did not receive a mechanized sort on the AFSM100, and that approximately 14 percent of Outside County Periodicals do not receive mechanized sorts, even if they are machinable. *Id.* at 26.

The Postal Service responds to the PR's claim that most FSS have been in operation during this last year but does not report the costs or productivities of these operations. The Postal Service states that even though several FSS machines were in operation during the year, it was only by the end of the year that most were out of the testing phase and able to operate full potential. *Id.* at 2.

The Postal Service next addresses the PR's concern that the share of costs incurred by flats in manual sorting operations has steadily increased since FY2007. The Postal Service notes that the absolute level of manual sorting costs has declined, not increased, since FY 2007, and it explains that about 75 percent of the flats sorted on the UFSM1000 are now being sorted on the much more efficient AFSM100. The Postal Service speculates that since the AFSM can sort much more efficiently than UFSM1000, it may be the case that mechanized sorting costs have declined compared to manual sorting costs. *Id.* at 10.

Commission Analysis

Commentors raise several issues. MPA/ANM/ABM contend that cost coverage should be assessed using short-run marginal cost (SRMC) and that the contribution from other mail created by Periodicals mailers should also be included in that evaluation. This latter approach is often referred to as the multiplier effect. Time argues that Periodicals cost coverage can be improved by cost reductions that could be obtained by improving operations and by making some strategic pricing changes. The Public Representative also discusses the cost of operations and Valpak suggests price increases.

Short-Run Marginal Cost Analysis. Sections 3622(c)(2) and 3633(a) require the Commission to determine if annual revenues exceed annual costs. The current methodology used to calculate attributable costs has evolved over a 40- year period through both PRA rate cases and the more recent ACD process. It reflects a long-run approach to costing. For a business or the Postal Service to remain viable, total revenue must equal or exceed total cost. To this end, each product's revenue has to exceed its attributable cost plus make

a reasonable contribution to institutional cost. This approach is incorporated into section 3622(c)(2). Further, section 3633(a)(2) requires the revenue for each competitive product to cover its attributable costs.

Using SRMC to assess the adequacy of revenues, *i.e.*, the adequacy of prices, may not result in a set of prices that covers average total costs because SRMC excludes capacity cost. However, long-run marginal cost (LRMC) reflects changes in capacity cost; thus, basing prices on LRMC helps ensure that prices produce revenues that cover average total cost.[8] SRMC may be appropriate for time-limited pricing program when there is excess capacity, but it is not appropriate for the purposes of assessing annual attributable costs. For this reason, short-run marginal cost is not an appropriate basis for evaluating the adequacy of revenues.

Multiplier Effect. Valpak argues that all products create a multiplier effect and that using the contribution from other products to assess Periodicals' cost coverage would be double counting. The Commission agrees. Each product must be evaluated using its own revenues and attributable cost.

Cost Reductions and Price Changes. An important issue with respect to Periodicals is the amount of cost incurred by the Postal Service in manual mail processing operations. Both the Public Representative and Time comment that the Postal Service could accrue savings by reducing manual flats processing operations. The Public Representative contends that half of the costs of processing flats occurs in manual processing operations. Time argues that the Postal Service incurs manual processing costs due to management decisions such as the "Hot Publications" program and by providing same-day processing for Periodicals that miss the Critical Entry Time (CET) for automation processing. The Postal Service states that "the majority of pieces worked manually are worked manually for reasons that have nothing to do with service (Hot 2C) concerns." Postal Service Reply Comments at 26.

The Postal Service provided an analysis of Periodicals FY 2010 manual piece and bundle processing costs in its Reply Comments. The Postal Service states that "[r]elative to the gap between average revenue and average attributable costs, manual mail processing costs are small." *Id.* at 25. The total cost incurred by manually processing Periodicals in FY 2010 was over $300 million.[9]

The Postal Service states that not all of the $300 million incurred in manual mail processing cost pools was due to processing activities. Manual mail processing cost pools contain costs for activities not directly related to processing pieces and bundles, for example costs associated with clocking in and out. The Postal Service uses IOCS tallies to isolate manual processing operation costs from the larger pool of manual processing costs. Table VII-5 contains the Postal Service's estimate of manual mail processing costs for three specific manual processing cost pools.

The Postal Service is unable to isolate the portion of the $188 million incurred due to manual processing that is required by nonmachinable pieces, compared to the portion of the $188 million incurred in manual

[8] For a discussion of these concepts, *see* Kahn, Alfred E., *The Economics of Regulation: Principles and Institutions*, Volume I: Principles, pp. 87-89, 1970.

[9] The Periodicals Outside County unit cost for mail processing cost pools associated with manual processing was 4.57 cents per RPW piece in FY 2010. Reply Comments at 26. The total attributable cost for FY 2010 is calculated by multiplying 4.57 cents x 6.5 billion Outside County Pieces. This results in a total attributable cost of over $300 million.

Table VII–5—Postal Service Estimate of FY 2010 Manual Piece and Bundle Processing Cost[1]

	MODS	NONMODS	MODS	
	LD43	MANF	MANF	Total
Piece Handling	$31,555,200	$75,601,000	$36,157,000	$143,313,200
Bundle Handling	$19,064,600	$21,694,200	$3,994,440	$44,703,200
Manual Processing	$50,619,800	$97,295,200	$40,101,400	$188,016,400

[1] This table is calculated using figures contained in the Postal Service's Reply Comments Table 5 at 29. The mail processing unit costs per piece in that table are multiplied by the Periodicals Outside County Volume.

processing costs due to management decisions such as the "Hot Publications" program. There may to be an opportunity for significant savings.

A recent United States Postal Service Office of Inspector General (OIG) report (No. CRR-AR-11-001) recommended elimination of the Hot2C program. The OIG Report indicates that management has agreed to a target date of April 2011 for issuing guidance on the Hot 2C matter. The Commission requests that the Postal Service supplement the record with a copy of that guidance when issued. The OIG Report also indicates the Postal Service will evaluate establishing a national CET for Periodicals. Here too, the Commission requests that the Postal Service supplement the record with a copy of that guidance when issued as well.

In contrast to the opportunities for cost reductions, Valpak contends that Periodicals prices should be increased substantially. The Commission recognizes that the year to year losses generated by Periodicals are a persistent and difficult problem. However, the Commission is not persuaded by Valpak that it should order prices to be increased beyond the statutory cap. Because Outside County Periodicals represents 96 percent of the class revenues, the Postal Service does not have the same discretion to set prices substantially above the price cap that it has with respect to products within Standard Mail. Thus corrective pricing measures are limited. Further, there are other options available to the Postal Service that it has not yet fully exercised. One set of options is on the costs side and the other is on the pricing side.

On the cost side, the Postal Service can continue to pursue the Flats Strategy that it outlines in its Exigency Request. This includes ending the Hot2C program. Other areas of potential cost reductions will be detailed in the forthcoming Periodicals Study Report.

On the pricing side, as noted in last year's ACD and in the sections that follow, there is room for improvement in worksharing discounts and in the prices for bundles and containers. The Postal Service can create additional incentives for mailers to prepare mail more efficiently. The extent to which these passthroughs do not achieve 100 percent reflects opportunities that the Postal Service has not fully utilized.

Given continuing year to year losses, the Postal Service states that "the Periodicals class does not satisfy 39 U.S.C. 3622(c)(2) of title 39." ACR at 35. Recognizing that this is one of 14 factors that must be taken into account, the Commission agrees and recommends that the Postal Service pursue the opportunities explored above and in the Periodicals Study to reduce the costs of handling flats.

Table VII–6—Outside County Periodicals Workshare Discounts Exceeding Avoidable Cost in FY 2010 Using R2009–2 Prices

Type of Worksharing	Discount	Avoidable Costs	Passthrough
Pre–sorting ($ per piece)			
Machinable Nonautomation 5D Flats	$0.097	$0.093	104.3%
Machinable Automation 5D Flats	$0.086	$0.084	102.4%
Nonmachinable Nonauto 3D/SCF Flats	$0.074	$0.046	160.9%
Nonmachinable Automation 3D/SCF Flats	$0.060	$0.042	142.9%
ADC Automation Letter	$0.040	$0.016	250.0%
3–Digit Automation Letter	$0.020	$0.002	1000.0%
5–Digit Automation Letter	$0.060	$0.019	315.8%
Pre–barcoding ($ per piece)			
Machinable Automation MADC Flats	$0.032	$0.026	123.1%
Nonmachinable Automation MADC Flats	$0.045	$0.022	204.6%

Source: ACR2010–PRC–LR5

Worksharing Discounts

No Within County passthroughs exceeded 100 percent. Nine Outside County passthroughs, identified in Table VII-6 exceeded 100 percent.[10]

Discounts that exceed avoided costs are permissible if a statutory exception applies. *See* 39 U.S.C. 3622(e). The Postal Service justifies the Periodicals discounts that exceeded 100 percent on the basis of section 3622(e)(2)(C), which authorizes workshare discounts greater than avoided cost if provided in connection with a subclass that consists exclusively of mail matter with ECSI value. FY 2010 ACR at 61.

Comments

As the Postal Service has prepared for the introduction of the FSS, the issues of passthroughs for Carrier Route pieces and the Price/Cost Ratios of sacks and pallets has come to the fore. Periodicals mailers have criticized the Postal Service in recent dockets for reducing incentives to Carrier Route pieces. Time maintains that only 30 percent of flats will be sorted on an FSS, leaving Carrier Route an efficient alternative for the majority of its mail. Time Comments, Addendum at 12. The Postal Service responds that Carrier Route pieces maintain a constant price differential with 5-Digit Automation pieces, and says that if the differential were increased it would encourage more preparation than will be necessary in an FSS environment. Postal Service Reply Comments at 39.

Commission Analysis

The Periodicals class qualifies for ECSI consideration; therefore, the Commission finds that the Outside County discounts that exceed avoidable costs are consistent with section 3622(e). The same nine categories that had passthroughs greater than 100 percent in Docket No. R2009-2, also have passthroughs greater than 100 percent using the prices

[10] Based on information in original filing using FY 2010 cost data and R2009-2 prices, as revised by Postal Service Response to CHIR No. 1, Questions 3, 4 and 7.

recently approved in Docket No. R2011-2; however, several of these passthroughs were reduced by several percentage points.[11] *See* R2011-2, PRC-LR-2.

With regard to carrier route passthroughs, Table VII-7 first shows that the Postal Service has been increasing the incentives for 5-Digit Automation pieces compared to Basic Carrier Route pieces, and Table VII-8 shows that the avoided cost for 5-Digit Automation pieces has been declining.

Table VII–7—Carrier Route and 5–Digit Automation Passthroughs Over Time

	Passthroughs		
	2008	2009	2010
CR Basic	88.15%	71.52%	71.05%
5–Digit Automation	61.37%	96.63%	102.38%

Sources: Docket Nos. ACR2007–ACR2010, PRC–LR5

Table VII–8—Changes in Avoided Costs for Carrier Route and 5 Digit Automation Pieces

	Avoided Cost Change ($/piece)	
	2008–2009	2009–2010
CR Basic	$0.03	$0.00
5 Digit Automation	$(0.17)	$(0.01)

Sources: Docket Nos. ACR2007 – ACR2010, PRC–LR5

In this ACD, the Commission is assessing whether current discounts, *i.e.*, the discounts in effect in FY 2010, comply with the statute. The Postal Service shows that the cost avoided in FY 2010 by moving mail from Machinable Nonautomation 5-digit Flats to Carrier Route Basic is 15.2 cents per piece. Thus, the Postal Service's own cost study shows that carrier route mail saves it money in the current operating environment. Further, the discount is only 10.8 cents per piece which means that the Postal Service is sorting mail to the carrier route that could be done cheaper by another party. If the Postal Service were to increase the discount to 15.2 cents, then more 5-digit mail would be sorted to the carrier route level by mailers or third parties who can sort the mail for less than 15 cents a piece.[12] This is the benefit of using 100 percent passthroughs.

The Postal Service contends that carrier route mail will have less value in an FSS environment, but there are no studies showing how much the avoided costs associated with sorting to the carrier route level will decrease. Given the studies available, increasing the discount for carrier route discount would save the Postal Service money. For this reason, the Commission recommends that in the future, the Postal Service increase the carrier route passthrough to incent more efficient mailer preparation. When FSS equipment becomes operational then the Postal Service's cost studies should reflect any reduction in the value of Carrier Route presort and discounts may be adjusted accordingly.

Price-Cost Ratios for Bundles and Containers

Discrete pricing for Outside County bundles, sacks, and pallets was introduced in Docket No. R2006-1. The prices, bottom-up costs, and ratios of price to bottom-up cost for each combination of item, presort level, and entry level are shown in the tables at the end of this section. These price-cost ratios can be thought of similarly to worksharing discounts, in the sense that they reflect many incentives for

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

[12] Similarly, the price for Carrier Route bundles should also reflect 100 percent of the cost. Using a 100 percent passthrough for Carrier route bundles and presort level would incentivize the most efficient mail preparation.

VII–9—Comparison of Price/Cost Ratios of Sacks to Pallets Between FY 2008 and R2011–2

Average of Destinating Containers	FY2008	FY2009	FY 2010	R2011–2	Percentage Point Change Since 2008
ADC Destinating Sack	30.8%	35.9%	36.5%	37.1%	6.30%
3d/SCF Destinating Sack	32.1%	36.1%	36.6%	37.2%	5.10%
5–D/CR Destinating Sack	29.9%	34.8%	34.1%	34.6%	4.70%
ADC Destinating Pallet	36.0%	49.5%	50.2%	51.0%	15.00%
3–D/SCF Destinating Pallet	35.0%	48.2%	48.8%	49.6%	14.60%
5–D/CR Destinating Pallet	30.6%	48.5%	48.6%	48.9%	18.30%

Sources: Docket Nos. ACR2007–ACR2010, PRC–LR–5, and Docket No. R2011–2, PRC–LR–3.

cost-reducing mail preparation behavior, but unlike worksharing discounts they do not explicitly reflect the relation of discounts to the costs avoided by greater mailer preparation. Price-cost ratios are used to describe how much of a cost is recognized in a given price element. The price-cost ratios for bundles, sacks, and pallets are significantly below 100 percent. Price-cost ratios range from a low of 15.8 percent for a mixed ADC sack entered at the origin sectional center facility, to a high of 54.6 percent for a 3-digit pallet entered at the origin bulk mail center.

Comments

Time asserts that the Postal Service has increased the prices for pallets more than sacks, which it says is a sign of an inefficient price structure, since sacks, especially origin-entered sacks, are much less efficient than destinating pallets. Time Comment Addendum at 12. The Postal Service asserts its price structure is rational because origin-entered pallets will receive a greater price increase than the average price increase it proposed in Docket No. R2011-2. Postal Service Reply Comments at 39.

Commission Analysis

The Commission recommends that the Postal Service increase the price/cost ratios of sacks in comparison to pallets.[13] Table VII-9, shows that the Postal Service has proposed relatively small increases in the price/cost ratio for destinating sacks, while proposing relatively large increases in destinating pallets. Using incentives to move mail out of sacks and onto pallets is an efficient price structure.

Table VII-9 shows that the price/cost ratios for destinating pallets have increased between 14.6 and 18.3 percentage points. In contrast, the price/cost ratios for destinating sacks have increased between 4.9 and 6.3 percentage points. The Postal Service has not explained why its price changes tend to favor the continued preparation of sacks, while discouraging pallet preparation.

[13] The Commission notes that the three categories that significantly exceeded 100 percent passthrough (with passthroughs of 250 percent, 315.8 percent, and 1,000 percent) are letter-only categories. The volumes associated with these categories account for 1.4 percent of the volume in all categories with passthroughs that exceed 100 percent, and for less than one-half of one percent of all Outside County volume. ACD FY 2010, PRC–ACR2010–LR5.

Table VII–10—Within County Passthroughs, FY 2010 Using R2009–2 Prices

Type of Worksharing	Discount	Avoided Costs	Passthrough
Presorting (dollars per piece)			
3–Digit Presort	$0.012	$0.054	22.2%
5–Digit Presort	$0.013	$0.139	9.4%
CR Basic	$0.046	$0.160	28.8%
High Density	$0.015	$0.030	50.0%
Saturation	$0.014	$0.028	50.0%
3–Digit Automation Letter	$0.009	$0.010	90.0%
5–Digit Automation Letter	$0.002	$0.019	10.5%
Pre–barcoding (dollars per piece)			
Basic Automation Flats	$0.016	$0.083	19.3%
3–Digit Automation Flats	$0.012	$0.065	18.5%
5–Digit Automation Flats	$0.006	$0.017	35.3%
Dropshipping (dollars per piece)			
DDU Dropship	$0.008	$0.029	27.6%

Source: PRC–ACR2010–LR5

Table VII–11—Outside County Passthroughs, FY 2010
Using R2009–2 Prices

Type of Worksharing	Discount	Avoided Costs	Passthrough
Presorting	(dollars per piece)		%
Machinable Nonautomation ADC Flats	$0.035	$0.036	97.2%
Machinable Nonautomation 3D/SCF Flats	$0.017	$0.035	48.6%
Machinable Nonautomation 5D Flats	$0.097	$0.093	104.3%
CR Basic	$0.108	$0.152	71.1%
High Density	$0.027	$0.030	90.0%
Saturation	$0.019	$0.028	67.9%
Machinable Automation ADC Flats	$0.026	$0.030	86.7%
Machinable Automation 3D/SCF Flats	$0.015	$0.033	45.5%
Machinable Automation 5D Flats	$0.086	$0.084	102.4%
Nonmachinable Nonauto ADC Flats	$0.115	$0.142	81.0%
Nonmachinable Nonauto 3D/SCF Flats	$0.074	$0.046	160.9%
Nonmachinable Nonauto 5D Flats	$0.116	$0.221	52.5%
Nonmachinable Automation ADC Flats	$0.094	$0.146	64.4%
Nonmachinable Automation 3D/SCF Flats	$0.060	$0.042	142.9%
Nonmachinable Automation 5D Flats	$0.107	$0.198	54.0%
ADC Automation Letter	$0.040	$0.016	250.0%
3–Digit Automation Letter	$0.020	$0.002	1000.0%
5–Digit Automation Letter	$0.060	$0.019	315.8%
Pre–barcoding			
Machinable Automation MADC Flats	$0.032	$0.026	123.1%
Nonmachinable Automation MADC Flats	$0.045	$0.022	204.5%

Source: PRC–ACR2010–LR5

Table VII–12—Outside County Bundle Price/Cost Ratios, FY 2010 Using R2009–2 Prices

Container Level	Bundle Level	Price	Cost	Price as Percent of Cost
Mixed ADC		(dollars per piece)		%
	MADC	$0.077	$0.185	41.6%
	ADC	$0.201	$0.495	40.6%
	3–D/SCF	$0.267	$0.641	41.7%
	5–D	$0.276	$0.688	40.1%
	Firm Bundle	$0.179	$0.918	19.5%
ADC				
	ADC	$0.111	$0.280	39.6%
	3–D/SCF	$0.183	$0.431	42.5%
	5–D	$0.199	$0.479	41.5%
	CR	$0.314	$0.733	42.8%
	Firm Bundle	$0.149	$0.733	20.3%
3–D/SCF				
	3–D/SCF	$0.125	$0.278	45.0%
	5–D	$0.145	$0.333	43.5%
	CR	$0.279	$0.565	49.4%
	Firm Bundle	$0.137	$0.565	24.3%
5–D/CR				
	5–D	$0.140	$0.320	43.8%
	CR	$0.147	$0.320	45.9%
	Firm Bundle	$0.077	$0.320	24.1%

Source: PRC–ACR2010–LR5

Table VII–13—Outside County Sack Price/Cost Ratios, FY 2010 Using R2009–2 Prices

Sack Level	Entry Point	Price	Cost	Price as Percent of Cost
Mixed ADC		(dollars per piece)		%
	OSCF	$0.42	$2.66	15.8%
	OADC	$0.42	$2.15	19.5%
ADC				
	OSCF	$2.01	$6.11	32.9%
	OADC	$2.01	$5.95	33.8%
	OBMC	$2.01	$5.24	38.4%
	DBMC	$1.40	$3.91	35.8%
	DADC	$0.80	$2.15	37.2%
3–D/SCF				
	OSCF	$2.10	$6.55	32.1%
	OADC	$2.10	$6.24	33.6%
	OBMC	$2.10	$5.44	38.6%
	DBMC	$1.50	$4.03	37.2%
	DADC	$1.20	$3.39	35.5%
	DSCF	$0.80	$2.15	37.2%
5–D/CR				
	OSCF	$2.70	$8.53	31.6%
	OADC	$2.70	$7.86	34.3%
	OBMC	$2.70	$7.11	38.0%
	DBMC	$2.00	$5.74	34.8%
	DADC	$1.70	$4.98	34.1%
	DSCF	$1.30	$3.84	33.9%
	DDU	$0.90	$2.67	33.7%

Source: PRC–ACR2010–LR5

Table VII–14—Outside County Pallet Price/ Cost Ratios, FY 2010 Using R2009-2 Prices

Pallet Level	Entry Point	Price	Cost	Price as Percent of Cost
ADC		(dollars per pallet)		%
	OSCF	$28.00	$66.75	41.9%
	OADC	$28.00	$59.80	46.98
	OBMC	$28.00	$52.58	53.3%
	DBMC	$22.40	$44.28	50.6%
	DADC	$12.40	$24.86	49.9%
3-D/SCF				
	OSCF	$33.36	$79.01	42.2%
	OADC	$33.36	$73.42	45.4%
	OBMC	$33.36	$61.19	54.5%
	DBMC	$23.80	$47.88	49.7%
	DADC	$20.70	$42.39	48.8%
	DSCF	$11.10	$23.15	47.9%
5-D/CR				
	OSCF	$42.13	$101.75	41.8%
	OADC	$42.13	$88.50	47.6%
	OBMC	$42.13	$77.27	54.5%
	DBMC	$31.90	$64.95	49.1%
	DADC	$30.20	$62.01	48.7%
	DSCF	$20.40	$42.48	48.0%
	DDU	$1.60	$3.42	46.8%

Source: PRC–ACR2010–LR5

Standard Mail

Introduction

The Standard Mail class has six products: Letters; Flats; Not-Flat Machinables (NFMs)/Parcels; Carrier Route; High Density and Saturation Letters; and High Density and Saturation Flats/Parcels. Standard Mail had a volume of 82.5 billion pieces in FY 2010. Standard Mail accounts for 48 percent of total mail volume and 22 percent of total contribution to institutional costs.

The principal FY 2010 findings are:

- Standard Mail contributed $5.5 billion to institutional costs.
- The attributable cost of Standard Mail Flats exceeded revenues by $577 million, resulting in a cost coverage of 82 percent.
- The Commission finds that the prices for Standard Mail Flats did not comply with 39 U.S.C 101(d) and directs corrective action.
- The attributable cost of Standard Mail NFMs/ Parcels exceeded revenues by $172 million, resulting in a cost coverage of 78 percent, but the Postal Service is making significant efforts to address this problem.
- Sixteen workshare discounts exceeded avoided costs.
    - » Three discounts were adjusted to reflect 100 percent of avoided cost in Docket No. R2011-2,
    - » One discount was justified on the basis of rate shock,
    - » Eight discounts were justified as necessary to promote efficient operations,
    - » Because of anomalous costs, the Commission is unable to determine if four discounts are consistent with section 3622(e).

Table VII–15—Standard Mail
Fiscal Year 2010 Volume, Revenue, Cost, Contribution, and Cost Coverage by Product

Standard Mail:	Volume (000)	Revenue ($000)	Attributable Costs ($000)	Contribution to Institutional Costs ($000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Costs/Pc. (Cents)	Cost Coverage
High Density & Saturation Letters	5,428,043	741,537	348,528	393,009	13.66	6.42	7.24	212.8%
High Density & Saturation Flats & Parcels	11,363,444	1,853,432	825,827	1,027,605	16.31	7.27	9.04	224.4%
Carrier Route	9,473,617	2,240,712	1,567,192	673,520	23.65	16.54	7.11	143.0%
Letters	48,508,586	9,294,785	5,127,431	4,167,353	19.16	10.57	8.59	181.3%
Flats	7,067,654	2,592,242	3,169,228	(576,986)	36.68	44.84	–8.16	81.8%
Not Flat–Machinables and Parcels	682,403	607,701	780,156	(172,455)	89.05	114.32	–25.27	77.9%
Inbound Intl. Negotiated Serv. Agreement Mail[1]	1,061	473	150	322	44.56	14.18	30.38	314.3%
Total Standard Mail	82,524,808	17,330,882	11,818,513	5,512,369	21.00	14.32	6.68	146.6%

[1] See Docket Nos. CP2008–14 and CP2008–15.
Source: PRC—ACR2010– LR4

- Per-piece revenue from Standard Mail Nonprofit pieces was 61.3 percent of Standard Mail commercial per-piece revenues. However, the price adjustment proposed in Docket No. R2011-2 is expected to produce an average revenue per piece that complies with the statute.

Financial analysis

The FY 2010 Standard Mail class cost coverage was 146.6 percent. As Table VII-15 shows, total Standard Mail FY 2010 revenue was $17.3 billion, which covered its attributable cost of $11.8 billion and contributed $5.5 billion to institutional cost. Standard Mail Flats and NFMs/Parcels did not generate enough revenue to cover their attributable costs, and thus added to the institutional cost burden of the Postal Service.

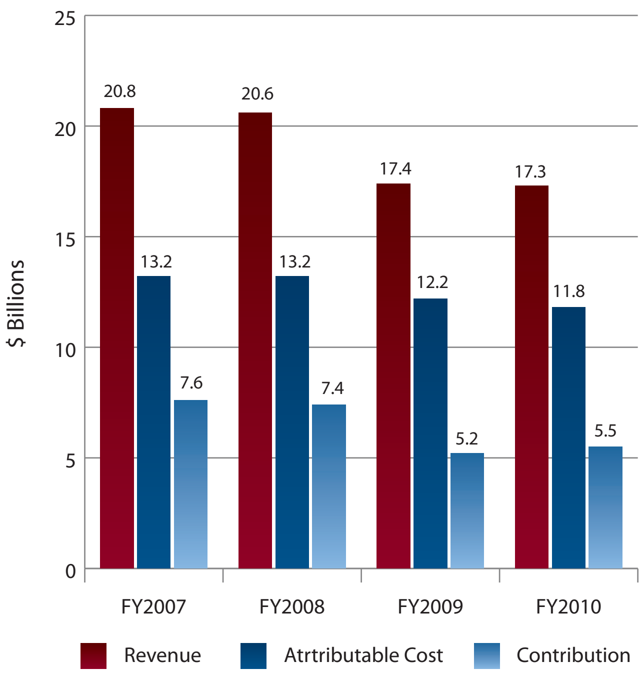
Standard Mail's cost coverage increased from 142.7 percent in FY 2009 to 146.6 percent in FY 2010. Due to a change in mail mix and a decrease in the cost of processing letters, Standard Mail unit attributable cost decreased by three percent in FY 2010. Between FY 2009 and FY 2010, Standard Mail volume decreased by less than one percent (fewer than 200 million pieces) and revenue decreased by less than one percent ($30 million decline). As Figure VII-1 demonstrates, the contribution from Standard Mail increased in FY 2010, reversing a two year trend of contribution declines.

Figure VII-2 shows the unit contribution of each Standard Mail product.

Standard Mail Letters

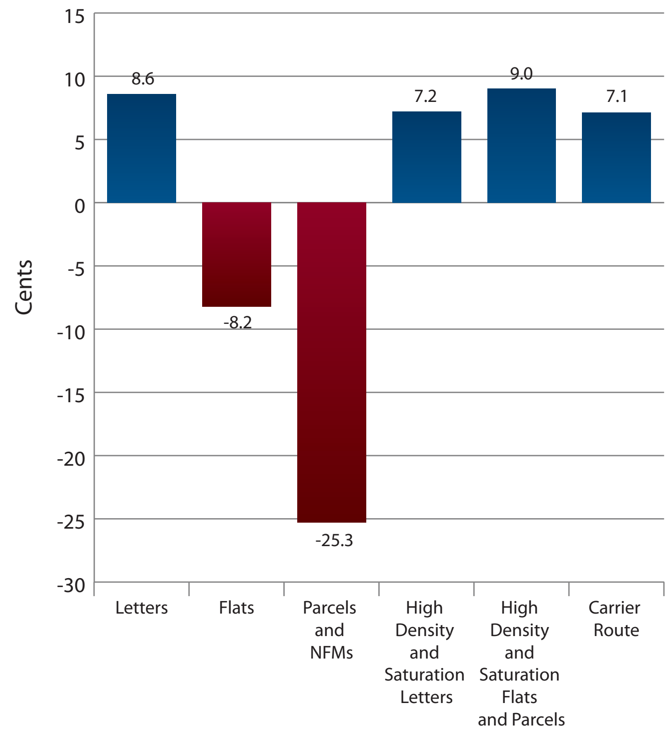
Standard Mail Letters prices recovered 181.3 percent of their attributable costs in FY 2010, an increase from the 174.1 percent recovered in FY 2009. On a unit basis, Letters contributed 8.6 cents per piece to the institutional cost of the Postal Service.

Figure VII–1—Standard Mail Trends



Source: 2007 ACD at 87, 2008 ACD at 59, 2009 ACD at 84, and Table VII-15.

Figure VII–2—Unit Contributions of Standard Mail Products



Source: Table VII-15.

Standard Mail Flats

Standard Mail Flats continue to present a significant concern. Cost coverage for Standard Mail Flats was 81.6 percent, with a loss of 8.2 cents per piece. As Figure VII-3 illustrates, neither commercial flats nor nonprofit flats covered their costs, resulting in a cost coverage below 100 percent for the whole product.

The FY 2010 cost coverage for Standard Mail Flats is 81.6 percent, and the contribution per piece is negative 8.2 cents. As shown in Table VII-16, from the time that the costs for the Flats Product have been separately reported in the CRA, Flats' revenue has not covered its costs.

The Commission stated its concern with the growing intra-class cross subsidy in previous ACDs and orders reviewing market dominant price adjustments. In the FY 2008 ACD, the Commission recommended that the Postal Service decrease the disparity between Standard Mail Flats and Letters in the next Market Dominant Price Adjustment or show that market characteristics or other non-cost factors justify continued unequal treatment.

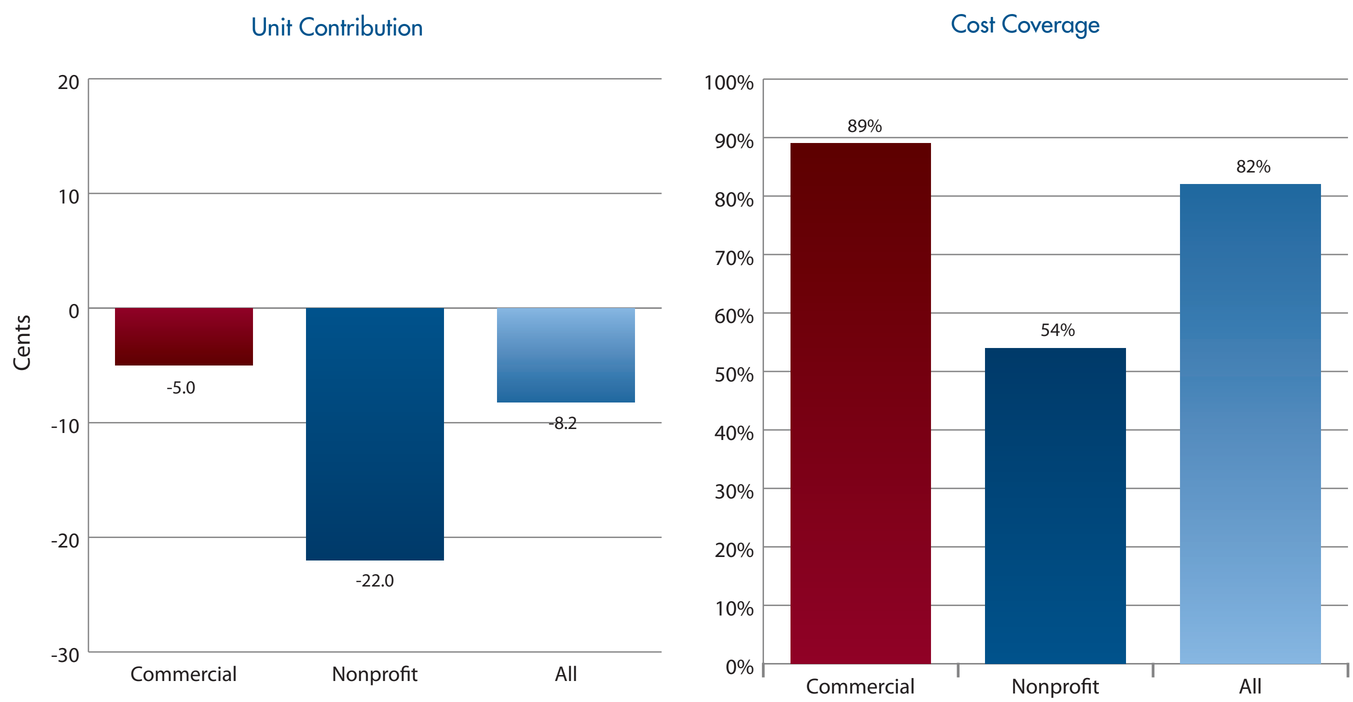
In Docket No. R2009-2, the Commission noted that the trend of below average increases for Flats in the recent price adjustments suggests a possible pattern of preference contrary to sections 3622(b) and (c).

Table VII–16—Standard Mail Flats Cost Coverage

	2008	2009	2010
Standard Flats	94.4%	82.3%	81.6%

Source: PRC–ACR 2010–LR4

Figure VII–3—Standard Mail Flats



	Volume (000)	Total Revenue ($ 000)	Attributable Cost ($ 000)	Contribution to Institutional Cost ($ 000)
Commercial Flats	5,748,778	2,251,965	2,538,901	(286,936)
Nonprofit Flats	1,318,876	340,277	630,327	(290,050)
Total Commercial and Nonprofit	**7,067,654**	**2,592,242**	**3,169,227**	**(576,986)**

Source: PRC–ACR 2010–LR4

In the FY 2009 ACD, the Commission found that the financial performance of this product failed to satisfy section 3622(c)(2). The Commission also found that the cost coverage issue:

> directly implicates the requirement of section 101(d), which directs the Postal Service to apportion the costs of the Postal Service on a fair and equitable basis and section 3622(b)(5), which requires that rates must be set to ensure adequate revenues to maintain financial stability.

FY 2009 ACD at 86. The Commission directed that the Postal Service devise a plan to improve the cost coverage of the Flats product.

In Docket No. R2010-4, the Postal Service presented a plan to increase Flats prices and reduce costs that was estimated to achieve at least 100 percent cost coverage in five years.[14] Key elements of that plan were: cost reductions, the 5.1 percent proposed Docket No. R2010-4 price increase, and increases for Flats of 2 percent above the change in CPI in the next five market dominant price adjustments. The Postal Service observed that it “has the flexibility under the PAEA to hold the overall increase for the class to CPI while combining below CPI increases for, say, Standard

[14] Responses of the United States Postal Service to Questions from the Bench at the Hearing for Dr. Kiefer, August 19, 2010, at 20.

Mail letters with above CPI increases for Standard Mail flats." Docket No. R2010-4 Tr. 3/419-20.

In the FY 2010 ACR, the Postal Service states:

> [w]ith the Commission's denial of the Postal Service's exigent rate increase request in Docket No. R2010-4, the Postal Service's plan for bringing the fourteen products to full attributable cost coverage is no longer workable. … Therefore, it seems most appropriate for the Commission to determine whether it can exercise any of its powers to remedy the cost coverage shortfall of the products in question.

FY 2010 ACR at 8.[15]

Comments

ACMA, Valpak, the Public Representative, L.L. Bean and the Postal Service submitted comments concerning Flats cost coverage, and compliance with sections 3622(c)(2), 3622(b)(5), and 101(d).

ACMA states it is "disappointed" in the low cost coverage for Flats, but that "no evidence is found here that the current prices are out of compliance with the ratemaking guidance in title 39." ACMA Comments at 10. It raises concerns regarding the accuracy of the costs used to calculate the Flats product cost coverage, stating that "the costs are not robust enough to support a finding of noncompliance." *Id.* at 13. ACMA concludes that the "Postal Service should be given continued freedom to make progress on its Flats Strategy and to manage the rates for Standard Flats." *Id.*

Valpak states that over the past three years, the Flats product's cumulative contribution is negative $1.4 billion. Further, it contends that "the Postal Service has deliberately allowed extensive intra-class subsidy of underwater products (*e.g.*, Standard Mail Flats)." Valpak Comments at 31. Valpak asks that the Commission determine the Postal Service has not used its pricing powers in accordance with PAEA, and has priced the Flats product in direct contradiction of section 101(d). *Id.* Valpak concludes that the Commission should "direct the Postal Service to immediately increase prices for Standard Flats by 11.0 percent." Valpak Comments (revised February 16, 2011) at 54.

The Public Representative states that in Docket No. R2010-4, the Postal Service proposed increasing Flats prices by 5.1 percent as part of a plan to improve the cost coverage of Standard Flats. The Public Representative asserts that the Commission "should hold the Postal Service to its plan." Public Representative Comments at 5.

L.L. Bean states that "the Postal Service has substantial pricing flexibility within Standard Mail to adjust prices for below costs products in a manner that would close the cost-gap." L.L. Bean Comments at 7. It concludes that "the core regulatory problem with Standard Flats is not the cost-coverage differential with Letters, but that Flats are priced below costs - resulting in higher-than-necessary rates for all above-costs products collectively." *Id.* at 6. L.L. Bean advocates that "the process of transitioning Standard Flats rates to full cost coverage and a reasonable contribution should begin now, allowing a graduated and predictable phasing toward that objective." *Id.* at 7. The alternative, L.L. Bean contends, is that a dramatic price increase would eventually become necessary, which could cause rate shock and would not be predictable for mailers. *Id.* at 8.

Commission Analysis

The Commission has repeatedly stated that the Postal Service should use its intra-class pricing flexibility to

[15] Product cost coverage shortfall occurs when the product revenue does not cover attributable cost.

reduce the cost coverage shortfall of Standard Flats.[16] In Docket No. R2010-4, the Postal Service advanced a "Flats Strategy" designed to eliminate the Flats intra-class cross subsidy. In this proceeding, it summarized that document, stating "the Postal Service presented a detailed plan for capturing efficiencies for Standard Mail Flats that, when combined with consecutive above average price increases, would result in full attributable cost coverage." FY 2010 ACR at 8. The Postal Service now contends that, given the constraints of the PAEA, it is impossible to execute its "Flats Strategy" with respect to Standard Mail Flats. FY 2010 ACR at 8.

Valpak, the Public Representative, and L.L. Bean argue that the Postal Service has such pricing and operational flexibility. The Commission finds that PAEA permits the Postal Service sufficient operational and pricing flexibility to allow it to accomplish its long-term goals for Standard Mail Flats as advanced in Docket No. R2010-4. It has simply chosen not to utilize that flexibility with respect to Standard Mail Flats. This is evidenced by its most recent price adjustment in Docket No. R2011-2, where the Postal Service utilized its pricing flexibility to increase Standard NFM/Parcel prices by an average of 11.3 percent in an attempt to reduce the cost coverage shortfall for that product.

As Table VII-17 shows, the preferential price adjustments accorded to Flats has led to an increasingly negative contribution per piece. Since the contribution of the Flats product was first reported in the CRA in FY 2008, the negative contribution per piece has grown 279 percent from negative 2.2 cents per piece in FY 2008 to negative 8.3 cents in FY 2010.

[16] 2008 ACD at 91, Order No. 191 Review of Postal Service Notice of Market Dominant Price Adjustment at 52, 2009 ACD at 84, Order No. 675 at 3.

Table VII–17—Standard Mail Flats Contribution Per Piece

	Contribution Per Piece (Cents)		
	2008	2009	2010
Standard Flats	(2.2)	(7.9)	(8.3)

Source: PRC–ACR 2010–LR4

Valpak, the Public Representative, L.L. Bean, and Bank of America have stated that the long-running contribution shortfall for Standard Mail Flats is an unfair and inequitable apportionment of costs in violation of 39 U.S.C 101(d).[17] The Commission agrees.

The Postal Service has lost $1.4 billion in contribution from Standard Mail Flats over the last three years, including $577 Million in FY 2010. This reflects an unfair and inequitable apportionment of the costs of postal operations to all Standard Mail users. The Commission has repeatedly encouraged the Postal Service to use its pricing flexibility to improve cost coverage for Standard Flats. Despite this encouragement, the Postal Service has failed to utilize the pricing flexibility granted to it by the PAEA to address this issue, and the negative contribution per piece continues to grow. Furthermore, the recently approved price changes are unlikely to improve cost coverage. For these reasons, the Commission finds that the prices in effect in FY 2010 for Standard Flats do not comply with section 101(d) of title 39.

Pursuant to section 3653(c), the Commission directs the Postal Service to increase the cost coverage of the Standard Mail Flats product through a combination of above-average price adjustments, consistent with the price cap requirements, and cost reductions until such time that the revenues for this product exceed attributable costs.

[17] Valpak Initial Comments at 54, Public Representative Comments at 6, L. L. Bean Initial Comments at 9, L. L. Bean Reply Comments at 5.

As embodied in the Postal Service's "Flats Strategy," above-CPI increases[18] will be necessary to increase the cost coverage of the Flats product, and should be accompanied by efforts to streamline operations to capture efficiency and reduce costs. It is important for the Postal Service to control the costs of this product, which have increased by more than 15 percent on a per piece basis since FY 2008, compared to a CPI-U increase of just over 1 percent. The Commission expects the Postal Service to design future Flats prices that will comply with the factors and objectives of the PAEA, including the need to mitigate rate shock and to maintain predictable and stable prices.

In requiring the Postal Service to take remedial action, the Commission does not impose a specific deadline. However the Postal Service should move as promptly as practicable to eliminate this inequity. This process must begin with the next market dominant price adjustment. The Commission finds that, starting with the next Notice of Market Dominant Price Adjustment, the Postal Service must begin the process of transitioning Standard Flats prices to full cost coverage.

Within 90 days of the issuance of the FY 2010 ACD, the Postal Service shall present a schedule of future above-CPI price increases for Standard Mail Flats. This schedule shall be updated with each subsequent Market Dominant Price Adjustment and ACR until the revenue of the Flats product exceeds its attributable cost. The schedule can take the form of Table VII-18.

Until such time, the Commission requires the Postal Service to provide the following information in Annual Compliance Reports and Notices of Market Dominant Price Adjustments to provide increased transparency

Table VII–18—Scheduled of Planned Standard Mail Flats Price Increases

Year	Planned Flats Average Price Increase
2012	CPI-U + X Percent
2013	CPI-U + Y Percent
etc.	

concerning the steps the Postal Service is taking to eliminate the intra-class cross subsidy with respect to Standard Mail Flats.

In subsequent ACRs the Postal Service shall report the following information:

- describe all operational changes designed to reduce flat costs in the previous fiscal year and estimate the financial effects of such changes;
- describe all costing methodology or measurement improvements made in the previous fiscal year and estimate the financial effects of such changes;
- a statement summarizing the historical and current fiscal year subsidy of the Flats product; and, the estimated timeline for phasing out this subsidy.

In subsequent Notices of Market Dominant Price Adjustments, the Postal Service shall report the following information:

- an explanation of how the proposed prices will move the Flats cost coverage toward 100 percent, and
- a statement estimating the effect that the proposed prices will have in reducing the subsidy of the Flats product.

Standard Mail NFMs and Parcels

The NFMs/Parcels product also did not produce sufficient revenues to cover its attributable cost. The net loss for the NFMs/Parcels product was $172.5 million in FY 2010. In Docket No. R2011-2, the

[18] *See* Responses of the United States Postal Service to Questions from the Bench at the Hearing for Dr. Kiefer, August 19, 2010, at 21 for the timeline provided therein.

average price increase for parcels was 11.3 percent, well over the class average of 1.740 percent. Similarly, in Docket No. R2009-2, the average price increase for parcels was 16.420 percent, well over the class average of 3.759 percent. The Postal Service is taking action to address this problem. Further, the Commission conditionally approved the transfer of certain Standard Mail Parcels to the competitive product list in Docket No. MC2010-36, which will change the make-up of the product.

In FY 2010, the prices for NFMs/Parcels were insufficient to recover its attributable cost or make a reasonable contribution to institutional cost. However, the Postal Service's "phasing-in" approach to reducing the intra-class subsidy is appropriate. *The Commission finds that the Postal Service should continue to utilize its intra-class pricing flexibility to eliminate the intra-class cross subsidy for this product.*

High Density and Saturation Letters

In FY 2010, the High Density and Saturation Letters product had a cost coverage of 212.8 percent. It contributed $393.0 million to the institutional cost of the Postal Service. Both the nonprofit and commercial components of the High Density and Saturation Letters product made a positive contribution to institutional cost.

In its comments, Valpak argues that "pricing and cost coverage on high density/saturation mail remain too high." Valpak Comments at 65. Valpak states that categories with relatively elastic demand should have relatively low cost coverages and thus pricing of High Density and Saturation products is not optimal. Valpak Comments at 65.

In Docket No. R2011-2, the Postal Service proposed below average increases to High Density and Saturation Letters (0.615 percent) and High Density and Saturation Flats/Parcels (0.403 percent). The Postal Service explained that the below average increases were in recognition of the market characteristics of these products.

High Density and Saturation Flats/Parcels

Revenues for the High Density and Saturation Flats/Parcels product exceeded attributable cost which resulted in cost coverage of 224.4 percent in FY 2010. The product as a whole contributed $1.0 billion to the institutional cost of the Postal Service. Both the nonprofit and commercial components of the High Density and Saturation Flats/Parcels product covered their attributable costs. However, the rate categories for High Density and Saturation parcels did not cover their costs. Table VII-19 shows the volume and contribution distribution of High Density and Saturation Flats and High Density and Saturation Parcels.

In Docket No. R2011-2, the Postal Service proposed above average price increases for High Density and Saturation Parcels. *The Commission finds that the Postal Service should continue to utilize its pricing flexibility with respect to High Density and Saturation Parcels.*

Table VII–19—FY 2010 High Density and Saturation Volume and Contribution by Shape

	Flats	Parcels	Total
Volume	11,363,186,132	258,284	11,363,444,416
Contribution	$1,027,834,381	$(229,083)	$1,027,605,298

Source: PRC–ACR 2010–LR4

Table VII–20—Standard Mail Carrier Route, High Density, and Saturation by Shape Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	Year–end Discount (cents)	Unit Cost Avoidance (cents)	Passthrough
Presorting (dollars/piece)			
High Density Letters (Carrier Route Letters)	6.90	22.50	30.7%
High Density Flats (Carrier Route Flats)	4.30	5.20	82.7%
High Density Parcels (Carrier Route Parcels)	12.50	(13.00)	–96.2%
Dropship (Dollars/Pound)			
DNDC Letters (Origin Letters)	16.3	25.6	63.7%
DSCF Letters (Origin Letters)	20.8	30.7	67.8%
DNDC Flats (Origin Flats)	16.3	23.0	70.9%
DSCF Flats (Origin Flats)	20.8	26.2	79.4%
DDU Flats (Origin Flats)	25.3	30.1	84.1%
DNDC Parcels (Origin Parcels)	22.1	89.5	24.7%
DSCF Parcels (Origin Parcels)	48.0	115.5	41.6%
DDU Parcels (OriginParcels)	62.5	125.9	49.6%

Source: PRC–ACR2010–LR4

In FY 2010, revenues from the Standard Mail Carrier Route Product (which includes letters, flats, and parcels) exceeded the product's attributable costs with cost coverage of 143.0 percent. The Carrier Route product contributed $674 million toward the Postal Service's institutional costs. The nonprofit component of the Carrier Route product failed to cover its attributable costs, which resulted in a negative contribution of $4.1 million.

Worksharing

In FY 2010, the worksharing passthroughs for 16 Standard Mail discounts exceeded avoidable costs. In Order No. 536, the Commission determined it appropriate to de-link High Density and Saturation prices, removing the passthrough relationship between those products. The worksharing relationships calculated by the Postal Service and analyzed herein pertain to discounts for products as affirmed by Commission Order No. 536.

Table VII-20 shows the presort and dropship passthroughs by shape for Carrier Route, High Density, and Saturation categories.

One worksharing category is problematic; the passthrough for High Density Parcels is negative.

The negative avoided cost differential (-13¢) is the result of the Postal Service's estimated cost for a High Density parcel exceeding the estimated cost for a Carrier Route parcel. Logically, High Density Parcels should be less costly then Carrier Route Parcels. Thus the Postal Service concludes that the costs are anomalous. The Commission agrees. For this reason, the Commission cannot determine whether the discount is consistent with section 3622(e).

Since the 2007 ACD, the Commission has urged the Postal Service to identify the source of this costing anomaly. The Postal Service has not yet reported any progress towards identifying the source of or remedy for this costing anomaly. The Postal Service should work towards developing better cost data to permit the calculation of passthroughs as required by 39 U.S.C. 3622(e) and to gain a better understanding of the underlying costs associated with these products. Anomalous data of this nature are subject to review in the strategic rulemaking Docket No. RM 2011-3.

No dropship discounts exceed avoided costs for FY 2010. *See* Table VIII-20 and VIII-22

Table VII-21 shows the passthroughs for the remaining products Letters, Flats, and NFMs/Parcels. In its discussion of discounts that exceed avoidable costs, the Commission follows the order of Table VII-21 as closely as practicable. Accordingly, the Commission first discusses Letters, then Flats, and finally NFMs/Parcels.

Letters

Four discounts for Standard Mail Letters exceeded avoidable cost in FY 2010: non-automation AADC machinable letters, non-automation Mixed AADC machinable letter, non-automation 3-digit non-machinable letters, and non-automation 5-digit non-machinable letters

The Commission is unable to evaluate the presort discount for non-automation AADC machinable letters (*see* Table VII-21 note 1), and was unable to do so in the FY 2009 ACD. The avoidable cost could not be calculated because the Postal Service's letter mail processing cost model only estimates costs for the combined non-automation machinable AADC and mixed AADC categories. *The Postal Service should develop the necessary cost data to permit a meaningful analysis of this discount*. Due to the anomalous avoided cost estimate, the Commission cannot determine whether this discount is consistent with section 3622(e).

The avoided cost estimate between automation and non-automation Mixed AADC machinable letters (-0.5¢ – the discount provided for mailer-applied barcodes) was estimated to be negative. The Commission is currently reviewing the letter model included in Proposal Nine of Docket No. RM2011-5, filed December 20, 2010, which contains a positive estimate for this avoided cost. If the estimated avoided cost for this discount is accurate, the passthrough is under 100 percent. However, the avoided cost estimate in that model produced a passthrough of over 100 percent for Standard Mail Automation AADC Letters. The Postal Service realigned the Automation AADC Letter discount with the avoided cost estimated using the Proposal Nine methodology in Docket No. R2011-2. Due to the anomalous avoided cost estimate, the Commission cannot determine whether the discount is consistent with section 3622(e).

The presort discounts for non-automation 3-digit non-machinable letters (1.7¢), and non-automation 5-digit non-machinable letters (10.5¢) exceeded 100 percent of the estimated avoided cost. In Docket No. R2009-

Table VII–21—Standard Mail Letters, Flats, NFMS, and Parcels (Commercial and Nonprofit) Presorting/Pre-barcoding Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	Year–end Discount (cents)	Unit Cost Avoidance (cents)	Passthrough
Standard Mail Automation Letters			
Presorting (dollars/piece)			
Automation AADC Letters (Automation Mixed AADC Letters)	1.7	1.7	100.0%
Automation 3–digit Letters (Automation AADC Letters)	0.2	0.2	100.0%
Automation 5–digit Letters (Automation 3–digit Letters)	1.8	2.0	90.0%
Pre–barcoding (dollars/piece)			
Automation Mixed AADC Letters (Nonautomation Machinable Mixed ADC Letters)	0.3	(0.5)	–60.0%
Standard Mail Nonautomation Letters			
Presorting (dollars/piece)			
Nonautomation AADC Machinable Letters (Nonautomation Mixed AADC Machinable Letters)	1.7	0.0	See Note 1
Nonautomation ADC Nonmachinable Letters (Nonautomation Mixed ADC Nonmachinable Letters)	8.7	11.1	78.4%
Nonautomation 3–digit Nonmachinable Letters (Nonautomation ADC Nonmachinable Letters)	4.4	1.7	258.8%
Nonautomation 5–digit Nonmachinable Letters (Nonautomation 3–digit Nonmachinable Letters)	11.7	10.5	111.4%
Standard Mail Flats			
Standard Mail Automation Flats			
Presorting (dollars/piece)			
Automation ADC Flats (Automation Mixed ADC Flats)	1.0	(0.2)	–500.0%
Automation 3–digit Flats (Automation ADC Flats)	6.8	5.6	121.4%
Automation 5–digit Flats (Automation 3–digit Flats)	7.2	12.9	55.8%
Pre–barcoding (dollars/piece)			
Automation Mixed ADC Flats (Nonautomation Mixed ADC Flats)	6.2	2.5	248.0%
Standard Mail Flats—Nonautomation			
Presorting (dollars/piece)			
Nonautomation ADC Flats (Nonautomation Mixed ADC Flats)	4.9	5.5	89.1%
Nonautomation 3–digit Flats (Nonautomation ADC Flats)	4.5	6.1	73.8%
Nonautomation 5–digit Flats (Nonautomation 3–digit Flats)	9.7	8.2	118.3%

Table VII–21—Standard Mail Letters, Flats, NFMS, and Parcels (Commercial and Nonprofit) Presorting/Pre-barcoding Workshare Discounts and Benchmarks *(continued)*

Type of Worksharing (Benchmark)	Year–end Discount (cents)	Unit Cost Avoidance (cents)	Passthrough
Standard Mail Parcels			
Presorting (dollars/piece)			
NDC Machinable Parcels (Mixed NDC Machinable Parcels)	40.0	40.2	99.6%
5–digit Machinable Parcels (NDC Machinable Parcels)	43.9	69.8	62.9%
NDC Irregular Parcels (Mixed NDC Irregular Parcels)	47.5	14.4	330.9%
SCF Irregular Parcels (NDC Irregular Parcels)	40.0	34.5	115.8%
5–digit Irregular Parcels (SCF Irregular Parcels)	5.9	45.4	13.0%
Pre–barcoding (dollars/piece)[2]			
Mixed NDC Machinable Barcoded Parcels[3] (Mixed NDC Machinable Nonbarcoded Parcels)	7.0	3.8	184.2%
Mixed NDC Irregular Barcoded Parcels[3] (Mixed NDC Irregular Nonbarcoded Parcels)	7.0	3.8	184.2%
Standard Mail NFMs			
Presorting (dollars/piece)			
NDC NFMs (Irregular Parcels) (Mixed NDC NFMs (Irregular Parcels))	51.9	23.7	219.2%
SCF NFMs (Irregular Parcels) (NDC NFMs (Irregular Parcels))	35.4	27.7	127.7%
5–digit NFMs (Irregular Parcels) (SCF NFMs (Irregular Parcels))	3.3	45.5	7.2%
Pre–barcoding (dollars/piece)[2]			
Mixed NDC Barcoded NFMs[3] (Mixed NDC Nonbarcoded NFMs)	7.0	3.8	184.2%

Source: PRC–ACR2010–LR4

[1] The Postal Service letters mail processing cost model only estimates costs for the combined non–automation machinable AADC and Mixed AADC categories.
[2] The Postal Service charges a surcharge for nonbarcoded pieces.
[3] The Postal Service Standard Mail NFM/Parcel mail processing cost model does not estimate costs separately for pre–barcoded and non–barcoded pieces. The Postal Service uses a pre–barcoding avoidable cost for BPM as a proxy. *See* table VII–27, pre–barcoding workshare discounts.

Table VII–22—Standard Mail Carrier Route Letters, Flats and Parcels (Commercial and Nonprofit) Dropship Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	Year–end Discount (cents)	Unit Cost Avoidance (cents)	Passthrough
Dropship			
Standard Mail Letters			
Dropship (dollars/pound)			
DNDC Letters (Origin Letters)	16.3	25.6	63.7%
DSCF Letters (Origin Letters)	20.8	30.7	67.8%
Standard Mail Flats			
Dropship (dollars/pound)			
DNDC Flats (Origin Flats)	16.3	23.0	70.9%
DSCF Flats (Origin Flats)	20.8	26.2	79.4%
Standard Mail Machinable Parcels			
Dropship (dollars/pound)			
DNDC Machinable Parcels (Origin Machinable Parcels)	21.5	89.5	24.0%
DSCF Machinable Parcels (Origin Machinable Parcels)	42.4	115.5	36.7%
DDU Machinable Parcels (Origin Machinable Parcels)	62.0	125.9	49.2%
Standard Mail Irregular Parcels, NFMs			
Dropship (dollars/pound)			
DNDC Irregular Parcels, NFMs (Origin Irregular Parcels, NFMs)	21.5	89.5	24.0%
DSCF Irregular Parcels, NFMs (Origin Irregular Parcels, NFMs)	46.6	115.5	40.3%
DDU Irregular Parcels, NFMs (Origin Irregular Parcels, NFMs)	70.1	125.9	55.7%

Source: PRC–ACR 2010–LR4

2, each of these passthroughs equaled 100 percent. However, a decrease in avoided costs between FY 2008 and FY 2010 caused these passthroughs to exceed 100 percent. The Postal Service adjusted the discount for non-automation 5-digit non-machinable to reflect 100 percent of avoided cost in prices approved in Docket No. R2011-2. Due to the realignment of this discount with the avoided cost in Docket No. R2011-2, the Commission finds these discounts satisfy 39 U.S.C. 3622. The Postal Service reduced the passthrough of non-automation 3-digit non-machinable letters toward a 100 percent passthrough, justifying a passthrough over 100 percent by citing section 3622(e)(2)(b). *The Postal Service should align the discount for non-automation 3-digit non-machinable letters with the avoided cost in future market dominant price adjustments.*

Flats

Four discounts for Standard Mail Flats exceeded avoidable cost in FY 2010.The presort discounts for Automation Mixed ADC flats, automation ADC flats, automation 3-digit flats, and 5-digit non-automation flats exceeded avoided costs.

In Docket No. R2009-2, each of these passthroughs equaled 100 percent. However, a decrease in avoided costs between FY 2008 and FY 2010 caused these passthroughs to exceed 100 percent. Furthermore, the avoided cost estimate for Automation ADC flats in FY 2010 was negative 0.2 cents. The negative avoided cost differential (-0.2¢) is the result of the Postal Service's estimated cost for an Automation ADC Flat exceeding the estimated cost for an Automation Mixed ADC Flat. Logically, Automation ADC Flats should be less costly then Automation Mixed ADC Flats. Thus the Postal Service concludes that the costs are anomalous. The Commission agrees. For this reason, the Commission cannot determine whether the discount is consistent with section 3622(e). *The Postal Service should work towards developing better cost data to permit the analysis of passthroughs as required by 39 U.S.C. 3622(e).*

The prices proposed by the Postal Service and approved by the Commission in Docket No. R2011-2 adjusted the discounts for Automation 3-Digit flats (5.6¢) and Nonautomation 5-digit flats (8.2¢) to reflect 100 percent of avoided cost. The prices proposed by the Postal Service and approved by the Commission adjusted the discount for Automation Mixed ADC flats (2.5¢) (the pre-barcoding of flats) to reflect 228 percent of avoided cost, a reduction of 20 percent. The Postal Service justifies the over 100 percent passthrough for Automation Mixed ADC flats under section 3622(e)(2)(D). Postal Service ACR at 56. The Postal Service believes the excessive discount is necessary to encourage pre-barcoding of flats as a way to support the implementation of the Flats Sequencing System program. For these reasons, the Commission finds the discounts satisfy 39 U.S.C. 3622.

NFMs/Parcels

Seven worksharing discounts for Standard Mail NFMs/Parcels exceeded avoided cost in FY 2010. The presort discount for NDC Irregular Parcels (14.4¢), SCF Irregular Parcels (34.5¢), NDC NFMs (Irregular Parcels) (23.7¢), and SCF NFMs (Irregular Parcels) (27.7¢) exceeded avoided cost. The Postal Service did not specifically estimate the avoided costs of Mixed NDC Machinable Barcoded Parcels, Mixed NDC Irregular Barcoded Parcels, and Mixed NDC Barcoded NFMs.

The Postal Service proposed a new Standard Mail Parcel mail processing model in Docket No. RM2010-12. The Commission accepted this model, with

modification, in Order No. 658. The Commission has also recently conditionally granted the Postal Service's request to transfer certain commercial Standard Mail Parcels to the competitive product list.

Due to the multiple dockets in FY 2010 and FY 2011 concerning Standard Mail Parcels, PostCom submitted comments encouraging the Commission to defer action regarding passthroughs in excess of 100 percent. Postcom Initial Comments at 4.

The Postal Service justifies all seven discounts in excess of estimated avoided cost on the basis of efficient operations, citing section 3622(e)(2)(D). Several of the discounts with passthroughs exceeding 100 percent were increased in the recently approved Market Dominant Price Adjustment in Docket No. R2011-2. Given the ongoing transition to the NDC network, the Postal Service cites the need to encourage certain worksharing behaviors by offering discounts in excess of 100 percent, citing the flexibility provided by section 3622 (e)(2)(A)(ii).

The Commission encourages the Postal Service to continue to streamline its parcel operations and improve efficiency. Passthroughs that exceed 100 percent over a significant period of time without supporting cost data evidence may require additional justification. *The Postal Service should closely monitor the situation to ensure that its desired objectives are achieved by these discounts.*

The Postal Service applies a non-barcoded surcharge to all Standard Mail NFMs/Parcels that do not bear a correct routing barcode. The Postal Service Standard Mail NFMs/Parcel mail processing cost model does not estimate costs separately for pre-barcoded and non-barcoded pieces. As a result, no reliable "cost avoidance" is available for the calculation of the passthroughs associated with pre-barcoding Standard Mail NFMs/Parcels. Although the Postal Service provides an estimate of the passthrough based on the cost savings for Bound Printed Matter Parcels, better costing is necessary to facilitate meaningful analysis of these passthroughs. The Postal Service reduced the Standard Mail Parcel non-barcoded surcharge in Docket No R2011-2 from 7.0 cents to 6.4 cents. The Postal Service justified this discount in excess of estimated avoided cost on the basis of efficient operations, citing section 3622(e)(2)(d). The Postal Service should work towards reliable cost data for these categories. The Commission finds that for FY 2010, the discounts for Standard Mail Parcels satisfy 39 U.S.C. 3622.

Standard Nonprofit Mail

39 U.S.C. 3626(a)(6) requires nonprofit prices to be set in relation to their commercial counterparts regardless of nonprofits' independent costs. In Docket No. R2009-2, Nonprofit prices were set to yield per-piece average revenues that were 60 percent of commercial per-piece average revenues at the class level. The Commission calculates that in FY 2010, the actual per-piece revenue from Standard Mail Nonprofit pieces was 61.3 percent of Standard Mail commercial per-piece revenue. In response to CHIR No. 4, the Postal Service re-calculated the Nonprofit per-piece revenue incorporating a distribution of fee revenues. In future ACDs, the Postal Service should calculate this ratio using this method.

The prices approved in Docket No. R2011-2 are expected to produce average per-piece revenue for Nonprofit mail equal to 60 percent of the average per-piece revenue for Commercial mail. As such, the Commission does not need to take action in regard to Nonprofit prices.

Standard Mail Volume Incentive Pricing Program

The Postal Service's 2010 Standard Mail Volume Incentive Pricing Program (Incentive Program) was designed to increase incremental Standard Mail volume and revenue during a typically low volume period. As with the previous Incentive Program, the Commission and the mailing community have supported the Postal Service's use of its pricing flexibility. The Incentive Program offered a 30 percent discount on incremental volume above a threshold volume tailored to each mailer.

In Order No. 439, the Commission required the Postal service to report information necessary to evaluate the outcome of the Incentive Program. The Postal Service has provided initial data collection reports on the 2010 Standard Mail Volume Incentive Program on November 2, 2010 and December 29, 2010. These reports contain tentative threshold and rebate calculations for eligible Standard Mail users. To date, the Postal Service has not filed the data needed to evaluate fully the program results. Without finalized data as required in Order No. 439, the Commission cannot evaluate Docket No. R2011-3 for compliance with section 3622(c)(10).

Package Services

Introduction

Package Service mail consists of the following five products: Single-Piece Parcel Post, Bound Printed Matter (BPM) Flats, BPM Parcels, Media and Library Mail, and Inbound Surface Parcel Post (at UPU rates).[19] These products have common traits, such as: none is sealed against inspection; none receives preferential handling or transportation; and generally, each consists of parcels containing merchandise, although heavier catalogs and directories may also be mailed as Package Services mail. In FY 2010, 658 million pieces were mailed as Package Services mail. This accounts for less than one-half of one-percent of total domestic market dominant Mail volume.

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

The principal FY 2010 findings are:

- The attributable costs for Package Services, as a class, exceeded revenues by $182 million equating to an 89.3 percent cost coverage.
- Single-Piece Parcel Post revenues did not cover attributable costs by $134 million. The Postal Service has given Single-Piece Parcel Post above average price increases that attempt to address the problem.
- Media and Library Mail revenues did not cover attributable costs by $89 million. The Postal Service has given Media and Library Mail above average price increases that attempt to address the problem.
- Bound Printed Matter Parcels revenues did not cover attributable costs by $27 million. The Postal Service has given Bound Printed Matter Parcels above average price increases that attempt to address the problem.
- Worksharing discounts over 100 percent were either justified or aligned with avoided costs in Docket No. R2011-2.

Financial Analysis

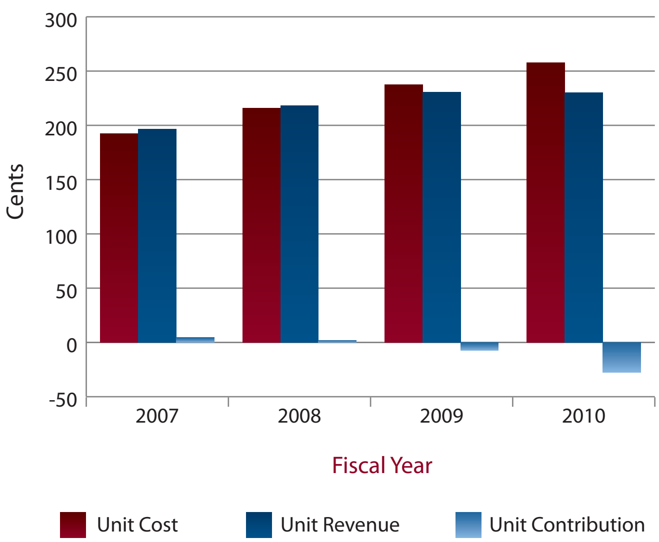
Table VII-23 shows that the Package Services class had a cost coverage of 89.3 percent. Figure VII-4 shows the continuation of unit contribution shifting from being slightly positive in FY 2007 and FY 2008, to slightly negative in FY 2009 and FY 2010.

Table VII–23
Fiscal Year 2010 Volume, Revenue, Cost and Cost Coverage
Package Services

	Volume (000)	Revenue ($000)	Attributable Cost ($000)	Contribution to Institutional Cost ($000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
Single–Piece Parcel Post	61,408.3	615,240.7	748,868.6	(133,627.9)	1,001.9	1,219.5	(217.6)	82.2%
Inbound Surface Parcel Post (at UPU Rates)	1,088.8	17,029.0	11,460.2	5,568.8	1,564.0	1,052.5	511.4	148.6%
Bound Printed Matter Flats	229,751.6	191,327.9	129,358.2	61,969.6	83.3	56.3	27.0	147.9%
Bound Printed Matter Parcels	244,735.5	322,544.2	349,249.1	(26,704.9)	131.8	142.7	(10.9)	92.4%
Media and Library Mail	122,322.1	369,361.4	458,551.4	(89,190.0)	302.0	374.9	(72.9)	80.5%
Inbound NSA Mail Intl	48.0	105.6	6.8	105.6				
Total Package Services	658,265.6	1,515,608.8	1,697,494.3	(181,885.5)	230.2	257.9	(27.6)	89.3%

Source: PRC–ACR 2010–LR1

Figure VII–4—Package Services



Inbound Surface Parcel Post (at UPU Rates)[20] and Bound Printed Matter Flats are the only products within the class to have revenues that exceed attributable cost in FY 2010. The losses from these three products amount to $250 million.

[20] *See* the International Section for a more detailed discussion of Inbound Surface Parcel Post (at UPU rates).

Single-Piece Parcel Post

The cost coverage for single-piece Parcel Post was 82.2 percent, a 9.7 percentage point decrease from FY 2009. The 82.2 percent cost coverage results in a $134 million loss for the product in FY 2010. This is the fourth consecutive year Single-Piece Parcel Post has failed to cover its attributable cost.

There was a 29 percent increase in unit attributable cost, and unit revenues increased 16 percent. In FY 2010, the average weight per piece of single-piece Parcel Post increased 20 percent, which partially explains the increased unit attributable costs and unit revenues.

Bound Printed Matter (BPM) Parcels

The FY 2010 cost coverage for BPM Parcels was 92.4 percent. In FY 2010, unit attributable costs increased by 4 percent, while unit revenues decreased by 2.0 percent. The loss was $27 million. This is the second consecutive year in which Bound Printed Matter Parcels attributable costs have exceeded revenues.

Bound Printed Matter (BPM) Flats

Bound Printed Matter Flats is the only domestic Package Services product that generated sufficient revenues to cover attributable costs in FY 2010. It contributed $62 million towards institutional cost. Unit attributable costs increased by 13 percent and unit revenues decreased by 4.2 percent, which led to a decrease in the contribution per piece of 10.2 cents from FY 2009 to FY 2010. Overall volume decreased by 3.8 percent from FY 2009 to FY 2010 despite a decrease in prices in Docket No. R2009-2, which were in effect all of FY 2010.

Media and Library Mail

Despite above-average rate increases in Docket Nos. R2008-1 and R2009-2, Media and Library Mail's attributable costs exceeded its revenue, producing a net loss of $89 million, and resulting in a cost coverage of 80.5 percent. This is the fourth consecutive ACD where Media and Library Mail's attributable costs exceeded revenues. Volumes decreased 12.7 percent in FY 2010. In addition, unit revenues increased by 6.2 percent in FY 2010, and unit attributable costs rose by 11.2 percent, which caused the cost coverage to fall 3.8 percentage points from FY 2009 to FY 2010.

Comments

No comments were received regarding Package Services.

Commission Analysis

Section 3622(c)(2) of the Act requires each class or type of mail service to cover its attributable costs and make a reasonable contribution to institutional costs.[21] *The Commission finds that the Package Services Class, as well as single-piece Parcel Post, Bound Printed Matter Parcels and Media and Library Mail, did not recover attributable costs or make a reasonable contribution to institutional costs.*

[21] The desirability of rates that recover attributable costs and make reasonable contributions to institutional costs is also supported by sections 101(d), 3622(b)(1), and 3622(b)(5).

Table VII–24
Docket No. R2011-2 Price Increases

Package Services Product	Rate Change (%)	FY 2010 Cost Coverage (%)
Single-Piece Parcel Post	1.807	82.2
BPM Flats	0.707	147.9
BPM Parcels	1.982	92.4
Media and Library Mail	1.964	80.5
Inbound Surface Parcal Post	1.531	148.6

In Docket No. R2011-2, the Postal Service gave each of the three Package Services products that did not cover costs an above average increase. *See* Table VII-24. While the resulting increases are not sufficient to bring revenues above attributable costs, the Postal Service is attempting to resolve the issue within the constraints of the annual price increase limitation.

In addition to giving below-cost products above-average price increases, the Postal Service believes that "[i]mproving operational efficiencies and general improvement in the economy are expected to aid the Postal Service in returning these products to full cost coverage." *Id.* at 13.

The Commission directs the Postal Service to continue to price Single-Piece Parcel Post, BPM Parcel, and Media and Library Mail in a way that moves these products to full cost coverage and to explore opportunities to achieve efficiencies in the handling of this mail.

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

Type of Worksharing (Benchmark)	FY 2010 Year–End Discount (Cents)	Unit Cost Avoidance (Cents)	Pass–through[1]
Media Mail			
Presorting (cents/piece)			
Basic (Single Piece)	39.0	43.0	90.7%
5–digit (Basic)	37.0	31.0	119.4%
Pre–barcoding (cents/piece)			
Single Piece Barcoded (Single Piece Non–barcoded)	3.0	4.0	75.0%
Library Mail			
Presorting (cents/piece)			
Basic (Single Piece)	37.0	43.0	86.0%
5–digit (Basic)	35.0	31.0	112.9%
Pre–barcoding (cents/piece)			
Single Piece Barcoded (Single Piece Non–barcoded)	3.0	4.0	75.0%

Source: PRC-ACR2010-LR6
[1] The calculated passthroughs are based on rounded unit avoidable costs.

Worksharing

There are worksharing discounts in the following products:

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

Tables VII-25, VII-26 and VII-27 present each Package Service worksharing discount, its associated cost avoidance, and the discount as a percentage of the avoided cost (passthrough).

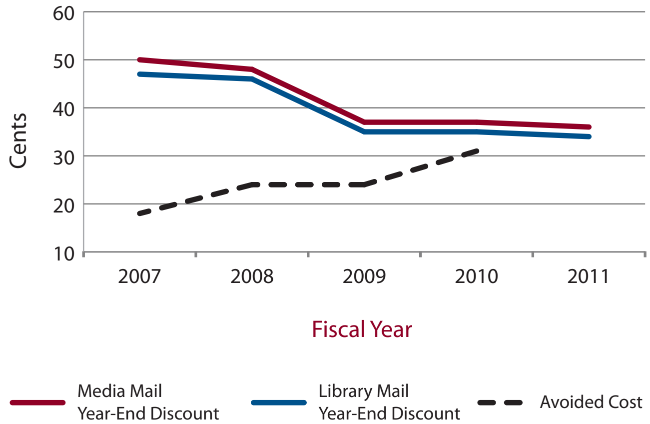
Media and Library Mail.

On December 20, 2010 the Postal Service filed Docket No. RM2011-5, which, in part, requested changes to the Media and Library mail processing avoided cost models.[22] The Postal Service included these proposed methodology changes in its ACR filing on December 29, 2010. In response to CHIR No. 1 question 12, the Postal Service updated mail processing avoided cost models using Commission approved methodologies.[23] The avoided cost figures in the tables below incorporate that response and use Commission approved methodologies at the time of the Postal Service's filing.

Table VII-25 shows the FY 2010 avoided costs, discounts, and passthroughs for Media and Library

[22] Docket No. RM2011-5, Proposal 12
[23] Response to CHIR No. 1, January 24, 2011, question 12.

Figure VII–5—Media and Library Mail 5-Digit Presort Avoided Cost and Discount



Mail. Five-digit presort discounts for Media Mail and Library Mail have exceeded 100 percent of avoided costs in FY 2010. However, as seen in Figure VII-5 the Postal Service has continuously reduced these passthroughs by decreasing discounts to align with avoided costs in Docket Nos. R2008-1, R2009-2, and R2011-2. The Postal Service justifies these passthroughs as mail that is educational, cultural, scientific or informational (ECSI) under § 3622(e)(2)(C) of title 39. The Commission accepts this justification for the excessive Media and Library Mail 5-digit presort discounts. The Commission encourages the Postal Service to continue aligning these discounts with their avoided costs.

Bound Printed Matter Flats and Parcels

Table VII-26 and Table VII-27 show FY 2010 year-end discounts, FY 2010 avoidable costs, and calculated passthroughs for Bound Printed Matter Flats and Bound Printed Matter Parcels, respectively. In Docket No. R2009-2 the Commission approved the Postal Service's alignment of DDU drop ship discounts for both BPM Flats and Parcels with avoided costs resulting in a 100 percent passthrough for DDU drop ship. Since then, unit avoided costs for DDU drop ship BPM Flats and Parcels have decreased resulting in the passthroughs increasing to 104.3 percent. Recently, in Docket No. R2011-2 the Postal Service again aligned these discounts with avoided costs. Therefore, no further action is necessary at this time.

The passthrough for DNDC Flats increased from 101.4 percent to 126.2 percent from FY 2009 to FY 2010, and the passthrough for DNDC Parcels increased from 100.5 percent to 125.1 percent. The change is due a decreases in the avoided costs for DNDC dropship Flats and Parcels. In Docket No. R2011-2, the Postal Service aligned these discounts with avoided costs; therefore, no additional action is necessary at this time.

The remaining BPM Flats and BPM Parcels workshare discounts were either at or below their respective avoided costs, and therefore satisfy section 3622(e)(2).

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

Type of Worksharing (Benchmark)	FY 2010 Year–End Discount (Cents)	FY 2010 Unit Cost Avoidance (Cents)	FY 2010 Passthrough[3]
BPM Flats			
Presorting (cents/piece)[1]			
Basic Flats (Single Piece Flats)	35.4	See Note [1]	
Carrier Route Flats (Basic Flats)	9.8	15.4	63.8%
Presorting (cents/pound)[1]			
Basic, Carrier Route Flats (Single Piece Flats)			
Zones 1&2	5.2	See Note [1]	
Zone 3	6.2	See Note [1]	
Zone 4	6.0	See Note [1]	
Zone 5	6.7	See Note [1]	
Zone 6	6.9	See Note [1]	
Zone 7	6.8	See Note [1]	
Zone 8	7.8	See Note [1]	
Pre–barcoding (cents/piece)[2]			
Single Piece Automatable Flats (Single Piece Nonautomatable Flats)	3.0	See Note [2]	
Basic Automatable Flats (Basic Nonautomatable Flats)	3.0	See Note [2]	
Carrier Route Automatable Flats (Carrier Route Nonautomatable Flats)	3.0	See Note [2]	
Drop Ship (cents/piece)			
Basic, Carrier Route DNDC Flats/IPPs (Basic Origin Flats)	22.0	17.4	126.2%
Basic, Carrier Route DSCF Flats (Basic Origin Flats)	61.6	63.6	96.8%
Basic, Carrier Route DDU Flats (Basic Origin Flats)	79.5	76.2	104.3%

Source: PRC–ACR 2010–LR6

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

[2] Separate estimates of pre–barcoding cost savings are not available for BPM flats. Based on the cost savings for BPM Parcels, the pre–barcoding discount for BPM flats implies a passthrough of 76.5%

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

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

Type of Worksharing (Benchmark)	FY 2010		
	Year–End Discount (Cents)	Unit Cost Avoidance (Cents)	Passthrough[2]
BPM Parcels/IPPs			
Presorting (cents/piece)[1]			
Basic Parcels/IPPs (Single Piece Parcels/IPPS)	55.8	See Note [1]	
Carrier Route Parcels/IPPs (Single Piece Parcels/IPPS)	9.8	15.4	65.3%
Presorting (cents/pound)[1]			
Basic, Carrier Route Parcels/IPPs (Single Piece Parcels/IPPs)			
Zones 1&2	4.6	See Note [1]	
Zone 3	4.5	See Note [1]	
Zone 4	4.5	See Note [1]	
Zone 5	3.9	See Note [1]	
Zone 6	3.8	See Note [1]	
Zone 7	3.0	See Note [1]	
Zone 8	1.4	See Note [1]	
Pre–barcoding (cents/piece)			
Single Piece Barcoded Parcels/IPPs (Single Piece Nonbarcoded Parcels/IPPs)	3.0	3.9	76.5%
Basic Barcoded Parcels/IPPs (Single Piece Nonbarcoded Parcels/IPPs)	3.0	3.9	76.5%
Carrier Route Barcoded Parcels/IPPs (Single Piece Nonbarcoded Parcels/IPPs)	3.0	3.9	76.5%
Drop Ship (cents/piece)			
Basic, Carrier Route DNDC Parcels/IPPs (Basic Origin Parcels/IPPs)	21.8	17.4	125.1%
Basic, Carrier Route DSCF Parcels/IPPs (Basic Origin Parcels/IPPs)	61.6	63.6	96.8%
Basic, Carrier Route DDU Parcels/IPPs (Basic Origin Parcels/IPPs)	79.5	76.2	104.3%

Source: PRC–ACR 2010–LR6

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

[2] The calculated passthroughs are based on rounded unit avoidable costs.

SPECIAL SERVICES

Introduction

The Special Services class consists of twelve products that can be categorized as Ancillary Services, "stand-alone" Special Services, and International Special Services. Ancillary Services is classified as one product; stand-alone Special Services consists of eight products; and International Special Services consists of three products.

The principal FY 2010 findings are:

- Special Services contributed more than $737.4 million towards institutional costs, which is the third highest contribution among all market dominant mail classes; and
- The attributable costs for Address Management Services, Stamp Fulfillment Services, and Collect-on-Delivery exceed revenue.

Financial Analysis

In FY 2010, the Special Service class, including international mail services, earned $2.9 billion in revenue and incurred $2.2 billion in total attributable cost.[24] The Special Services class produced a cost coverage of 134.0 percent. Table VII-28 displays the financial information for the Special Services mail categories.

Ancillary Services

The Ancillary Services product consists of 22 services that may only be used in conjunction with other mail services.[25] The Ancillary Services product earned $1.8 billion in revenue and incurred $1.3 billion in attributable cost. The product contributed $471.7 million towards the institutional cost of the Postal Service and had a cost coverage of 136.8 percent. The Postal Service distributes the revenue for some Ancillary Services to their host mail class as fee revenue and thus, such revenue is not included in the calculation of the cost coverage for Ancillary Services.[26]

Although the Ancillary Services product satisfies the applicable provisions of title 39, the revenue for Collect-on-Delivery (COD) did not satisfy 39 U.S.C. 3622(c)(2), which requires each class of mail or mail type to cover its attributable cost and to provide a reasonable contribution to institutional costs. The cost coverage for COD is 79.1 percent.

In FY 2009, COD was profitable with a cost coverage of 114.7 percent. However, in FY 2010, COD total cost increased by 24 percent, from $6.6 million to $8.2 million. One explanation for the significant increase in attributable cost is IOCS sampling problems related to the declining volume of COD transactions. Response to CHIR No. 1, question 13. Over the past 10 fiscal years, the volume for COD has declined almost 70 percent, from 2.7 million in FY 2001 to 834,000 in FY 2010. Figure VII-6 shows the declining volume trend for COD and suggests that the volume will continue to decline in subsequent fiscal years.

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24 For a discussion of International Special Services, *see* Market Dominant International section.

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

26 These services are Address Correction Services, Applications and Mailing Permits, Business Reply Mail, Bulk Parcel Return Service, Certificate of Mailing, Merchandise Return Service, Parcel Airlift, Return Receipt for Merchandise, Shipper Paid Forwarding, and Special Handling.

Table VII–28—Market Dominant Special Services
Fiscal Year 2010 Volume, Cost, Revenue, and Cost Coverage by Product

Market Dominant Special Services	Units[1] (000)	Total Revenue ($000)	Attributable Cost ($000)	Contribution to Institutional Cost ($000)	Unit Revenue (Cents)	Unit Cost (Cents)	Contribution to Institutional Unit Cost (Cents)	Cost Coverage
Domestic Special Services								
Ancillary Services Product								
Certified Mail	268,724.724	752,429.224	634,691.242	117,737.982	280.000	236.186	43.814	118.55%
COD	834.483	6,522.005	8,245.738	–1,723.733	781.562	988.125	–206.563	79.10%
Insurance	39,146.196	125,567.053	98,623.510	26,943.543	320.764	251.936	68.828	127.32%
Registered Mail	2,966.550	47,805.705	42,566.649	5,239.056	1,611.492	1,434.887	176.604	112.31%
Stamped Cards	29,302.270	879.068	645.920	233.148	3.000	2.204	0.796	136.10%
Stamped Envelopes	N/A	14,028.517	3,717.386	10,311.131				377.38%
Other Ancillary Services[2]	1,605,496.227	807,075.588	494,109.194	312,966.394	50.270	30.776	19.493	163.34%
Total Ancillary Services	1,946,470.450	1,754,307.160	1,282,599.638	471,707.522	90.128	65.894	24.234	136.78%
Stand–Alone Products								
Address Management Services	423,251.296	18,129.422	21,628.504	–3,499.082	4.283	5.110	–0.827	83.82%
Caller Service	179.709	93,920.879	30,621.321	63,299.558	52,262.830	17,039.416	35,223.415	306.72%
Change of Address Credit Card Auth.	11,363.461	11,214.161	1,382.702	9,831.459	98.686	12.168	86.518	811.03%
Confirm Service	N/A	2,658.500	1,105.477	1,553.023				240.48%
Customized Postage	4.000	900.000	50.000	850.000	22,500.000	1,250.000	21,250.000	1800.00%
Money Orders	123,404.756	183,152.827	126,338.894	56,813.933	148.416	102.378	46.039	144.97%
Post Office Box Service	14,187.477	813,186.449	674,891.906	138,294.543	5,731.720	4,756.955	974.765	120.49%
Stamp Fulfillment Services[3]	3,099,425	3,069.349	5,778.908	–2,709.559	0.099	0.186	–0.087	53.11%
Total Stand–Alone Special Services	3,671,815.699	1,126,231.587	861,797.712	264,433.875	30.672	23.471	7.202	130.68%
Total Domestic Special Services	5,618,286.149	2,880,538.747	2,144,397.350	736,141.397	51.271	38.168	13.103	134.33%
International Special Services[4]	2,032.108	28,920.002	27,402.399	1,517.603	1,423.153	1,348.472	74.681	105.54%
Total Special Services	5,620,318.257	2,909,458.749	2,171,799.749	737,659.000	1,474.424	1,386.640	87.784	133.97%

Source: PRC–ACR2010–NP–LR1

[1] Units refer to the amount of transactions for each service except for Stamped Envelopes and PO Boxes which refers to the amount of box purchases and box rentals, respectively.
[2] The FY 2010 ACR did not isolate costs for Other Ancillary Services
[3] The Postal Service billing determinants and CRA estimates include the nonpostal Philatelic sales with Stamp Fulfillment Services
[4] International Special Services are found in the International Mail section

Figure VII–6—Collect-On-Delivery Volume and Trend FY 2001–FY 2010

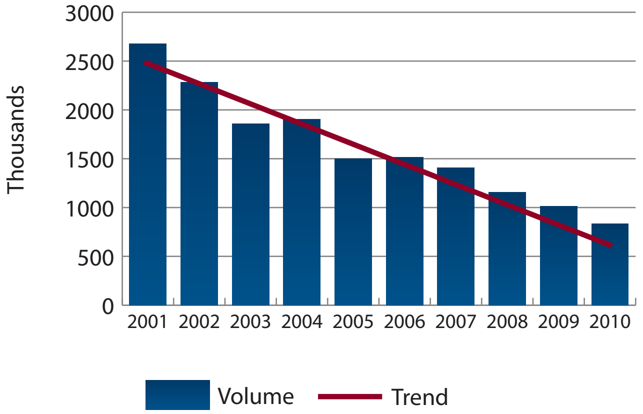
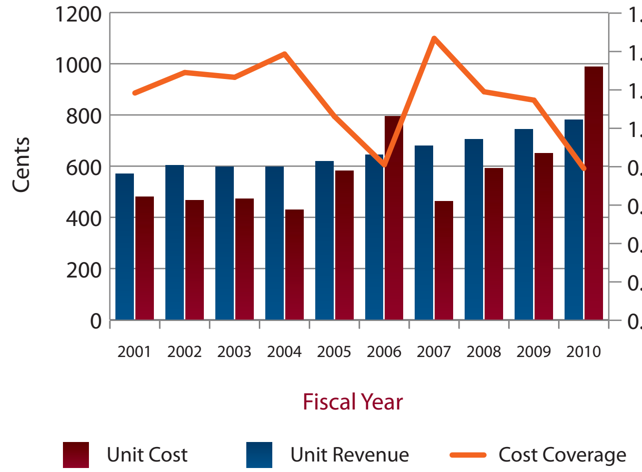


Figure VII–7—COD Unit Revenue, Unit Cost, and Cost Coverage FY 2001–FY 2010



The Postal Service explains that "most of the costs for COD total cost are determined from the In-Office Cost System (IOCS)." Response to CHIR No. 1, question 13. Further, the Postal Service states that because the volume of COD is extremely small, there are "relatively few [IOCS] tallies where employees are found handling COD in any given year." *Id.* In FY 2010, the Postal Service states that there were only 15 clerk and mailhandler tallies. *Id.* Consequently, cost estimates exhibit larger year-to-year variability.[27]

Figure VII-7 shows unit revenue, unit cost, and cost coverage from FY 2001 – FY 2010. Figure VII-7 clearly shows that COD's cost coverage is volatile. Further, Figure VII-7 shows that unit revenue per transaction increased by 212.0 cents or 37.2 percent between FY 2001 and FY 2010. Over the same time period, COD's unit cost was sporadic with high peaks in FY 2006 and FY 2010.

In Docket No. R2011-2, the Commission approved the Postal Service request to increase the prices for COD by an average of 4.2 percent. The Postal Service explains that this increase should help close the gap in the cost coverage. Response to CHIR No. 1, question 13. The Postal Service further notes that the sampling next year could result in COD having a cost coverage that exceeds 100 percent. *Id.*

The Commission finds that the appropriate action is for the Postal Service to consider using a moving average for calculating COD attributable cost. Alternatively, the Postal Service could investigate alternatives to sampling.

Stand-Alone Special Services

The eight stand-alone Special Services are Address Management Services, Caller Service and Reserve Number, Change-of-Address Credit

[27] The Coefficient of Variation (CV) measures the variability of a data set in relationship to the average value in the data set. A large CV (typically greater than 25 percent), indicates that there is a lot of dispersion in the data set. The Response to CHIR No. 1, question 13 indicates that for COD, the CVs are almost 40 percent for mailing processing (where most of the increases in costs occurred in FY 2010) and almost 50 percent for window service costs. This is one explanation for why the mail processing and window service costs for COD tend to vary from year to year.

Card Authentication, Confirm Service, Customized Postage, Money Orders, Post Office Boxes, and Stamp Fulfillment Services. As separate products, each of the eight stand-alone services must individually cover its attributable costs. Two products, Address Management Services and Stamp Fulfillment Services, did not generate enough revenue to cover their attributable cost. All other stand-alone special services satisfy the applicable provisions of Chapter 36 of title 39.

For FY 2010, the Postal Service's CRA report included revenue and attributable cost data for each stand-alone Special Service, including the three stand-alone products added to the market dominant product list in FY 2010.[28] The Commission requests that the Postal Service's CRA continue to identify cost data for each stand-alone Special Services product in subsequent ACR filings.

While the CRA isolated revenue and costs for each product within the Special Services class, the RPW report did not isolate revenues and transactions for six products: Address Management Services, Customized Postage, Caller Service, Confirm Service, Change-of-Address Credit Card Authentication, and Stamp Fulfillment Services. *To assist in the analysis for Special Services, the Postal Service is directed to identify revenues and volumes for each Special Services product in the RPW.*

Address Management Services. Address Management Services consists of 34 services that enable bulk business mailers to better manage the quality of their mailing lists. PRC Order No. 391 added Address Management Services to the Market dominant product list in FY 2010.[29] As a result, this is the first time the Postal Service has identified costs for the product.[30]

In FY 2010 Address Management Services generated $18.1 million in revenue and incurred $21.6 million in attributable cost. Accordingly, the product did not generate enough revenue to cover its attributable cost and had a negative contribution of $3.5 million. The FY 2010 cost coverage for Address Management Services is 83.8 percent.

In Docket No. R2010-4, the Postal Service stated that it plans to phase out services that are not covering their costs.[31] *Given that this is the first time the Postal Service has estimated costs for Address Management Services and the product received an average increase of 1.69 percent in Docket No. R2011-2,*[32] *the Commission finds that the appropriate action is for the Postal Service to raise the contribution for Address Management Service through cost reductions and future price adjustments. In its FY 2011 ACR, the Postal Service is directed to report on its effort to reduce costs for Address Management Services. The Postal Service should also focus on its cost methodology and refine it, if necessary.*

Additionally, Order No. 391 directed the Postal Service to file current fee and revenue information for eight address management services.[33] The ACR's Nonpostal Section discusses the current fee and revenue for the eight services. ACR at 72. *In*

[28] In FY 2010, Address Management Services, Customized Postage, and Stamp Fulfillment Services.

[29] Docket No. MC2009-19, Order Approving Addition of Postal Services to the Mail Classification Schedule Product Lists, January 13, 2010 (Order No. 391).

[30] See Library Reference USPS-FY2010-28, Excel file, AMS2010.xls.

[31] Docket No. R2010-4, Statement of James M. Kiefer on Behalf of United States Postal Service at 50 and 52 (July 6, 2010).

[32] Docket No. R2011-2, Order Reviewing Postal Service Market Dominant Price Adjustments, Table III-E-1, Special Services Price Adjustment, at 53, February 16, 2011 (Order No. 675).

[33] Docket No. MC2009-19, Order No. 391 at 11.

future ACR filings, the Postal Service is directed to file the fee and revenue data associated with the eight services in the Special Services section in its discussion of the Address Management Services product.

Caller Service. Caller Service is a premium service available to customers who require more than free carrier service or receive more mail than can be delivered to the largest installed post office box at a postal facility. Customers who use this service pick up their mail at the Post Office call window or loading dock.

In FY 2010, Caller Service earned $93.9 million in revenue and incurred $30.6 million in total attributable cost. The product contributed $63.3 million towards institutional costs and had a cost coverage of 306.7 percent. This was the second year the CRA separated costs for Caller Service from Post Office Boxes to permit analysis of Caller Service as a stand-alone product.

Change-of-Address Credit Card Authentication. The Change-of-Address Credit Card Authentication product allows customers to file change-of-address requests online and over the telephone. The Postal Service charges a $1 fee to verify the customer's identity and has a third party agreement with a credit card vendor to manage the Change-of-Address program. This was the second year the CRA isolated cost data for the Change-of-Address Credit Card Authentication product.

In FY 2010, the Postal Service processed 11.2 million internet and telephone change-of-address applications, collectively, which generated $11.2 million in revenue. The CRA indicates that the product incurred $1.4 million in attributable costs. However, a portion of the total revenue generated for the product is paid to the third party vendor. ACR at 47. As a result, the Postal Service indicates that the cost coverage for Change-of-Address Credit Card Authentication product does not equal the revenue divided by the attributable cost figure. The Postal Service supplemented its filing by providing a non-public library reference that shows the actual revenue earned by the product (once the portion of the revenue paid to the third party vendor is removed) and the expenses incurred in FY 2010.[34] Based on a review of the non-public library reference, the Commission finds that the revenues for Change-of-Address Credit Card Authentication covered its attributable cost in FY 2010.

Confirm. Confirm consists of four subscription tiers that allow business mailers to receive scan (tracking) data about mailpieces.[35]

In FY 2010, Confirm Service earned $2.7 million in revenue and incurred $1.1 million in total attributable cost. The product contributed $1.6 million towards institutional costs and had a cost coverage of 240.5 percent. Compared to FY 2009, Confirm's cost coverage improved by 158.9 percentage points.

Customized Postage. The Customized Postage product permits vendors to provide their customers with Postal Service authorized postage consisting of customer-selected images. PRC Order No. 391 added Customized Postage to the Market dominant product list in FY 2010.[36] Additionally, in FY 2010,

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34 *See* Library Reference USPS-FY09-NP26, Excel file, "COACreditCard2010.xls."

35 Mailers can subscribe to the Bronze, Gold, Silver, and Platinum tiers and may purchase Additional IDs which allow mailers to receive scan data for their clients.

36 Docket No. MC2009-19, Order Approving Addition of Postal Services to the Mail Classification Schedule Product Lists, January 13, 2010 (Order No. 391).

four vendors participated in the Customized Postage program and the Postal Service charged $300,000 per vendor.

The Commission identified a discrepancy between the revenue listed in the RPW and the CRA. The RPW reports revenue of $600,000 while the CRA reports revenue of $1.2 million. In response to CHIR No. 1, question 16, the Postal Service stated that the RPW "only found records of payment (of $600,000) for two of the four contracts. In actuality, three of the four contractors paid in FY 2010, for a total of $900,000, while payment from one of the contractors was not received until early FY 2011." *Id*. Further, the Postal Service states that one of the payments from three vendors who paid in FY 2010 was "not credited to the correct account," which is why the RPW only reported $600,000. The Postal Service suggests that the Commission should report $1.2 million as the revenue for FY 2010. *Id*.

The Commission recognizes that the Postal Service acquired additional revenue in FY 2011 for Customized Postage that should have been paid in FY 2010. However, for the FY 2010 compliance review, the Commission will only analyze the booked revenue at the end of FY 2010. Therefore, in FY 2010, Customized Postage earned $900,000 in revenue and incurred $50,000 in total attributable cost. The product contributed $850,000 towards institutional costs and had a cost coverage of 1,800.0 percent.

Thus the Postal Service must ensure that its reported RPW figures for all products are accurate, and that its financial reports (CRA, billing determinants, and RPW) are consistent with each other. RPW estimates are used in the annual report for the Postal Service, which is certified by an independent registered public accounting firm, and signed by the Postmaster General. While the discrepancy is relatively minor, it nonetheless underscores an important point.

Money Orders. Money Orders service provides the customer with an instrument for payment of a specified sum of money. The maximum value for which a domestic postal money order may be purchased is $1,000.

Money Orders earned $183.2 million in revenue and incurred $126.3 million in attributable cost. Money Orders contributed $56.8 million towards the institutional costs of the Postal Service and had a cost coverage of 145.0 percent. The unit attributable cost for the Money Orders decreased by 5.4 percent, which is why Money Orders cost coverage improved in FY 2010. The Commission finds that Money Orders complied with applicable provisions of title 39.

Post Office Boxes. The Post Office (PO) Boxes product consists of eight Fee Groups (1-7 and E) which are based on the market value of the postal facilities.[37] Fee Groups determine the rate a customer must pay to rent a PO Box. The most expensive postal locations are contained in Fee Group 1 and the least expensive are contained in Fee Group 7.

In FY 2010, PO Boxes generated $813.2 million in revenue and incurred $674.9 million in attributable cost. PO Boxes contributed $138.3 million towards the institutional costs of the Postal Service and had a cost coverage of 120.5 percent.

On June 17, 2010, the Commission approved the Postal Service's request to establish a competitive PO Boxes product, transferring 52 ZIP Code locations

37 Fee Group E is offered free-of-charge to customers where the Postal Service does not provide offer carrier delivery.

from the Special Services class in the market dominant product list to the competitive product list.[38] All of the PO Box locations were in Fee Group 1.[39]

Stamp Fulfillment Services. Stamp Fulfillment Services provide the fulfillment of stamp orders placed by mail, phone, fax, or online to the Stamp Fulfillment Services office in Kansas City, Missouri.[40] Stamp orders mailed to domestic destinations are charged a $1.00 handling fee, plus an additional $2.00 for customized orders. Orders mailed to non-domestic destinations will pay a $6.00 handling fee, plus $2.00 for customized orders.[41] PRC Order No. 487 added Stamp Fulfillment Services to the market dominant product list in FY 2010.[42]

The CRA reports that in FY 2010, Stamp Fulfillment Services generated $3.1 million in revenue and incurred $5.8 million in attributable cost. Stamp Fulfillment Services contributed a negative $2.7 million towards the institutional costs of the Postal Service and had a cost coverage of 53.1 percent. However, the Commission notes that the CRA included nonpostal philatelic sales revenue and cost with Stamp Fulfillment Services. Further, the Commission observes that in FY 2010, stamp orders were approximately 90 percent of the revenue for Stamp Fulfillment Services. Therefore, it is reasonable to conclude that Stamp Fulfillment Services did not cover its attributable cost in FY 2010 and is inconsistent with section 3622(c)(2).[43]

The Postal Service explains that it plans to evaluate costs and pricing strategies for Stamp Fulfillment Services in order to determine how best to cover costs. In addition, the Postal Service states that it will also consider the "balance between covering costs for Stamp Fulfillment Services and promoting stamp sales through cost effective channels." Response to CHIR No. 1, question 13.

Thus, the Commission finds that the appropriate action is for the Postal Service to develop a plan to improve the cost coverage for Stamp Fulfillment Services. The Postal Service is directed to report on its efforts to evaluate costs and pricing strategies for Stamp Fulfillment Services in its FY 2011 ACR.

MARKET DOMINANT INTERNATIONAL PRODUCTS

Introduction

Market dominant international mail consists of seven products: Outbound First-Class Single-Piece Mail International, Inbound First-Class Single-Piece Mail International (at UPU rates), Inbound First-Class Single-Piece Mail International (at non-UPU rates), Inbound Surface Parcel Post (at UPU rates), International Ancillary Services, International Reply Coupon Service,

38 Docket No. MC2010-20, Order Approving Request to Transfer Selected Post Office Box Service Locations to the Competitive Product List, July 17, 2010 (Order No. 473). For financial information on Competitive PO Boxes, see Library Reference PRC-ACR2010-NP-LR1.

39 The Postal Service's transfer request did not affect Group E boxes at the 52 ZIP Code locations.

40 The Stamp Fulfillment Services center handles orders for stamps and two nonpostal services: philatelic sales and Officially Licensed Retail Products.

41 These handling fees do not apply to certain combined orders of stamps and philatelic items, to certain stamps sent as part of a subscription, or to orders requested expedited shipping.

42 Docket MC2009-19, Order Accepting Product Descriptions and Approving Addition of Stamp Fulfillment Services to the Mail Classification Schedule Product Lists, July 13, 2010 (Order No. 487).

43 In response to CHIR No. 4, question 6, the Postal Service provides FY 2010 revenue and cost estimates for Stamp Fulfillment Service that exclude the nonpostal Philatelic Sales product. The Postal Service estimates that in FY 2010, Stamp Fulfillment Services earned $2.9 million in revenue and incurred $4.9 million in attributable costs, which corresponds to a cost coverage of 60.0 percent. The Commission views the Postal Service's response as a satisfactory proxy for the revenue and attributable cost for Stamp Fulfillment Services. However, the Commission expects the Postal Service's CRAs to report accurate revenue and attributable cost for Stamp Fulfillment Services. *See* Response of the United States Postal Service to Chairman's Information Request No. 4, questions 5-6, February 28, 2011.

and International Business Reply Mail Service.[44] In addition, for the first time, the Postal Service reports financial results for Global Direct Entry with Foreign Postal Administrations. It intends to formalize these NSAs, entered into prior to the PAEA, in FY 2011.

The Postal Service establishes rates and fees of general applicability for Outbound First-Class Single-Piece Mail International and outbound services within the International Ancillary Services product pursuant to the provisions of 39 U.S.C. 3622. For Inbound First-Class Single-Piece Mail International, Inbound Surface Parcel Post (at UPU rates), and inbound services within the International Ancillary Services product, rates are determined by international agreement through the Universal Postal Union (UPU)[45] or through bilateral agreement.

The principal FY 2010 findings are:

- Revenues exceeded attributable costs for market dominant international products as a whole by $281.7 million;
- Revenues exceeded attributable costs for the Outbound First-Class Single-Piece Mail International and Inbound Surface Parcel Post (at UPU rates) products by $327.4 million and $5.6 million, respectively;
- Revenues for Inbound First-Class Single-Piece Mail International, including revenues from Canada-origin inbound First-Class Mail International, did not cover attributable costs by $53.2 million;
- Revenues for International Ancillary Services exceeded attributable costs by $1.5 million, although the Inbound Registered Mail service failed to cover attributable costs by $6.2 million.

The section below presents a financial analysis of market dominant international mail products. In addition, the Quality of Service link to terminal dues system and market dominant international negotiated service agreements are discussed.[46]

Financial Analysis

During FY 2010, market dominant international mail products as a whole provided a net contribution to the institutional costs of the Postal Service of $281.7 million. This represents an improvement of 65.5 percent compared to FY 2009. Outbound First-Class Single-Piece Mail International, Inbound First-Class Single-Piece Mail, Inbound Surface Parcel Post (at UPU rates), and International Ancillary Services all showed an increase in contribution over FY 2009. Each of these products is discussed below. The financial results for Inbound First-Class Single-Piece Mail (at non-UPU rates) are non-public. For purposes of this analysis, therefore, the results for this product

44 For FY 2010, the Postal Service does not report any volumes, revenues or costs for the International Reply Coupon Service product. With respect to the International Business Reply Mail Service product, the Postal Service only reports volumes and revenues. Given the available data, the Commission is unable to determine at this time whether these products comply with the statute.

45 The Universal Postal Union is a United Nations technical agency through which international treaties governing the exchange of international mail, including the rates, are negotiated among its 191 members. The United States is a member of the UPU.

46 Unless stated otherwise, this section analyzes revenues and expenses for international mail products developed according to the "booked" accounting method. The use of booked revenues and expenses ensures that the Commission's financial analyses are consistent with the Postal Service's audited financial statements. The Postal Service uses "imputed" revenues reported in the FY 2010 ICRA, which differ from booked revenues reported in the RPW. Under the imputed method, inbound revenues for the current fiscal year are estimated using current-year volumes multiplied by the current-year "settlement" rates, i.e., terminal dues, inward land rates, etc., which are converted to U.S. dollars using the average Special Drawing Right (SDR) to U.S. dollar exchange rates in effect during the fiscal year. By contrast, under the booked method, inbound revenues for a fiscal year are estimated using volumes from the same period last year and current settlement rates, converted to U.S. dollars using a fixed SDR to U.S. dollar exchange. For FY 2010, the Postal Service implemented the Foreign Post Settlement (FPS) system, which will replace the imputed method. Under the FPS system, inbound revenue accruals provided to the ICRA and RPW will be based upon current-year volumes and the current settlement rates, with the resulting inbound revenues converted to U.S. dollars using current SDR to U.S. dollar exchange rates.

and Inbound First-Class Single-Piece Mail International (at UPU rates) are discussed in the aggregate under the heading Inbound First-Class Single-Piece Mail International.

Outbound First-Class Single-Piece Mail International

Outbound First-Class Single-Piece Mail International is the largest source of market dominant international mail contribution, amounting to $327.4 million during FY 2010. The cost coverage was 190.2 percent. Compared to FY 2009, the contribution for Outbound First-Class Single-Piece Mail International improved by 13.3 percent and the cost coverage increased 28.5 points.

Inbound Surface Parcel Post (at UPU Rates)

During FY 2010, revenues from Inbound Surface Parcel Post (at UPU rates) exceeded attributable costs by $5.6 million, resulting in a cost coverage of 148.6 percent. Both contribution and cost coverage for Inbound Surface Parcel Post (at UPU rates) improved compared to FY 2009, when revenues failed to cover attributable costs. In FY 2009, the contribution was a negative $2.4 million, and the cost coverage was 84.5 percent.

Inbound First-Class Single-Piece Mail International

The Postal Service provides financial results for two products under the heading Inbound First-Class Single-Piece Mail International: 1) Inbound First-Class Single-Piece Mail International (at UPU rates), which consists of inbound letter post subject to UPU terminal dues rates, and 2) Inbound First-Class Single-Piece Mail International (at non-UPU rates), which consists of inbound letter post from Canada subject to negotiated rates.[47] For FY 2010, attributable costs exceeded revenues for Inbound First-Class Single-Piece Mail International as a whole by $53.2 million. The resulting cost coverage was 79.4 percent. According to the Postal Service, Inbound First-Class Single-Piece Mail International from each country category of origin "showed improvement over Fiscal Year 2009." Response to CHIR No. 1, question 23(a). The Postal Service adds that "revenue increased, expenses decreased and contribution improved despite declining volumes." *Id.*

Inbound Letter Post (at UPU rates)

This product accounted for the bulk of the reported loss for Inbound First-Class Single-Piece Mail International. The Postal Service states that the "UPU per item and per kilogram terminal dues rates were . . . not based upon USPS costs" and, therefore, did not generate sufficient revenues to cover costs. FY 2010 ACR at 21. Moreover, terminal dues rates are set according to a formula that is renegotiated in the UPU only once every four years. Thus, the Postal Service maintains it "does not independently determine these prices for delivering foreign origin mail." *Id.* Although the Commission recognizes that the formula used to derive the terminal dues rates is determined within the context of a United Nations system of one country, one vote, the Postal Service does play an active role in the UPU working group that develops the terminal dues formula.

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[47] The term "letter post" is the name given to international mail that is not classified as Parcel Post or Express Mail (EMS). Also known as LC/AO mail (*i.e.*, letters and cards, and all other, including flats, small packets, bags, and containers), letter post consists of mail similar to domestic First-Class Mail, Periodicals, Standard Mail, Bound Printed Matter, and Media/Library Mail, weighing up to four pounds (1.8 kilograms). Inbound letter post from Canada enters the U.S. pursuant to the United States Postal Service to Add Canada Post United States Postal Service Contractual Bilateral Agreement for Inbound Market Dominant Services. *See* Request of the United States Postal Service to Add Canada Post United States Postal Service Contractual Bilateral Agreement for Inbound Market Dominant Services to the Market Dominant Product List, Notice of Type 2 Rate Adjustment, and Notice of Filing Agreement (Under Seal), Docket Nos. MC2010-12 and R2010-2, November 19, 2009.

Because the current UPU terminal dues rates will remain in effect through 2013, with modest annual increases, it is clear that the resulting non-compensatory terminal dues rates will continue to adversely affect the financial performance of Inbound First-Class Single-Piece Mail International. For FY 2010, therefore, the Commission concludes that Inbound First-Class Mail International did not satisfy the "requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service." *See* 39 U.S.C. 3622(c)(2). Under the circumstances, *the Commission recommends that the Postal Service continue efforts to negotiate more compensatory terminal dues rates in the UPU Terminal Dues Group and pursue adoption of the most compensatory rates possible at the 2012 UPU Congress.*

Pursuant to the UPU Convention, the Postal Service (or any postal administration) may negotiate bilateral (or multilateral) rate agreements with other postal administrations as an alternative to the UPU terminal dues rates for some or all of its inbound letter post. In this regard, during FY 2010, the Postal Service negotiated terminal dues rates applicable to inbound letter post in bilateral agreements concluded with TNT Post (Netherlands) and the China Post Group.[48] The Commission approved these agreements, which are effective in FY 2011.[49] The Postal Service states that it will continue "working to improve the inbound cost coverage via bilateral agreements . . . in the upcoming calendar year." FY 2010 ACR at 21.

The Commission commends the Postal Service for its successful negotiation of two bilateral agreements during FY 2010. The Commission recommends that the Postal Service pursue more aggressively the negotiation of additional compensatory bilateral (or multilateral) agreements in the upcoming fiscal year, notwithstanding the relative improvement in contribution and cost coverage during FY 2010.

Inbound Letter Post (at non-UPU rates)

Revenues from terminal dues rates negotiated through the bilateral agreement with Canada Post—the only bilateral agreement applicable to inbound letter post during FY 2010—did not cover attributable costs. However, when financial results are analyzed using the FY 2010 imputed method, results improve—although costs for inbound letter post from Canada still exceed revenues.[50]

The Postal Service defends its financial model used to justify the higher negotiated Canadian inbound letter post rates implemented in January 2010. That financial model, based upon the imputed method, estimated a positive contribution for inbound letter post from Canada during FY 2010. However, the Postal Service notes that most of the revenues estimated in the financial model will appear in calendar year 2011, and therefore cannot be compared to the revenues reported for FY 2010.[51] In addition, the Postal Service states that a lower exchange rate, and higher mail processing and domestic transportation costs than those estimated

48 *See* Request of United States Postal Service to Add Inbound Market-Dominant Multi-Service Agreements with Foreign Postal Operators to the Market Dominant Product List, Notice of Type 2 Rate Adjustments, and Notice of Filing Two Functionally Equivalent Agreements (Under Seal), Docket Nos. MC2010-35, R2010-5 and R 2010-6, August 13, 2010.

49 *See* PRC Order No. 549, Order Adding Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 to the Market Dominant Product List and Approving Included Agreements, Docket Nos. MC2010-35, R2010-5 and R2010-6, September 30, 2010.

50 *See* USPS-FY10-NP2, Excel File Reports.xls, worksheet tab A Pages (md).

51 Response to CHIR No. 2, question 6. The Postal Service reports financial results on a fiscal year basis while the bilateral agreement with Canada Post is implemented on a calendar year basis.

in the financial model, reduced the estimated contribution, which nevertheless remained positive. *Id.*

The Commission's analysis is consistent with the analysis of the Postal Service with respect to the improved financial results for inbound letter post during FY 2010. Nevertheless, the fact remains that for FY 2010 the negotiated bilateral terminal dues rates did not cover the attributable costs of inbound letter post from Canada, and exacerbated the negative contribution for inbound First-Class Single-Piece Mail International as a whole. Moreover, there is a discrepancy between the positive cost coverage estimated in the financial model, even after substituting known exchange rates and actual FY 2010 costs, and the reported cost coverage for FY 2010. The Postal Service's financial model underestimated the actual costs and therefore overestimated the expected contribution.

For FY 2010, the Commission concludes that the terminal dues rates for inbound letter post from Canada did not satisfy section 3622(c)(2). *The Commission therefore recommends that the Postal Service include in future financial models accompanying negotiated price changes for inbound letter post (at non-UPU rates) a higher cost contingency that is sufficient to account for the uncertainties inherent in estimating attributable costs.*

International Ancillary Services

For FY 2010, revenues from International Ancillary Services as a whole exceeded attributable costs by $1.5 million, resulting in a cost coverage of 105.5 percent.[52] Within the International Ancillary Services product, however, costs for Inbound Registered Mail service exceeded revenues by $6.2 million. This loss in contribution represents a significant improvement compared to the loss of $16.0 million for Inbound Registered Mail reported in FY 2009.

The Postal Service observes that Inbound Registered Mail "exhibited increased revenue, decreased costs and improved contribution between Fiscal Year 2009 and Fiscal Year 2010." Response to CHIR No. 1, question 23(b). Despite this improvement, revenues received by the Postal Service for handling Inbound Registered Mail are constrained by fixed rates of reimbursement established pursuant to the UPU Convention. *Id*. Moreover, rates for Inbound Registered Mail are renegotiated by UPU-member countries once every four years.

The Commission notes that the UPU is working to improve reimbursement rates for handling Inbound Registered Mail and that a minimal increase was implemented by the UPU in 2010. *The Commission therefore recommends that the Postal Service work within the UPU to ensure a more compensatory increase in supplementary rates for Inbound Registered Mail to be approved at the 2012 UPU Congress.*

Quality of Service Link to Terminal Dues

Terminal dues revenues are derived from payments for handling and delivering inbound letter post. Under the UPU's Quality Link Measurement System (QLMS), payments are adjusted for the quality of service provided in the country of destination for inbound letter post coming from other countries participating in the system.

As an incentive for participating in the system, the Postal Service receives an automatic 2.5 percent

[52] The International Ancillary Services product consists of the following special services: Certificate of Mailing, Registered Mail, Inbound Registered Mail, Return Receipt, Inbound Return Receipt, Restricted Delivery, Inbound Restricted Delivery, and Customs Clearance and Delivery Fee (Inbound).

increase in its terminal dues payments from other participating postal administrations. The Postal Service is also eligible for an additional 2.5 percent bonus payment if service performance achieves the UPU established annual performance target. For the Postal Service, the FY 2010 target was 88 percent of inbound letter post delivered within the domestic overnight, two-day, and three-day service standards for First-Class Mail.

As discussed above, terminal dues payments from UPU-member countries to the Postal Service for delivering inbound letter post did not cover attributable costs during FY 2010. Because the Postal Service did not meet the UPU quality of service target for calendar year 2009,[53] it received less than the maximum terminal dues payment for the first quarter (October-December 2009) of FY 2010, thereby denying the Postal Service a small amount of additional revenue. Preliminary service performance scores for January through November 2010 generally show improvement in the monthly on-time performance scores compared to the same monthly on-time performance scores reported in CY 2009. This improvement indicates that the Postal Service is likely to exceed the UPU quality of service target for calendar year 2010, as well as the calendar year 2009 actual on-time performance score. The Commission encourages the Postal Service to continue efforts to improve its on-time service performance.

Market Dominant International Negotiated Service Agreements

In addition to the Canada Post-United States Postal Service Contractual Bilateral Agreement for Inbound Market Dominant Services, which establishes terminal dues rates for inbound letter post from Canada, the Postal Service reports financial results for Global Direct Entry with Foreign Postal Administrations. Under this mail service, foreign postal operators can enter items bearing the indicia of the respective domestic mail classes directly with the Postal Service for delivery in the U.S. Such items are entered at negotiated rates. During FY 2010, inbound direct entry items were received from the postal operators of six countries.

The Postal Service reports Global Direct Entry Contracts with Foreign Postal Administrations as a market dominant product for the first time in the FY 2010 ICRA.[54] The Postal Service states that the "arrangements" governing inbound direct entry predate Commission regulation of market dominant products pursuant to the PAEA. Response to CHIR No. 5, question 7(a)-(b). The Postal Service adds that it "plans to update, and where necessary, formalize these arrangements in the coming fiscal year and to file a request to add the resulting bilateral agreements to the Mail Classification Schedule" as part of the market dominant product list. *Id.*

Based upon the financial results provided for the six foreign postal operators, revenues exceeded attributable costs for Global Direct Entry Contracts with Foreign Postal Administrations as a whole, resulting in a net contribution to the institutional costs of the Postal Service. *The Commission recommends that the Postal Service act promptly to add these bilateral agreements to the Mail Classification Schedule as part of the market dominant product list.*

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[53] Response to CHIR No. 1, question 19(a).

[54] *See* USPS-FY10-NP2, Excel File Reports (Booked).xls, worksheet tab A Pages (md), Table A-2, Note 6.

Negotiated Service Agreements

In FY 2010, the Postal Service had market dominant NSAs in effect with the Bradford Group (Docket No. MC2007-4) and Lifeline (Docket No. MC2007-5). These agreements offer specific mailers discounts (rebates) designed to encourage higher mail volumes.

The Postal Service provided the financial performance of NSAs using two methodologies: the Postal Service methodology and the Commission-accepted methodology. The Postal Service methodology compares actual volumes to before-rates volumes estimated when originally proposing the agreements. The Postal Service estimates that volumes sent above the before-rates volume is incentivized by the rebates. Bradford's actual volume of 197 million pieces fell short of the before-rates volume of 202 million pieces as estimated in 2007 by the Postal Service. Bradford sent over 63 million flat-shaped pieces, 9 million pieces above the before-rates volume estimated for that shape. The Postal Service estimates that the Flat volume above the before-rates estimated volume was volume incentivized by the rebates. The Postal Service estimates that the additional Flat volume mailed by Bradford increased contribution by $71,161.

Lifeline mailed over 90 Million pieces, 20 million less than the before-rates volume estimated by the Postal Service in 2007. However, Lifeline sent roughly 2.5 million pieces above the discount threshold. The Postal Service estimates that no volume was incentivized due to the $24,756 in rebates. As such, the Postal Service estimates a loss in contribution of $24,756 due to the rebates collected by Lifeline. The Postal Service estimates that the net effect of these two agreements was an increase in contribution of $46,405.

To assess performance under the agreements, the Commission uses the accepted methodology which incorporates contract year after-rates volume, the marginal discount earned, and the Standard Regular and ECR own-price elasticities.[55] In the second year of its three year agreement, the Bradford Group received $114,000 in rebates on over 9 million pieces. The Commission's analysis shows that roughly 2 million incremental pieces can be attributed to the rebates.[56] This implies rebates were paid on 7 million pieces that would have been sent without the incentive.

In contract year two, the rebated mail pieces sent by the Bradford Group were a mix of Standard Mail Flats and Carrier Route Flats. The Standard Mail Flats sent by Bradford had an average contribution of negative 10.0 cents per piece, while the Carrier Route Flats had an average contribution of 7.5 cents per piece. Due to the negative per piece contribution from Standard Mail Flats, the mail mix of incentivized pieces had an average contribution of 2 cents per piece before the discount. With the discount, average contribution was 0.7 cents per piece. Thus, the volume incentivized by the rebates yielded an additional total contribution of $16,167. However, the Postal Service paid $88,100 in rebates on pieces that would have been mailed without the rebate. Thus, the Postal Service lost nearly $72 thousand in contribution in the second year of the Bradford Group NSA.

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[55] The Postal Service's estimates reflect subclasses, rather than products, that were used prior to the PAEA. Standard Regular includes the following commercial Standard Mail products: Letters. Flats, and NFMs/Parcels. ECR refers to Enhanced Carrier Route. It includes the following commercial products: Carrier Route, High Density and Saturation Letters, and High Density and Saturation Flats and Parcels.

[56] The accepted methodology was developed in Docket No. MC2004-3. The 2010 Standard Mail Regular elasticity is -0.286 and the Carrier Route elasticity is -0.727, as provided in the attachment to the January 20, 2011 letter from Andrew German.

39 U.S.C. 3622(c)(10) requires that special classifications improve the net financial position of the Postal Service or improve operational performance, while not causing competitive harm. The Bradford Group NSA is estimated to have had a negative effect on the net financial position of the Postal Service in FY 2010. However, the first two years of the agreement combined have resulted in an increased contribution to the Postal Service. Further, the FY 2010 loss in contribution was relatively minor. Finally, if the Postal Service anticipates that the final year of the agreement will have a sizable negative financial impact, the Postal Service has the protection of a cancellation clause.

In the second full year of its three year agreement, Lifeline collected $24,756 in rebates on nearly 2.5 million pieces. Using the accepted methodology, the Commission estimates that over 1 million pieces were incentivized by the rebates, earning the Postal Service $115,651 in additional contribution. The

Table VII–29—FY 2010 Summary of Net Effect on Contribution ($ in Thousands)

	FY 2009	FY 2010	Total
Lifeline	25	104	129
Bradford	93	(72)	21
Total	118	32	150

remaining 1 million discounted pieces produced a lost contribution in the amount of $11,801. As a result of the Lifeline NSA, the Postal Service realized a net gain in contribution of $103,850.

Table VII-29 summarizes the financial effects of volume-incentive NSAs active in FY 2010 for the past two fiscal years.

For these reasons, the Commission finds the two market dominant NSAs in effect in FY 2010 consistent with title 39.

Chapter VIII

Competitive Products

Introduction

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

PRC Order No. 43 adopted regulations establishing standards for determining the lawfulness of competitive products' rates or prices. PRC Order No. 43, October 29, 2007. It first established which products would be considered to be competitive. This competitive product list has been subsequently amended pursuant to 39 U.S.C. 3642. The list of competitive products for Fiscal Year 2010 is shown in Table VIII–1.

Table VIII–2 contains the Postal Service's FY 2010 disaggregated revenue, cost, and volume for several groupings of competitive products. Table VIII–2 shows the Commission's audited FY 2010 figures.

FY 2010 competitive volumes, compared with FY 2009 increased 2.8 percent, unit revenues increased 3.8 percent, and unit attributable costs decreased 1.4 percent. See PRC-ACR2010-LR1. Unit contribution from the aggregate of all competitive products increased from $1.42 in FY 2009 to $1.70 in FY 2010. Specifically, unit contribution increased $0.76 for Express Mail and $0.17 for Priority Mail. The overall cost coverage for all competitive products increased from 131.8 percent in FY 2009 to 138.7 percent in FY 2010. Competitive products' total contribution to institutional costs increased from $1.96 billion to $2.42 billion.

In this chapter the Commission reviews competitive mail products, including competitive negotiated service agreements to determine whether any rates or fees in effect during FY 2010 were not in compliance with applicable provisions of chapter 36 of title 39. The Commission's review is guided by section 3633(a) of title

Table VIII–1
Competitive Domestic and International Products

DOMESTIC
Express Mail
Priority Mail
Parcel Select
Parcel Return Service
Premium Forwarding Service
Address Enhancement Service
Greeting Cards and Stationery
Shipping and Mailing Supplies
Post Office Box Service
Domestic Competitive NSA Products[1]
INTERNATIONAL
Outbound International Expedited Services
Outbound Priority Mail International
Inbound Air Parcel Post (at UPU rates)
International Priority Airlift (IPA)
International Surface Airlift (ISAL)
International Direct Sacks M-Bags
International Ancillary Services
International Money Transfer Service—Inbound
International Money Transfer Service—Outbound
International Competitive NSA Products[2]

[1]See the Domestic Competitive NSA section of this Chapter for a complete list of domestic competitive NSAs

[2]See the International section of this Chapter for a complete list of Competitive International NSAs.

39, which sets forth the legal standards applicable to rates for competitive products, directing the Commission to promulgate regulations to:

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

The Commission also includes an analysis of Competitive Market Tests and the Competitive Products Fund at the end of this Chapter.

The FY 2010, principal findings are:

- Revenues from the Postal Service's competitive products as a whole exceeded the sum of their attributable costs, plus group-specific costs. Thus, market dominant products did not subsidize competitive products during FY 2010 and the Postal Service met the requirement of section 3633(a)(1).
- Revenues for four products were less than the costs attributed to them and did not satisfy section 3633(a)(2). The remaining competitive products did satisfy section 3633(a)(2).
- The contribution from competitive products to the recovery of the Postal Service's institutional costs was 7.1 percent, which exceeds the 5.5 percent regulatory requirement. Consequently, the Postal Service met the requirement of section 3633(a)(3) during FY 2010.

Section 3633 (a)(1)

The incremental costs of competitive products are used to test whether revenues from market dominant products cross-subsidize competitive products. Order No. 399 approved the Postal Service's methodology to produce a hybrid incremental cost model using the available incremental costs for domestic competitive mail. PRC Order No. 399, January 27, 2010. Order No. 399 further established that in lieu of incremental costs, international competitive mail would use attributable costs because incremental costs are not available for international products. *Id.* Combining the incremental costs from domestic competitive mail, domestic group specific costs and the attributable cost for international competitive

Table VIII–2
Fiscal Year 2010 Volume, Revenue, Cost and Cost Coverage
Select Competitive Products and Competitive Product Groupings

COMPETITIVE MAIL	Volume (000)	Revenue ($000)	Attributable Cost ($000)	Contribution to Institutional Cost ($000)	Rev./Pc-. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
Express Mail	42,553	827,898	495,560	332,338	1,945.571	1,164.571	781.000	167.1%
Priority Mail	809,471	5,656,639	4,246,634	1,410,005	698.807	524.619	174.189	133.2%
Parcel Select and Parcel Return Service (PRS)	296,824	568,756	419,897	148,859	191.614	141.463	50.150	135.5%
Competitive International Mail	270,737	1,480,530	967,055	513,475	546.853	357.194	189.658	153.1%
Competitive Domestic Services	82,675	135,018	115,681	19,336	163.312	139.923	23.388	116.7%
Competitive International Services	1,261	8,267	12,056	(3,790)	655.757	956.366	(300.609)	68.6%
Total Competitive Mail and Services	1,419,584.173	8,677,107.978	6,256,884.340	2,420,223.638	611.243	440.755	170.488	138.7%

mail results in a total hybrid incremental cost for competitive products of $6.386 billion.[1]

The total revenues for competitive products in FY 2010 were $8.677 billion. *See* Table VIII–2.[2] Accordingly, revenues from competitive products exceeded the hybrid incremental costs in FY 2010. Consequently, *the Commission finds that revenues from market dominant products do not subsidize competitive products, satisfying section 3633(a)(1).*

Section 3633(a)(2)

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

In FY 2010, the Commission finds the following products' attributable costs exceed their respective revenues:

- Address Enhancement Service
- Inbound International Expedited Services 2 (EMS Cooperative)
- International Ancillary Services
- International Money Transfer Service (IMTS)[3]

The Commission finds that in FY 2010, Address Enhancement Service did not generate sufficient

1 International Money Transfer Service is counted as one product, but is a competitive product grouping that consists of Inbound International Money Transfer Service, and Outbound International Money Transfer Service. For a complete discussion of these products see the international section of this chapter.

2 Group specific costs includes costs from competitive market tests because these costs are specific to a competitive product and do not vary with volume. However, discontinuing the experiment will eliminate the cost.

3 This is a competitive product grouping that consists of Inbound International Money Transfer Service, and Outbound International Money Transfer Service. For a complete discussion of these products see the international section of this chapter.

revenues to cover attributable costs, which is inconsistent with section 3633(a)(2). This is the first ACD where the Postal Service has attempted to estimate the attributable costs associated with Address Enhancement Service. The Postal Service recently proposed, and the Commission approved, a 5.4 percent increase for this product that went into effect January 2, 2011.[4] In Response to CHIR No. 4, question 7, the Postal Service states that it, "plans to evaluate costs and pricing strategies in order to determine how best to cover costs." Therefore, *prior to the next ACR, or the next general competitive product price increase if it precedes the ACR, the Postal Service is directed to develop accurate costs for this product and provide a plan of what future pricing strategies are necessary to ensure that is product is in compliance with section 3633(a)(2).*

For FY 2010, the Commission finds that the Inbound EMS product consisting of countries in the EMS Cooperative did not satisfy section 3633(a)(2). *The Commission therefore recommends that in future financial models the Postal Service increase the cost contingency factor used for setting Inbound International Expedited Services rates through the EMS Cooperative.*

The Commission concludes that the International Ancillary Services product did not satisfy section 3633(a)(2). As a result, *the Commission recommends that the Postal Service ensure the proper recording and reporting of revenues for competitive international insurance.*

For FY 2010, the Commission finds that IMTS did not satisfy section 3633(a)(2) using the booked revenues reported by the Postal Service in its financial statements. *The Commission recommends no additional action on the part of the Postal Service with respect to IMTS.*[5]

The Commission finds that all other competitive products produced sufficient revenues to recover attributable costs in FY 2010, satisfying the requirements of 3633(a)(2).

Section 3633(a)(3)

In implementing section 3633(a)(3), the Commission established that if the contribution to institutional costs earned by competitive products was equal to 5.5 percent or more of the institutional costs of the Postal Service, then competitive products would be making an appropriate contribution toward the recovery of its institutional costs. See 39 CFR 3015.7(c). Thus, the Postal Service's competitive products as a whole would meet the requirements of section 3633(a)(3) if the dollar value of the sum of their contributions was equal to or greater than 5.5 percent of the Postal Service's institutional costs.

In FY 2010, the Postal Service reported total institutional costs for all products to be $34 billion. This means competitive products must contribute at least $1.87 billion to institutional costs to adhere to section 3633(a)(3). The total contribution to institutional costs from competitive products in FY 2010 was $2.5 billion – 7.1 percent of total institutional costs. In absolute terms, competitive products' contribution to institutional costs has increased $0.5 billion from FY 2009. *The Commission finds that competitive products contributed an appropriate amount of institutional costs in FY 2010, in satisfaction of section 3633(a)(3).*

4 *See* Order Approving Changes In Rates Of General Applicability For Competitive Products (December 2, 2010).

5 *See* the international section of this chapter for a complete discussion of this product's compliance with section 3633(a)(2).

Domestic Competitive Negotiated Service Agreements

For FY 2010, the Postal Service provided total volume, revenue, and cost data on each domestic competitive NSA that was in effect during the fiscal year. Rule 3050.21(g)(2) requires that the Postal Service file data with the Commission that are sufficient to evaluate each agreement for compliance with section 3633. For certain agreements, specific billing determinants by weight, zone, and cube were not provided because, according to the Postal Service, the information was not available.[6]

Pursuant to section 3633(a)(2), each NSA product must cover its attributable costs. There were 39 domestic competitive NSA products in effect and active in FY 2010. The Postal Service provided actual revenue, volume, and estimated costs for 28 agreements.[7] Each of these agreements appears to comply with the statutory requirements of section 3633(a)(2). For the remaining 11 agreements[8] the Postal Service did not file complete volume data;[9] therefore, the Commission has insufficient evidence that demonstrates that these agreements comply with section 3633(a)(2). *For the FY 2011 ACR, the Postal Service must collect and provide data for each NSA in effect during FY 2011 to enable the Commission to make a determination of compliance with regard to section 3633(a)(2).*

The Commission notes that the following changes were made to the supporting worksheets for domestic NSAs:

- the addition of cost avoidance for Priority mailpieces;
- inclusion of D-Report adjustments;
- incorporation of the CRA adjustment for Alaska Air Priority transportation; and
- changes in distribution of other costs for Parcel Select and Parcel Return Service.

In response to CHIR No. 5, question 3, the Postal Service appears to make an argument that these changes could be considered changes to quantification techniques. It also states that such changes may be considered changes to analytical principles, which must be accepted by the Commission before being used in the context of an ACR. The Commission preliminarily views these changes as changes to analytical principles which require prior Commission approval before being used in an ACR. Accordingly, the Commission uses the workpapers filed in response to CHIR No. 5, question 3, which remove these four changes to evaluate compliance with 3633(a)(2). Using these revised workpapers does not change the Commission's findings regarding domestic NSAs' compliance with section 3633(a)(2). If the Postal Service seeks to use these techniques in future proceedings, it should file for approval prior to incorporating such changes. Once the Postal Service files for approval of these changes, the Commission will be able to fully

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6 *See* LR-FY10-NP27, file "NSACostRevenue SummaryFY10.xlsx", column L.

7 *See* Docket Nos. CP2009-13/MC2009-11; CP2009-17/MC2009-13; CP2009-2/MC2009-1; CP2009-21/MC2009-15; CP2009-24/MC2009-17; CP2009-25/MC2009-18; CP2009-3/MC2009-2; CP2009-30/MC2009-25; CP2009-31/MC2009-25; CP2009-37/MC2009-27; CP2009-39/MC2009-29; CP2009-4/MC2009-3; CP2009-42/MC2009-31; CP2009-43/MC2009-32; CP2009-44/MC2009-33; CP2009-45/MC2009-34; CP2009-55/MC2009-36; CP2009-56/MC2009-37; CP2009-61/MC2009-40; CP2009-63/MC2009-42; CP2010-15/MC2010-15; CP2010-16/MC2010-16; CP2010-2/MC2010-2; CP2010-4/MC2010-4; CP2010-5/MC2010-5; CP2010-6/MC2010-6; CP2010-76/MC2010-31; CP2010-9/MC2010-9; MC2008-5.

8 *See* Docket Nos. CP2008-26/MC2008-8; CP2009-14/MC2009-12; CP2009-24/MC2009-17; CP2009-33/MC2009-25; CP2009-38/MC2009-28; CP2009-40/MC2009-30; CP2009-54/MC2009-35; CP2009-6/MC2009-5; CP2010-1/MC2010-1; CP2010-3/MC2010-3; CP2010-77/MC2010-32.

9 *See* Response to CHIR No. 1, question 18 (under seal).

evaluate the proposals. The Postal Service notes that the NSA "analysis methods have begun to stabilize and we [the Postal Service] can anticipate there will be fewer corrections and changes in the future." This should minimize the need for rulemakings to make analytical principle changes for NSAs.

COMPETITIVE INTERNATIONAL PRODUCTS

Competitive international mail consists of nine products featuring rates and fees of general applicability.[10] Those products are: Outbound International Expedited Services, Outbound Priority Mail International, Inbound Air Parcel Post (at UPU rates), International Priority Airmail (IPA), International Surface Airlift (ISAL), International Direct Sacks-M-Bags, International Money Transfer Service—Outbound, International Money Transfer Service—Inbound, and International Ancillary Services.

In addition to the nine products listed above, competitive international mail also consists of a number of products whose rates and fees are established pursuant to one or more Negotiated Service Agreements—negotiated contracts between the Postal Service and a qualifying mailer or foreign postal administration that govern outbound or inbound international mail. Below, the Commission discusses separately the financial performance of competitive international mail products and competitive international Negotiated Service Agreements.

Financial Analysis of Competitive International Products with Rates of General Applicability

For FY 2010, revenues for competitive international mail products with rates of general applicability collectively covered their attributable costs and provided a net contribution to the institutional costs of the Postal Service.[11] Among competitive international mail products, the following provided a positive contribution to institutional costs: Outbound International Expedited Services, Outbound Priority Mail International, Inbound Air Parcel Post (at UPU rates), International Priority Airmail (IPA), International Surface Airlift (ISAL), and International Direct Sacks-M-Bags.

The Commission concludes that for FY 2010, each of the above-referenced competitive international mail products featuring rates of general applicability satisfy section 3633(a)(2). However, for the combined International Money Transfer Service—Outbound (IMTS-Outbound) and International Money Transfer Service—Inbound (IMTS-Inbound) product, and International Ancillary Services, revenues did not

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10 During FY 2010, rates and fees of general applicability for competitive international mail products were implemented by the Postal Service on May 11th, 2009 and January 4th, 2010. *See* Notice of the United States Postal Service of Changes in Rates of General Applicability for Competitive Products Established in Governors' Decision No. 09-01, February 10, 2009; *see also* Notice of the United States Postal Service of Changes in Rates of General Applicability for Competitive Products Established in Governors' Decision No. 08-19, November 13, 2009.

11 Unless stated otherwise, this section analyzes revenues and expenses for international mail products developed according to the "booked" accounting method. The use of booked revenues and expenses ensures that the Commission's financial analyses are consistent with the Postal Service's audited financial statements. The Postal Service uses "imputed" revenues reported in the FY 2010 ICRA, which differ from booked revenues reported in the RPW. Under the imputed method, inbound revenues for the current fiscal year are estimated using current-year volumes multiplied by the current-year "settlement" rates, *i.e.*, terminal dues, inward land rates, etc., which are converted to U.S. dollars using the average Special Drawing Right (SDR) to U.S. dollar exchange rates in effect during the fiscal year. By contrast, under the booked method, inbound revenues for a fiscal year are estimated using volumes from the same period last year and current settlement rates converted to U.S. dollars using a fixed SDR to U.S. dollar exchange. For FY 2010, the Postal Service implemented the Foreign Post Settlement (FPS) system, which will replace the imputed method. Under the FPS system, inbound revenue accruals provided to the ICRA and RPW will be based upon current-year volumes and the current settlement rates, with the resulting inbound revenues converted to U.S. dollars using current SDR to U.S. dollar exchange rates.

cover attributable costs, and therefore did not satisfy section 3633(a)(2).

International Money Transfer Service

In FY 2010, the Commission approved the Postal Service's request to classify IMTS-Outbound and IMTS-Inbound as separate products on the competitive product list.[12] More recently, the Postal Service petitioned the Commission to approve a methodological change by which the Postal Service could separate the financial results for the IMTS-Outbound and IMTS-Inbound products.[13] Because the petition is under review, the Postal Service, of necessity, must report the financial results of the outbound and inbound IMTS products together.[14]

Revenues did not cover the attributable costs of the combined IMTS product using the "booked" method reported in the RPW. Response to CHIR No. 4, question 11. Using the "imputed" method, however, the Postal Service reports that revenues for the combined IMTS product covered attributable costs. According to the Postal Service, these differing financial results reflect the reporting of revenue associated with "money order float" and "outstanding money orders taken into revenue" under the imputed method, and the exclusion of such revenues under the booked method. *Id*. In contrast to revenues, attributable costs are the same under both methods.[15]

The Commission concurs that revenues covered the attributable costs of the combined IMTS product using the imputed method and recognizes the Postal Service's successful efforts to reduce IMTS costs. For FY 2010, however, the Commission concludes that IMTS did not satisfy section 3633(a)(2) using the booked revenues reported by the Postal Service in its financial statements. Under the circumstances, *the Commission recommends no additional action on the part of the Postal Service with respect to IMTS.*

International Ancillary Services

The Postal Service reports revenues and costs separately for the following services that comprise the competitive International Ancillary Services product: Registered Mail, Return Receipt, Insurance, and Customs Clearance and Delivery Fee (Inbound).[16] With the exception of outbound Insurance, each of the above-referenced services provides a positive contribution to institutional costs. Nevertheless, attributable costs exceeded revenues for the International Ancillary Services product as a whole because of the financial performance of outbound Insurance, resulting in negative contribution.

The Postal Service observes that a cause of competitive insurance's poor financial performance is "the possible undercounting of insurance revenue."

[12] *See* PRC Order No. 391, Order Approving Addition of Postal Services to the Mail Classification Schedule Product Lists, Docket No. MC2009-19, January 13, 2010. The IMTS-Outbound product features prices of general applicability for postal money orders cashed (and electronic transfers accessed) in foreign countries. The IMTS-Inbound product consists of agreements with 10 foreign postal administrations that pre-date the PAEA and govern Postal Service payment of foreign money orders presented at post offices in the U.S. There is no charge to the recipient for receiving payment.

[13] *See* Petition of the United States Postal Service Requesting Initiation of a Proceeding to Proposed Changes in Analytic Principles, Docket No. RM2011-5, December 20, 2010.

[14] USPS-FY10-NP2 (non-public), Excel file Reports (Booked).xls, worksheet tab A Pages (c), at page A-2, Note 5.

[15] *Compare* USPS-FY10-NP2 (non-public), Excel file Reports (Booked).xls, worksheet tab A Pages (c), and Excel file Reports.xls, worksheet tab A Pages (c).

[16] The Postal Service does not report revenues and costs for three ancillary services—Certificate of Mailing, Inbound Return Receipt, and Inbound Insurance. For Outbound Restricted Delivery, the Postal Service reports transactions and revenues. However, costs for Outbound Restricted Delivery are not separately identified, and instead are reported with Outbound Return Receipt. USPS-FY10-NP2 (non-public), Excel file Reports (Booked).xls, worksheet tab A Pages (c), at page A-2, Note 6.

FY 2010 ACR at 67. The Postal Service states that it is "unable to offer a definitive explanation as to whether revenue for insurance is understated at this time," although it is studying this possibility. *Id.* In response to an information request, the Postal Service adds that it believes insurance revenue is understated "due to the exclusion of revenue for insurance arising from sales transactions made through the Click-N-Ship (CNS) channel" for Priority Mail International (PMI). Response to CHIR No. 1, question 24(c). Instead, insurance sales revenue was included with Priority Mail International revenue, rather than separately identified in the CNS transaction and recorded with insurance. *Id.* The Postal Service's response also provides the total amount of insurance sales revenue generated from CNS transactions during FY 2010.[17]

In addition, the Postal Service attributes the poor financial performance to a 42 percent increase in costs, caused largely by an increase in indemnities.[18]

The Postal Service maintains that it has "taken steps to improve the financial performance of the [International Ancillary Services] product by raising prices for international insurance effective January 1, 2011." Response to CHIR No. 1, question 24(b). Moreover, the Postal Service asserts that "[c]ontribution will likely improve once revenue from online channels is reported with other insurance revenue." *Id.*

The Commission agrees with the Postal Service's analysis that the contribution of the International Ancillary Services product will likely improve once revenue is properly recorded for insurance. However, the Commission finds that FY 2010 total insurance revenues, which includes insurance sales revenue generated from CNS transactions separately reported by the Postal Service, did not cover the attributable costs of the International Ancillary Services product.

Given these circumstances, the Commission concludes that the International Ancillary Services product did not satisfy section 3633(a)(2). As a result, *the Commission recommends that the Postal Service ensure the proper recording and reporting of revenues for competitive international insurance.*

Financial Analysis of Competitive International Negotiated Service Agreements

Each competitive international product that features rates not of general applicability has been established in an international Negotiated Service Agreement (NSA). Such contractual agreements often require a minimum volume and/or revenue commitment by mailers or foreign postal administrations in exchange for discounted rates from the Postal Service.

In general, each international NSA or contract is classified as a separate competitive product on the competitive product list.[19] Accordingly, the Commission must evaluate each international contract classified as a separate competitive product for its consistency with section 3633(a)(2), which requires that each product cover its attributable costs. International contracts that exhibit similar market or cost characteristics, however, are grouped together

17 Response (non-public) to CHIR No. 1, question 24(c).

18 Response to CHIR No. 1, question 24(b). The financial performance of insurance, as well as outbound Registered Mail and Return Receipt, also reflects the fact that these ancillary services are "relatively small" and therefore "may exhibit annual cost variations associated with small transactional volumes." Response of the United States Postal Service to CHIR No. 2, Question 19(b), Docket No. ACR2009. During the Commission's consideration of the Postal Service's FY 2009 Annual Compliance Reported, the Postal Service stated its intent to monitor the financial performance of the underlying ancillary services during FY 2010 "to determine whether [FY 2009] is an anomaly or indication of a trend." *Id.* For FY 2010, the Postal Service did not provide information from its monitoring plan.

19 PRC Order No. 43, Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products, Docket No. RM2007-1, October 29, 2007, sections 2177, 3001.

into a single product under one product heading. Such international contracts as a group are classified as the product and collectively evaluated for consistency with section 3633(a)(2).

For FY 2010, the Postal Service reports volume, revenue and cost data on each international NSA or contract. The Postal Service provides such data on 104 international NSAs, 91 of which relate to outbound mail and 13 of which relate to inbound mail. The financial results for outbound and inbound international contracts are separately discussed below.

Competitive Outbound International Negotiated Service Agreements

The Commission has established classifications for outbound competitive products featuring negotiated rates under the following product headings: Direct Entry Parcels Contracts, Global Direct Contracts, Global Expedited Package Services (GEPS) Contracts, Global Expedited Package Service Non-published Rates 2, and Global Plus Contracts.[20] For FY 2010, the Postal Service reports data for 91 outbound contracts for Global Direct Contracts, GEPS Contracts, and contracts for Global Plus 1 and Global Plus 2.

Based upon the data provided, the Commission finds that 90 of the 91 outbound international contracts generated sufficient revenues to cover their attributable costs.[21] However, most of these contracts are grouped under the above-referenced product headings and therefore should be collectively evaluated for consistency with section 3633(a)(2). *The Commission concludes that Global Direct Contracts, GEPS Contracts and Global Plus Contracts provided a net contribution to the institutional costs of the Postal Service.*

Competitive Inbound International Negotiated Service Agreements

Like outbound NSAs, the Commission establishes classifications for inbound competitive products featuring negotiated rates. The competitive product list identifies international contracts under the following product headings: Inbound International Expedited Services, Inbound International Expedited Services 3 (China Post), Inbound Air Parcel Post (at non-UPU rates), Inbound Surface Parcel Post (at non-UPU rates), Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1, Inbound Direct Entry with Foreign Postal Administrations, and International Business Reply Service Competitive Contract 1 and 2.

For FY 2010, the Postal Service reports data for 13 Inbound International NSAs: Inbound International Expedited Services, Inbound Air Parcel Post (at non-UPU rates), Inbound Surface Parcel Post (at non-UPU rates), Inbound Direct Entry with Foreign Postal Administrations, and International Business Reply Service.

Inbound International Expedited Services. The Postal Service has bilateral agreements with more than180 foreign postal administrations under the auspices of the UPU Express Mail Service (EMS) Cooperative for the delivery of expedited inbound international mail referred to as Inbound EMS. In addition, the Postal Service has a separate bilateral agreement with the

[20] Under the Direct Entry Parcels Contracts product heading, Direct Entry Parcels 1 is listed as the product. With respect to the GEPS Contracts, the listed products are Global Expedited Package Services 1 and Global Expedited Package Services 2. The Global Plus Contracts product heading lists Global Plus 1, 1A, 2, and 2A as products.

[21] The contract in which attributable costs exceed revenues is one contract among many within the product and therefore not subject to section 3633. However, because market dominant products must not subsidize competitive products, and because the U.S. Government has granted the Postal Service a letter monopoly, the Postal Service should not allow any service to continue to generate negative contribution.

China Post Group.[22] Inbound EMS volumes enter the U.S. pursuant to these agreements. Rates for the delivery of most Inbound EMS are established by the Postal Service through the UPU's EMS Cooperative.

On the competitive product list, Inbound EMS rates established through the EMS Cooperative constitute a product. Rates applicable to EMS from China constitute a separate product on the competitive product list. In the ICRA, however, the Postal Service only reports the financial results for Inbound EMS from all countries, including China, under the heading Inbound International Expedited Services. Both products are discussed below.

For FY 2010, revenues for Inbound International Expedited Services as a whole did not cover attributable costs using the booked or imputed accounting methods. The Postal Service notes that based upon the imputed method, "the ICRA shows better financial performance for Inbound International Expedited Services." FY 2010 ACR at 67, fn 27. This stands in contrast to the financial results for FY 2009 in which revenues for Inbound International Expedited Services covered attributable costs based upon the imputed method, though not based upon the booked method.

The Postal Service states that using the booked method, "Revenues and contribution for Inbound EMS improved between Fiscal Year 2009 and Fiscal Year 2010, although expenses increased to offset these improvements." Response to CHIR No. 1, question 24(a). The Postal Service adds that most of the increased expenses occurred from "mail processing, and about 10 percent of the increase can be explained by the scan barcode edit." *Id.* Introduced in FY 2010, the scan barcode edit identifies inbound EMS pieces that "had originally been recorded incorrectly as inbound Parcel Post or Letter Post." Response to CHIR No. 5, question 5. The Postal Service also observes that the FY 2010 financial performance of Inbound EMS was adversely affected by price increases implemented in January 2010, which did not apply in the first quarter of FY 2010 (October to December 2009). FY 2010 ACR at 66.

The Postal Service asserts that it is addressing the financial performance of Inbound EMS by raising Inbound EMS prices again. These price increases became effective in January 2011. It also maintains that the estimates in its financial model upon which the January 2011 price increases were based showed that these prices would generate sufficient revenues to cover costs and thereby satisfy the statutory pricing criteria for competitive products. *Id.* at 66–67.

In response to an information request concerning the difference between the FY 2010 actual results and earlier financial models, which showed that its proposed rates that became effective in CY 2009 and CY 2010 would cover costs, the Postal Service explained that the models were "based upon 'imputed' revenues and expenses" and adds that the causes were "both revenue and cost related." Response to CHIR No. 2, question 8. With respect to revenue, the Postal Service states that the financial model estimated revenues using the higher CY 2010 prices. By contrast, the actual FY 2010, Quarter 1 rates were lower than the rates for Quarters 2–4, which reflect the Postal Service's CY 2010 prices. If the higher CY 2010 prices were used for the full

[22] *See* Request to Add Inbound Expedited Services 1 to the Competitive Product List, and Notice of United States Postal Service of Filing China Post Group—United States Postal Service Contractual Bilateral Agreement (Under Seal), Docket Nos. MC2010-13 and CP 2010-12, November 20, 2009.

fiscal year, Inbound EMS "would have reported a small positive contribution." *Id*. In addition, an unfavorable exchange rate compared to the one used in the financial model, which was accurate at the time, caused a reduction in actual revenues, thereby reducing contribution, although maintaining a small positive contribution. *Id*.

With respect to costs, the Postal Service reports that unit domestic mail processing, delivery and other costs were higher than the inflation-adjusted costs estimated in the financial models, while domestic transportation unit costs were slightly lower. The net effect of these cost changes would have reduced the estimated contribution, although the contribution would have remained positive. *Id*.

Finally, the Postal Service references the Commission's finding in the FY 2009 ACD that the differing financial results for Inbound EMS:

> are not a consequence of any postal management action. Rather, such results are a consequence of a Commission-mandated methodological change requiring the use of booked revenues and expenses for purposes of analyzing the financial performance of all products. FY 2009 ACD at 121.

As a result, the Commission recommended "no additional action" given the positive contribution of Inbound EMS using imputed revenues and expenses. *Id*.

The Postal Service misinterprets the Commission's recommendation, which reflected the negative contribution using the booked method, while recognizing that Inbound EMS covered its attributable costs based upon the imputed method. By contrast, for FY 2010, Inbound EMS under both the booked and imputed methods does not cover its attributable costs.

The Postal Service is responsible for setting inbound EMS rates annually, which are then implemented on a calendar year basis rather than on a fiscal year basis. The Postal Service therefore needs to ensure that such rates cover attributable costs for the entire fiscal year to comply with section 3633(a)(2). Moreover, exchange rate fluctuations and price changes that reduce revenues and otherwise adversely affect contribution must be adequately factored into the financial models used in setting the Inbound EMS rates.

For FY 2010, the Commission concludes that the Inbound EMS product consisting of countries in the EMS Cooperative did not satisfy section 3633(a)(2). *The Commission therefore recommends that in future financial models the Postal Service increase the cost contingency factor used for setting Inbound International Expedited Services rates through the EMS Cooperative.*

In the ICRA, as noted above, the Postal Service provided financial results for its bilateral agreement with China Post Group together with Inbound EMS from all other foreign postal operators in the EMS Cooperative. At the request of the Commission, the Postal Service provided separate financial results using the booked method for inbound EMS from the China Post Group. Using the booked methodology, revenues from Inbound EMS from the China Post Group did not cover attributable costs. Financial results using the imputed method for Inbound EMS from the China Post Group were not separately provided by the Postal Service. Based upon the Commission's analysis, however, it appears that the bilateral agreement with China Post Group covered its attributable costs using the imputed method.

Inbound Surface Parcel Post (at non-UPU rates). Inbound Surface Parcel Post (at non-UPU rates) is a product classification intended to house multiple contracts between the Postal Service and foreign postal administrations. During FY 2010, this product was comprised of only one contract between the Postal Service and Canada Post.[23]

For FY 2010, the Postal Service reports financial results for Inbound Surface Parcel Post (at non-UPU rates). The Postal Service also separately provides the financial results for Expedited Parcels and Xpresspost. Expedited Parcels enter the U.S. as inbound surface parcels. Xpresspost is a service similar to domestic Priority Mail for documents and merchandise and enters the U.S. Priority Mail network. Based upon the data provided, the Postal Service reports that Inbound Surface Parcel Post (at non-UPU rates), including Expedited Parcels and Xpresspost, generated sufficient revenues to cover attributable costs.

The Commission concludes that Inbound Surface Parcel Post (at non-UPU rates) entered pursuant to the Canada Post–United States Postal Service Contractual Bilateral Agreement for Competitive Inbound Services satisfies section 3633(a)(2).

Inbound Direct Entry Contracts with Foreign Postal Administrations. Inbound Direct Entry Contracts with Foreign Postal Administrations (IDE) is classified as one product on the competitive product list. Under the IDE product, the Postal Service provides foreign postal administrations with the ability to ship sacks of parcels that are pre-labeled for direct entry into the Postal Service's domestic network in exchange for applicable domestic postage plus a sack handling fee.

[23] *See* PRC Order No. 376, Order Concerning Bilateral Agreement with Canada Post for Inbound Competitive Services, Docket No. MC2010-14, December 30, 2010.

For FY 2010, the Postal Service reports financial results for three contracts which comprise the IDE product. Based upon the financial results provided, each of the contracts generated sufficient revenues to cover attributable costs, resulting in the product as a whole providing a net contribution to institutional costs. As a result, *for FY 2010, the Commission finds that the Inbound Direct Entry Contracts product with Foreign Postal Administrations satisfies section 3633(a)(2).*

Inbound Air Parcel Post (at non-UPU rates). Inbound Air Parcel Post (at non-UPU rates) consists of a contractual agreement with a group of postal administrations governing the receipt of inbound air parcels at inward land rates, *i.e.*, the rates postal administrations pay each other for the handling and delivery of such parcels. These agreements constitute a product on the competitive product list. There is also a separate agreement with Royal Mail of Great Britain, which is also listed as a separate product.

At the request of the Commission, the Postal Service provided separate financial results for both products. Based upon the results provided, *the Commission concludes that for FY 2010 each product generated sufficient revenues to cover attributable costs, resulting in both Inbound Air Parcel Post (at non-UPU rates) products making a net contribution to the institutional costs of the Postal Service.*

International Business Reply Services Competitive Contracts. On the competitive product list, International Business Reply Services Competitive Contracts 1 and International Business Reply Services Competitive Contracts 2 are identified as products. Under these products, an IBRS contract customer supplies prepaid IBRS packaging for use

by its customers in foreign countries to return used or defective merchandise weighing up to 4 pounds at no direct cost to the foreign customer. The IBRS contract customer compensates the Postal Service for this service, and the Postal Service remits to the relevant foreign postal administration the amount due for collection of such items in the foreign country and transportation to the U.S.

The Postal Service has entered into five IBRS contracts. Revenue and attributable cost data provided for each contract reveal that all five generated sufficient revenues to cover costs. Consequently, *the Commission finds that International Business Reply Services Competitive Contracts as a whole provided a net contribution to the institutional costs of the Postal Service.*

COMPETITIVE MARKET TESTS

Two competitive market tests were in effect during FY 2010: Collaborative Logistics and Samples Co-Op Box. Section 3641 authorizes the Postal Service to "conduct market tests of experimental products in accordance with this section." A product may not be tested, however, unless it satisfies each of the following conditions:

- The product is significantly different from all products offered by the Postal Service within the 2-year period preceding the start of the test (section 3641(b)(1));
- The product will not result in undue market disruption, especially for small business concerns (section 3641(b)(2)); and
- The product is correctly characterized as either market dominant or competitive (section 3641(b)(3)).

In addition, market tests of experimental products may not exceed 24 months (section 3641(d)), or annually exceed $10 million in revenue (section 3641(e)).

The Postal Service reports the total revenue for Collaborative Logistics in FY 2010 was $1,667,856, which exceeded total costs reported by the Postal Service. The Postal Service also provided a total cost figure under seal for Collaborative Logistics in USPS-FY10-NP27. In response to Chairman's Information Request No. 1 Question 25, the Postal Service filed a more detailed explanation of the actual costs it believes the Market Test incurred during FY 2010. USPS-FY10-NP30 Excel file: ChIR.1.Q.25.NONPUBLIC.Collab. Logistics.xls. The revenue figure presented by the Postal Service is greater than the cost figure presented under seal, demonstrating that Collaborative Logistics is providing a contribution to institutional costs.

The Sample Co-Op Box market test was authorized by the Commission in Order No. 452, Docket No. MT2010-1 (May 5, 2010). The Postal Service reports the cost of this market test was $250,000 and generated no revenue. The Postal Service stated,

> no noticeable impact on operational efficiency was observed. Market test results also confirmed that the design of the piece worked extremely well. Moreover, no results of the experiment indicated that offering this product created an inappropriate competitive advantage for the Postal Service or any mailer.

ACR at 70.

The costs associated with both of these market tests have been added to the group specific to ensure competitive products as a whole are in compliance with section 3633(a)(1).

Neither market test exceeded 24 months duration nor exceeded the $10 million revenue limit.

COMPETITIVE PRODUCTS FUND

The Competitive Products Fund was established by 39 U.S.C. 2011 to deposit receipts from competitive products revenues, returns on its investments and any amounts directly associated with the competitive products enterprise. It is a revolving fund and can be used for the withdrawals within mandated limits for the payment of costs attributable to competitive products. The Postal Service has filed all materials required under Commission Rules 3060.20 through 3060.30 relating the Competitive Products Fund as Library Reference USPS-FY10-39.

The fund balance in the Postal Service Competitive Products Fund Report at October 1 of each fiscal year is as follows.

Fiscal Year	Investment Income ($000)	Pre Tax Income ($000)	Income Tax ($000)	Balance in Competitive Products Fund ($000)
2008	0	14,386	4,935	9,451
2009	2	368,228	128,880	248,801[1]
2010	198	549,407	192,292	606,114

[1]The balance of the Competitive Products Fund held within the U.S. Treasury and listed in Table III-Detail of Treasury Securities Outstanding, September 30, 2010 of the Monthly Statement of Public Debt is $249 million.

The FY 2010 Postal Service Competitive Products Report indicates that the Competitive Products Fund generated pretax earnings of $550.8 million, producing a tax obligation of $192.8 million, which was transferred to the Postal Service Fund January 15, 2011.

Overall, FY 2010 Shipping Services revenue totaled $8.68 billion, up 6.7 percent from FY 2009, and volume totaled 1.7 billion pieces. The FY 2010 contribution for Shipping Services equaled 7.12 percent of the Postal Service's institutional costs.

The Statement of Allocated Assets and Liabilities for Competitive Products is filed for the first time pursuant to the PAEA requirement that any withdrawals from the Competitive Products Fund be satisfied from revenues generated from competitive products.[24] There has been no borrowing from the Fund since inception.

[24] 39 U.S.C. 2011(e)(1)(B)(i).

Chapter IX

Nonpostal Services

Introduction

The PAEA required the Commission to review nonpostal services provided by the Postal Service to determine whether they may be authorized to continue as nonpostal services, or should be terminated. 39 U.S.C. 404(e). Those nonpostal services that were authorized to continue are to be regulated under title 39 as market dominant, competitive, or experimental products. 39 U.S.C. 404(e)(5).

In Docket No. MC2008-1, the Commission authorized 14 nonpostal services to continue. Of these nonpostal services authorized to continue,[1] two were designated as market dominant and 12 were designated as competitive. Table IX lists the 14 nonpostal services authorized to continue in Order No. 154.

FY 2010 Analysis

Pursuant to rule 3050.21(i), the Postal Service reported FY 2010 cost, revenue, and volume for nonpostal services. A review of the financial results for nonpostal services[2] reveals that they generated $430.6 million in revenue and incurred $256.1 million in expenses, which resulted in a net income of $174.5 million. Only the Migratory Bird service failed to cover its expenses with a minor loss of $238,000.[3]

In its review of the CRA and RPW, the Commission observed two instances where nonpostal services were included with the Special Services class. In the CRA, the revenue, volume, and cost associated with some

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1 Docket No. MC2008-1, Review of Nonpostal Services Under the Postal Accountability and Enhancement Act, December 19, 2008 (Order No. 154).

2 See ACR at 71 where the Postal Service presents a table that identifies the revenue, expense, and volume for the following: (1) Migratory Bird; (2) Passports; (3) Passport Photos; (4) Officially Licensed Retail Products; (5) FedEx Dropboxes; (6) Meter Manufacturers Program; (7) Electronic Postmark; (8) MoverSource; (9) Licensing Programs Other Than Officially licensed Retail Products; and (10) Hybrid Mail. Some items in the table were redacted. *See* Library Reference USPS-FY2010-NP27 for an unredacted table.

3 The Commission notes that two services listed in the table, Migratory Bird and Passports, are not nonpostal services subject to review under section 404(e) of title 39. Order No. 154 at 57-59.

philatelic sales purchases were included with the Stamp Fulfillment Services product. *See* Response to CHIR No. 4, question 6. Also, the non-public RPW and the competitive billing determinants identified Officially Licensed Retail Products as a Competitive special service. *Because the financial data for nonpostal services must be separated from postal services, the Commission directs the Postal Service to report nonpostal revenues with Miscellaneous Revenue/Other Income in the CRA and the RPW.*

Currently, in Docket No. MC2010-24, the Commission is reviewing proposed mail classification language for nonpostal services.[4] The Postal Service proposed to realign and combine the 14 nonpostal services into 12 nonpostal services. *In its subsequent ACR filings, the Postal Service is directed to report revenue, cost, and volume data for each nonpostal service approved in Docket No. MC2010-24.*

Table IX–1—Nonpostal Services as of Order No. 154

	Market Dominant
1	MoverSource
2	Philatelic Sales
	Competitive
1	Affiliates for Website
2	Affiliates—Other (Linking Only)
3	Electronic Postmark
4	FedEx Drop Boxes
5	Licensing Programs Other Than Officially Licensed Retail Products
6	Meter Manufacturers Marketing Program
7	Non-Sale Lease Agreements (Non-Government)
8	Officially Licensed Retail Products (OLRP)
9	Passport Photo Service
10	Photocopying Service
11	Training Facilities (In part)
12	Warranty Repair Program

[4] Docket No. MC2010-24, Notice and Order Concerning Mail Classification Schedule Language for Nonpostal Services, May 7, 2010 (Order No. 457).

Appendix A

Empirical Review of Price Cap Application

The Commission's rules for the pre-implementation review of proposed rate adjustments calculate the percentage change in rates for each class by using the most recent available historical billing determinants to weight the percentage change of each rate cell. The rules also instruct the Postal Service to make reasonable adjustments to the billing determinants to account for classification changes such as the addition, elimination, or redefinition of rate categories. *See* 39 C.F.R. § 3010.23. At the time the rules were proposed, several parties expressed concern that this approach might not accurately reflect the actual change in rates. The Commission took note of these concerns and stated its intent to monitor the effectiveness of the rules. *See* RM2007-1 Order No. 26, para 2069-2077 (August 15, 2007).

As part of the monitoring process, the Commission included in the 2009 ACD a review of the R2008-1 rate adjustment. The review consisted of a comparison of the percentage change in rates for each class calculated using two different sets of billing determinants as weights. The first of these was the historical billing determinants used in the Commission's pre-implementation review, and the second was the billing determinants from the first full year that the R2008-1 rates were in effect.[1]

This year, the Commission performs a similar post-implementation review of the R2009-2 rate adjustment. Unlike the R2008-1 adjustment, it is not possible to construct a full year of billing determinants that begins on the day of implementation.[2] Therefore, the four quarters following the implementation of R2009-2 rates (FY2009 Q4 through FY2010 Q3) are used instead. Table A–1 presents a comparison of the average rate

1 This is roughly the last 1 ½ quarters of FY 2008 plus the first 2 ½ quarters of FY 2009.

2 Billing determinants are broken out between before and after the implementation date of R2009-2 rates, but because of negative inflation that occurred in FY2010, there was no rate adjustment implemented one year later, as would normally be the case. Therefore, it is not possible to divide FY2010 Q3 billing determinants between the period less than a year and more than a year after the implementation of R2009-2 rates. A few minor issues with the First-Class Mail International billing determinants are dealt with as described in PRC-ACR2010-LR3.

Table A-1
Percentage Change in Rates

R2008-1	Pre-implementation Proxy Volumes	Volumes at R2008-1 Rates	Difference
First-Class	2.886	2.916	0.030
Periodicals	2.724	2.908	0.184
Standard	2.838	2.835	-0.003
Package Services	2.875	2.631	-0.244
Special Services	2.848	2.863	0.015
R2009-2	**Pre-implementation Proxy Volumes**	**Volumes at R2009-2 Rates**	**Difference**
First-Class	3.770	3.743	-0.027
Periodicals	3.967	4.340	0.373
Standard	3.781	3.574	-0.207
Package Services	3.800	3.660	-0.140
Special Services	3.715	3.615	-0.100
Cummulative	**Pre-implementation Proxy Volumes**	**Volumes at New Rates**	**Difference**
First-Class	6.765	6.768	0.003
Periodicals	6.799	7.374	0.575
Standard	6.726	6.510	-0.216
Package Services	6.784	6.387	-0.397
Special Services	6.669	6.581	-0.087

increase for each class from the pre-implementation review with those developed using actual volumes sent at the R2009-2 rates. It also shows the results of last year's review of R2008-1 rates and the cumulative effect of both rate adjustments.[3]

The table shows that, on a cumulative basis, the change in rates for Standard Mail, Package Services, and Special Services as measured using a post-implementation price index is less than the pre-implementation price index. For First-Class mail, the post-implementation price index modestly exceeds the pre-implementation price index (0.003 percent), while the post-implementation price index for Periodicals exceeds the pre-implementation price index by 0.575 percent

The R2009-2 rate adjustment included several classification changes, including the introduction of Full-Service IMb discounts. Despite a slow start, the percentage of First-Class letters using Full-Service IMb during the post-implementation period was close to the levels estimated by the Postal Service over the first year of implementation. The adoption rates for First-Class flats and Standard Mail were significantly less than forecast.[4] However, the volume of First-Class flats and the amount of the Full-Service IMb discount for Standard Mail are small enough that the effect of the low adoption rates on the average rate increases

[3] The cumulative changes are greater than the sum of the two adjustments due to compounding.

[4] The Postal Service did not report any volume of Full-Service IMb cards.

was relatively small. In contrast, classification changes in Standard Mail parcels appear to have had a significant effect on the measured change in rates. Changes in overall volume levels for parcels complicate the analysis, but it is clear that the pre-implementation assumptions about the redistribution of volumes from eliminated categories elevated the measured rate increase compared with actual post-implementation volumes.

Nevertheless, preliminary analysis suggests that the differences shown above primarily reflect continuing patterns of volume shifts within each class. For example, First-Class single-piece letter volume decreased by about 17 percent, while automation letter volume decreased by only about 9 percent. Therefore using the updated volume weights, the rate increase for automation letters (3.1 percent) accounts for a larger share of the class average increase than it did in the pre-implementation calculation. Similarly, the rate increase for single-piece letters (4.8 percent) accounts for a smaller share than it did in the original calculation. Because single-piece and automation letters combine to make up the majority of First-Class Mail volumes, these volume trends are the primary reason that the average increase is lower when the actual volumes at R2009-2 rates are used.

This effect is the result of a continuing trend in First-Class Mail where single-piece letter volume is declining faster than the rest of the class. In last year's review of the R2008-1 rate adjustment, this trend resulted in larger increases at post-implementation volumes because in that case single-piece letters received a smaller increase than automation letters. As the cumulative rate change figures in Table A-1 show, this year's reversal nearly offsets last year's result.

The Commission intends to continue monitoring the effectiveness of its rules through similar analysis in the future. However, as there was no general market dominant rate adjustment implemented in FY2010, next year's ACD will not include the type of analysis shown in Table A-1.


Disaster Relief

Appendix B

Financial Results Under Previous Classification And Comparison Of Original And Revised Revenue, Pieces, And Weight Figures

This appendix presents: (1) FY 2010 data using the mail classification system in place prior to passage of the PAEA, and (2) a comparison of original and revised Revenue, Pieces, and Weight (RPW) reported figures. The revised figures, however, are pro forma as they were based on a methodological change not applicable to the prior fiscal year.

Previous Mail Classification System

Prior to the PAEA, the classes of mail were subdivided into subclasses and the financial reports reflected that organization. The PAEA uses the term product, defined as "a postal service with a distinct cost or market characteristic for which a rate or rates are, or may reasonably be applied." 39 U.S.C. 102(6). Within classes, the Postal Service reports data by product, not by subclass. To facilitate historical comparisons, Table B–1 presents volumes, revenues, attributable costs, and contribution to institutional cost using the former classification scheme of subclasses.

Revised RPW Figures

The RPW report always contains data from the current year and the previous year. For example, the FY 2010 RPW contains both FY 2009 and FY 2010 data. From time to time, the Postal Service will revise RPW figures. Typically, revisions for a past year are reported in a current RPW. Under the PRA, such changes did not have a material impact on the Commission's rate and classification responsibilities, however, such changes may materially affect results of the prior year's ACD.

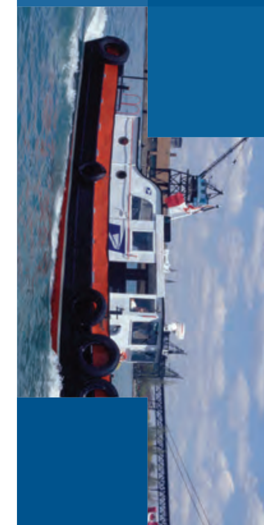
Table B-1
Fiscal Year 2010 Volume, Revenue, Cost and Cost Coverage by Class Previous Classification (Subclasses)

	Volume (000)	Revenue ($000)	Attributable Cost ($000)	Contribution to Institutional Cost ($000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
Competitive Mail								
Express Mail	42,553	827,898	495,560	332,338	1,945.571	1,164.571	781.000	167.1%
Priority Mail	809,471	5,656,639	4,246,634	1,410,005	698.807	524.619	174.189	133.2%
Parcel Select & Parcel Return Service (PRS)	296,824	568,756	419,897	148,859	191.614	141.463	50.150	135.5%
Competitive Int'l Mail	270,737	1,480,530	967,055	513,475	546.853	357.194	189.658	153.1%
Competitive Domestic Services	82,675	135,018	115,681	19,336	163.312	139.923	23.388	116.7%
Competitive Int'l Services	1,261	8,267	12,056	(3,790)	655.757	956.366	(300.609)	68.6%
Total Competitive Mail and Services	1,419,584	8,677,108	6,256,884	2,420,224	611.243	440.755	170.488	138.7%
Market Dominant Mail								
First-Class Mail								
Letters, Flats & Parcels	73,500,160	32,072,558	15,819,039	16,253,519	43.636	21.522	22.114	202.7%
Cards	4,368,559	1,058,001	635,621	422,379	24.219	14.550	9.669	166.5%
Standard Mail								
Regular	45,041,170	10,903,460	7,322,850	3,580,610	24.208	16.258	7.950	148.9%
Nonprofit	11,217,473	1,591,268	1,753,966	(162,698)	14.186	15.636	(1.450)	90.7%
Regular and Nonprofit	**56,258,643**	**12,494,728**	**9,076,816**	**3,417,912**	**22.209**	**16.134**	**6.075**	**137.7%**
Enhanced Carrier Route (ECR)	24,374,651	4,627,266	2,544,018	2,083,249	18.984	10.437	8.547	181.9%
Nonprofit ECR	1,890,453	208,415	197,529	10,886	11.025	10.449	0.576	105.5%
ECR and NECR	**26,265,104**	**4,835,681**	**2,741,547**	**2,094,134**	**18.411**	**10.438**	**7.973**	**176.4%**
Periodicals								
Within County	695,455	74,301	98,495	(24,194)	10.684	14.163	(3.479)	75.4%
Outside County	6,574,014	1,804,533	2,391,343	(586,810)	27.449	36.376	(8.926)	75.5%
Package Services								
Single-Piece Parcel Post	61,408	615,241	748,869	(133,628)	1,001.885	1,219.490	(217.605)	82.2%
Bound Printed Matter	474,487	513,872	478,607	35,265	108.301	100.868	7.432	107.4%
Media Mail	114,914	348,382			303.168			
Library Rate	7,408	20,980			283.189			

Table B-1
Fiscal Year 2010 Volume, Revenue, Cost and Cost Coverage by Class Previous Classification (Subclasses)—Continued

	Volume (000)	Revenue ($000)	Attributable Cost ($000)	Contribution to Institutional Cost ($000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
Media and Library Mail	122,322	369,361	458,551	(89,190)	301.958	374.872	(72.914)	80.5%
U.S. Postal Service Mail	431,206							
Free Mail	67,214		66,303	(66,303)		98.645		
Market Dominant Int'l Mail	335,547	912,571	632,371	280,200	271.965	188.460	83.505	144.3%
Total Market Dominant Mail	169,154,120	54,750,848	33,147,563	21,603,285	32.367	19.596	12.771	165.2%
Market Dominant Services								
Certified Mail	268,725	752,429	634,691	117,738	280.000	236.186	43.814	118.6%
COD	834	6,522	8,246	(1,724)	781.562	988.125	(206.563)	79.1%
Insurance	39,146	125,567	98,624	26,944	320.764	251.936	68.828	127.3%
Registered Mail	2,967	47,806	42,567	5,239	1,611.492	1,434.887	176.604	112.3%
Stamped Envelopes		14,029	3,717	10,311				377.4%
Stamped Cards		879	646	233				136.1%
Money Orders	123,405	183,153	126,339	56,814	148.416	102.378	46.039	145.0%
Post Office Box Service		813,186	674,892	138,295				120.5%
Caller Service		93,921	30,621	63,300				
Other Special Services		842,747	524,055	318,692				160.8%
International Services	2,032	28,920	27,402	1,518				105.5%
Other Income		625,262		625,262				
Total Mail and Services	170,573,704	66,962,376	41,576,247	25,386,129	39.257	24.374	14.883	161.1%
Institutional Costs			34,005,721					
Appropriations: Revenue Forgone		88,877						
Investment Income		25,326						
Total Revenues		67,076,580						
Total Costs			75,581,968					
Net Income (Loss)		(8,505,388)						

Source: Library Reference PRC-ACR2010-LR1



The RPW total revenue figure must equal the audited total revenue figure appearing in the Postal Service's Annual Report. The revisions are reported at the product (or service) level. Thus, only by comparing the FY 2009 data from the FY 2010 report with the FY 2009 data from the FY 2009 report is it possible to determine that figures have been revised. Ex post changes may be significant as any revised product revenues will have some impact on the net contribution of affected products.

During its review of the ACR and accompanying materials, the Commission discovered that FY 2009 revenue and volume figures had been revised in the year-to-date RPW report for FY 2010. For example, the FY 2009 volumes and revenues reported for Within County were revised downward by 16 percent and 16.9 percent, respectively. This is a substantial revision.

The FY 2009 numbers for virtually every postal product were revised in FY 2010. Most adjustments were relatively small and would have had no impact on the Commission's conclusions. However, based on the revisions, cost coverages reported in the FY 2009 ACD would change.

Apparently, the Postal Service employed a revised methodology, approved in Docket No. RM2010-10, for calculating FY 2009 and FY 2010 revenues in the RPW.[1] Evidently, this was done to facilitate comparative analyses of FY 2009 and FY 2010. However, the Postal Service gave no notice that it was revising FY 2009 RPW figures.

Unless specifically authorized otherwise, changes in methodology are to be applied prospectively. In Order No. 650, the Commission approved a methodological change beginning with FY 2010 reporting.

For reporting purposes, revisions based on methodological changes to a prior year's RPW figures made following the issuance of that year's ACD are inappropriate. If the Postal Service wishes to perform a comparative analysis using a revised methodology, it is free to do so, provided the results are clearly labeled pro forma.

The revisions to the FY 2009 data are based on a methodology not applicable to that year. The valid figures are those relied upon in the FY 2009 ACD. Thus, the Commission's findings in that ACD remain valid.

For informational purposes, Table B-2 shows the original and revised FY 2009 RPW figures.

[1] Docket No. RM2010-10, Order Concerning Analytical Principles for Periodic Reporting (Proposal Two), January 14, 2011 (Order No. 650).

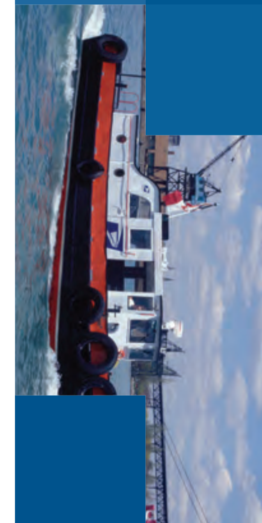


Table B–2—Revenue, Pieces, and Weight by Classes of Mail and Special Services for Fiscal Year 2009 The Original Filed in ACD 2009 (RPW 2009) Compared with the Revised Filed in ACD 2010 (RPW 2010) (Data in Thousands)

	Revenue ($)				Pieces				Weight (Pounds)			
	Revised FY 2009	Original FY 2009	Change		Revised FY 2009	Original FY 2009	Change		Revised FY 2009	Original FY 2009	Change	
Service Category			Amount	Percent			Amount	Percent			Amount	Percent
First-Class Mail:												
Single-Piece Letters	13,320,933	13,298,977	21,956	0.2	30,066,660	30,016,465	50,195	0.2	914,548	912,864	1,684	0.2
Single-Piece Cards	454,390	454,534	(143)	(0.0)	1,616,231	1,616,755	(524)	(0.0)	10,330	10,348	(18)	(0.2)
Total Single-Piece Letters and Cards	**13,775,324**	**13,753,511**	**21,813**	**0.2**	**31,682,890**	**31,633,220**	**49,671**	**0.2**	**924,878**	**923,212**	**1,666**	**0.2**
Presort Letters	15,656,797	15,616,345	40,453	0.3	44,943,532	44,807,701	135,831	0.3	1,881,815	1,874,581	7,234	0.4
Presort Cards	622,876	666,224	(43,348)	(6.5)	2,944,297	3,126,016	(181,718)	(5.8)	24,019	25,335	(1,316)	(5.2)
Total Presort Letters and Cards	**16,279,673**	**16,282,569**	**(2,895)**	**(0.0)**	**47,887,829**	**47,933,717**	**(45,888)**	**(0.1)**	**1,905,834**	**1,899,916**	**5,918**	**0.3**
Flats	3,528,090	3,539,892	(11,802)	(0.3)	2,854,785	2,864,496	(9,711)	(0.3)	594,433	597,233	(2,801)	(0.5)
Parcels	1,117,255	1,113,758	3,497	0.3	582,836	580,826	2,011	0.3	190,316	189,711	605	0.3
Domestic Negotiated Serv. Agreement Mail	98,554	98,554	0	0.0	301,476	301,476	0	0.0	12,337	12,337	0	0.0
Outbound First-Class Mail International	756,357	756,357	0	0.0	456,449	456,449	0	0.0	55,791	55,791	0	0.0
Inbound Intl. Letter-Post Single-Piece & NSA Mail	161,354	161,354	0	0.0	0	0	0		0	0	0	
Inbound Intl. Negotiated Serv. Agreement Mail	0	0	0		0	0	0		0	0	0	
First-Class Mail Fees	166,647	166,761	(115)	(0.1)	0	0	0		0	0	0	
First-Class Dom. NSA Mail Fees	0	0	0		0	0	0		0	0	0	
Total First-Class Mail	**35,883,254**	**35,872,756**	**10,498**	**0.0**	**83,766,266**	**83,770,183**	**(3,917)**	**(0.0)**	**3,683,590**	**3,678,201**	**5,389**	**0.1**
Standard Mail:												
High Density and Saturation Letters	672,691	681,946	(9,255)	(1.4)	4,995,529	5,085,391	(89,862)	(1.8)	227,198	228,548	(1,350)	(0.6)
High Density and Saturation Flats & Parcels	1,891,556	1,971,816	(80,260)	(4.1)	11,801,047	12,356,828	(555,781)	(4.5)	2,115,165	2,174,819	(59,653)	(2.7)
Carrier Route	2,293,684	2,271,929	21,754	1.0	9,953,347	9,856,763	96,584	1.0	2,012,078	1,993,435	18,643	0.9
Letters	8,813,844	8,773,592	40,253	0.5	46,800,733	46,559,408	241,324	0.5	2,597,519	2,585,932	11,587	0.4
Flats	2,868,410	2,865,807	2,603	0.1	7,837,100	7,793,175	43,925	0.6	1,981,328	1,963,766	17,562	0.9
Not Flat-Machinables and Parcels	637,808	631,898	5,910	0.9	684,919	679,041	5,878	0.9	308,688	305,920	2,769	0.9

Table B–2—Revenue, Pieces, and Weight by Classes of Mail and Special Services for Fiscal Year 2009 The Original Filed in ACD 2009 (RPW 2009) Compared with the Revised Filed in ACD 2010 (RPW 2010) (Data in Thousands)—Continued

Service Category	Revenue ($)				Pieces				Weight (Pounds)			
	Revised FY 2009	Original FY 2009	Change Amount	Change Percent	Revised FY 2009	Original FY 2009	Change Amount	Change Percent	Revised FY 2009	Original FY 2009	Change Amount	Change Percent
Domestic Negotiated Serv. Agreement Mail	78,319	78,319	0	0.0	374,955	374,955	0	0.0	37,023	37,023	0	0.0
Inbound Intl. Negotiated Serv. Agreement Mail	374	374	0	0.0	649	649	0	0.0	160	160	0	0.0
Standard Mail Fees	88,444	88,419	25	0.0	0	0			-	0		
Standard Mail Dom. NSA Mail Fees	0	0			0	0			-	0		
Total Standard Mail	**17,345,129**	**17,364,099**	**(18,970)**	**(0.1)**	**82,448,280**	**82,706,211**	**(257,931)**	**(0.3)**	**9,279,160**	**9,289,602**	**(10,443)**	**(0.1)**
Periodicals Mail:												
In-County	75,344	90,616	(15,271)	(16.9)	721,786	859,268	(137,482)	(16.0)	212,543	267,226	(54,683)	(20.5)
Outside County	1,947,356	1,932,085	15,271	0.8	7,179,114	7,094,447	84,668	1.2	2,805,003	2,765,136	39,867	1.4
Periodicals Mail Fees	15,446	15,443	3	0.0	0	0			0	0		
Total Periodicals Mail	**2,038,147**	**2,038,144**	**3**	**0.0**	**7,900,900**	**7,953,715**	**(52,815)**	**(0.7)**	**3,017,546**	**3,032,362**	**(14,816)**	**(0.5)**
Package Services Mail:												
Single-Piece Parcel Post	699,909	699,269	640	0.1	80,793	80,716	76	0.1	444,722	444,397	325	0.1
Inbound Intl. Surface Parcel Post (at UPU Rates)	12,880	12,880	0	0.0								
Inbound Intl. Negotiated Service Agreement Mail	74	74	0	0.0	32	32	0	0.0	92	92	0	0.0
Bound Printed Matter Flats	206,450	206,445	5	0.0	238,801	238,799	2	0.0	332,353	332,351	2	0.0
Bound Printed Matter Parcels	362,618	362,608	10	0.0	270,627	270,623	4	0.0	780,725	780,716	8	0.0
Media and Library Mail	397,790	397,398	392	0.1	140,273	140,139	134	0.1	314,834	314,553	280	0.1
Package Services Mail Fees	3,978	3,977	1	0.0								
Total Package Services Mail	**1,683,699**	**1,682,651**	**1,048**	**0.1**	**730,526**	**730,309**	**216**	**0.0**	**1,872,726**	**1,872,110**	**616**	**0.0**
U.S. Postal Service Mail	0	0	0		455,426	454,865	561	0.1	126,288	126,141	146	0.1
Free Mail	0	0	0		62,038	61,958	80	0.1	30,283	30,243	40	0.1
Total Mailing Services Mail	**56,950,229**	**56,957,650**	**(7,421)**	**(0.0)**	**175,363,436**	**175,677,241**	**(313,806)**	**(0.2)**	**18,009,593**	**18,028,660**	**(19,068)**	**(0.1)**
Ancillary Services:												
Certified Mail	730,780	729,813	967	0.1	266,841	266,491	350	0.1				
Collect on Delivery	7,559	7,564	(5)	(0.1)	1,015	1,015	(1)	(0.1)				

Table B-2—Revenue, Pieces, and Weight by Classes of Mail and Special Services for Fiscal Year 2009 The Original Filed in ACD 2009 (RPW 2009) Compared with the Revised Filed in ACD 2010 (RPW 2010) (Data in Thousands)—Continued

	Revenue ($)				Pieces				Weight (Pounds)			
	Revised	Original	Change		Revised	Original	Change		Revised	Original	Change	
Service Category	FY 2009	FY 2009	Amount	Percent	FY 2009	FY 2009	Amount	Percent	FY 2009	FY 2009	Amount	Percent
Delivery Confirmation	166,105	166,105	0	0.0	1,062,932	1,062,932	0	0.0				
Insurance	129,079	129,069	9	0.0	43,771	43,767	3	0.0				
Registered Mail	49,923	49,906	17	0.0	3,183	3,182	1	0.0				
Return Receipts	543,835	543,142	693	0.1	220,539	220,271	268	0.1				
Stamped Envelopes and Cards	17,222	17,222	0	0.0	0	0						
Other Domestic Ancillary Services	42,287	42,232	55	0.1	18,559	18,536	23	0.1				
Outbound International Ancillary Services	16,334	16,103	231	1.4	1,914	1,749	165	9.4				
Inbound International Ancillary Services	9,581	9,581	0	0.0	31	31	0	0.1				
Total Ancilliary Services	1,712,704	1,710,738	1,966	(0.1)	1,618,785	1,617,975	810	0.1				
Special Services:												
Money Orders	189,728	189,728	0	0.0	135,039	135,039	0	0.0				
Post Office Box Service	817,075	817,075	0	0.0	0	0	0					
Other Domestic Special Services	111,446	94,822	16,625	17.5	410,995	0	410,995					
Total Additional Special Services	1,118,250	1,101,625	16,625	0.0	546,035	135,039	410,995	304.4				
Total Mailing Services Services	2,830,954	2,812,363	18,591	0.7	2,164,819	1,753,014	411,805	23.5				
Total Mailing Services Mail and Services	59,781,183	59,770,014	11,169	0.0								
Other Mailing Services Revenue	81,114	213,791	(132,677)	(62.1)								
Total Mailing Services Revenue	59,862,297	59,983,804	(121,507)	(0.2)								
Express Mail:												
Total Express Mail	884,571	884,571	0	0.0	47,015	47,015	0	0.0	44,915	44,915	0	0.0
Priority Mail:												
Total Priority Mail	5,367,921	5,362,466	5,455	0.1	790,896	790,070	826	0.1	1,636,001	1,634,452	1,550	0.1

Table B–2—Revenue, Pieces, and Weight by Classes of Mail and Special Services for Fiscal Year 2009 The Original Filed in ACD 2009 (RPW 2009) Compared with the Revised Filed in ACD 2010 (RPW 2010) (Data in Thousands)—Continued

	Revenue ($)				Pieces				Weight (Pounds)			
	Revised FY 2009	Original FY 2009	Change		Revised FY 2009	Original FY 2009	Change		Revised FY 2009	Original FY 2009	Change	
Service Category			Amount	Percent			Amount	Percent			Amount	Percent
Parcel Select Mail:												
Total Parcel Select Mail	466,112	466,112	0	0.0	222,932	222,932	0	0.0	869,465	869,465	0	0.0
Parcel Return Service Mail:												
Total Parcel Return Service Mail	48,922	48,922	0	0.0	18,255	18,255	0	0.0	39,340	39,340	0	0.0
International Mail:												
International Expedited Services												
Outbound International Expedited Services	267,287	267,287	0	0.0	5,522	5,522	0	0.0	24,426	24,426	0	0.0
Inbound International Expedited Services	72,891	72,891	0	0.0	0	0	0		0	0	0	
International Priority Mail												
Outbound Priority Mail International	750,204	750,204	0	0.0	23,629	23,629	0	0.0	121,711	121,711	0	0.0
Inbound Air Parcel Post	15,815	15,815	0	0.0	0	0	0		0	0	0	
Other International Mail	238,503	238,503	0	0.0	273,139	273,139	0	0.0	39,089	39,089	0	0.0
International Mail Fees	76	76	0	0.0	0	0	0		0	0	0	
Total International Mail	1,344,777	1,344,777	0	0.0	302,290	302,290	0	0.0	185,226	185,226	0	0.0
Total Shipping Services Mail	8,112,302	8,106,848	0	0.1	1,381,387	1,380,561	826	0.1	2,774,947	2,773,397	0	0.1
Ancillary Services:												
Outbound International Ancillary Services	5,782	5,782	0	0.0	1,083	1,083	0	0.0				
Inbound International Ancillary Services	146	146	0	0.1	27	27	0	0.1				
Total Ancilliary Services	5,928	5,928	0	0.0	1,111	1,111	0	0.0				
Special Services:												
Premium Forwarding Service	17,068	17,068	0	0.0	1,227	1,227	0	0.0				
Intl. Money Orders & Money Transfer Service	2,574	2,574	0	0.0	264	264	0	0.0				
Other Domestic Special Services	116,052		116,052		80,595							

Table B–2—Revenue, Pieces, and Weight by Classes of Mail and Special Services for Fiscal Year 2009
The Original Filed in ACD 2009 (RPW 2009) Compared with the Revised Filed in ACD 2010 (RPW 2010)
(Data in Thousands—Continued)

	Revenue ($)				Pieces				Weight (Pounds)			
			Change				Change				Change	
Service Category	Revised FY 2009	Original FY 2009	Amount	Percent	Revised FY 2009	Original FY 2009	Amount	Percent	Revised FY 2009	Original FY 2009	Amount	Percent
Total Special Services	135,694	19,642	116,052	590.9	82,086	1,491	0	5,405.4				
Total Shipping Services Services	141,622	25,570	116,052	453.9	83,197	2,602	0	3,097.8				
Total Shipping Services Mail and Services	8,253,924	8,132,417	116,052	1.5								
Other Shipping Services Revenue	0	0	0									
Total Shipping Services Revenue	8,253,924	8,132,417	116,052	1.5								
Total Mailing and Shipping Services												
Total All Mail	65,062,531	65,064,498	(1,966)	(0.0)	176,744,822	177,057,802	(312,980)	(0.2)	20,784,539	20,802,057	(17,518)	(0.1)
Total All Services	2,972,576	2,837,933	134,643	4.7	2,248,017	1,755,616	492,401	28.0				
Total All Mail and Services	68,035,107	67,902,431	132,677	0.2								
Total All Other Revenue	81,114	213,791	(132,677)	(62.1)								
Total All Revenue	68,116,221	68,116,221	(0)	(0.0)								


Disaster Relief

Appendix C

Methodology Changes and MODS

This appendix contains two parts: (1) a summary of the methodological changes, and (2) a discussion of the Postal Service's Management Operational Data System (MODS).

Methodology Changes

In FY 2010, the Postal Service filed a number of petitions to change analytical principles relating to its periodic reports. A summary of the proposed changes to the analytical principles, and the Commission's analysis and recommendations of the changes are provided below.

RM2010-8: Proposal One

The Postal Service proposed to immediately eliminate Transportation Cost System (TRACS) rail sampling subsystem. Instead, it proposed to use the TRACS Inter-BMC highway distribution factors for distributing freight rail and rail plant load cost pools in CS14. The rationale for this change, as stated by the Postal Service, was the continued decline in freight rail costs as a result of a shift in transportation from rail to trucks. The shift in transportation costs was due to the realignment of transportation and distribution networks, including the implementation of Network Distribution Centers (NDCs) that began in FY 2009.[1] The Postal Service noted that this change would have minimal impacts on distribution keys.

Upon review of the proposal, when comparing the FY 2009 TRACS Inter-BMC highway key with that of the TRACS freight rail distribution key, the Commission found large differences in the attributable cost shares for some classes of mail, particularly First-Class Mail, and suggested the 2009 TRACS freight rail key as an alternative

1 The Postal Service has been transforming the Bulk Mail Center (BMC) into a new system of Network Distribution Centers (NDCs) since 2009. The NDC network consolidates the processing of originating mail into fewer sites to increase operational efficiency, decrease cost, and maintain service quality.

proxy. In its response to the Commission's concerns, the Postal Service suggested that continued use of the 2009 TRACS freight rail distribution key would be a reasonable alternative to using the FY 2010 Inter-BMC highway distribution key that is initially proposed.

The Commission concurred with the Postal Service that the immediate elimination of the TRACS rail sampling subsystem would result in a more efficient use of resources. However, the Commission found that the FY 2009 freight rail distribution key would be a more appropriate representative distribution key than that of the Inter-BMC highway. The Commission recommended a modified Proposal One that the Postal Service should use the FY 2009 freight rail distribution key to distribute the costs of freight rail to products in FY 2010 and in subsequent reporting years. The proposed change was incorporated into the FY2010 ACR. *See* Order No. 424.

RM2010-10: Proposals Two –A and Two-B

Proposal Two-A

Proposal Two-A was a resubmission of the proposal in Docket No. RM2009-5. In that Docket, the Postal Service proposed to reduce the sample size of Origin-Destination Information System—Revenue, Pieces and Weight (ODIS-RPW) data by 20 percent. As described in RM2009-5, the proposal was part of an organization-wide policy to lower administrative expenses in response to its financial difficulties. It estimated that the reduction in sample size would reduce the number of tests by about 25,600, and would have saved approximately $6 million in data collection expenses on an annual basis. Through a number of chairman information requests, the Commission asked the Postal Service to quantify the loss in precision that its proposal would cause in ODIS-RPW data at various levels of aggregation. The Postal Service did not provide the requested quantification of the proposal's impact, stating that preparing the requested information would be too expensive and time consuming. The Commission denied the proposal; because the Postal Service did not quantify the reduction in precision and the impact it would have on critical analysis of services performance, costs and rate setting (Order No. 396).

In this Docket, the Postal Service resubmitted the same proposal as Proposal Two-A concurrently with Proposal Two-B. Under Proposal Two-A, it intended to reduce the ODIS-RPW sample size by 20 percent, starting from the first Quarter of FY 2010. In Proposal Two-B, the Postal Service was concurrently seeking the approval to allocate 10 percent of the current ODIS-RPW sample size to a special study to implement an alternative and more reliable ODIS-RPW sampling method. If the Commission approved Proposal Two-A, the Postal Service would allocate 10 percent of the ODIS-RPW sample to conduct Proposal Two-B, and would reduce another 10 percent of the sample to reduce expenses. If Proposal Two-A was not approved, it would still request the approval to implement the reallocation of 10 percent of the current sample to implement Proposal Two-B.

To address the Commission concerns raised in Order No. 396, the Postal Service provided a sensitivity analysis to estimate the impact of loss of precision of ODIS-RPW data on two principal applications, *i.e.*, on revenue and volume data. It also argued that some studies that rely on the ODIS-RPW data system would not be significantly affected or that the problem could be mitigated by conducting analysis at a higher level of aggregation. The Commission agreed that the effect of imprecision in ODIS-RPW-based

billing determinants on class price cap calculations would be minimal. At the national level, the ODIS-RPW sample produces revenue, volume, and mail characteristic estimates that are precise. However, the Postal Service's sensitivity analyses and arguments do not resolve the rest of the issues identified in Order No. 396. The problem of imprecision in the disaggregated ODIS-RPW data is still a concern.

In RM2009-5, the Commission emphasized that the Postal Service must demonstrate the proposal would not make the disaggregated data significantly less functional. The Postal Service did not fully demonstrate in the current docket what the Commission sought in RM2009-5. It also had not quantified the loss of precision that would result from reducing the sample size by 20 percent as requested by the Commission. Consequently, the impact of Proposal Two-A on the integrity of data vital to Postal Service activities couldn't be determined. For these reasons, the Commission denied Proposal Two-A. *See* Order No. 650.

Proposal Two-B

The Postal Service proposed to reduce ODIS-RPW sample size by 10 percent and use the money saved to test an alternative ODIS-RPW sampling frame. Currently, the sample frame unit is defined as an entire mailstream of a given shape (*i.e.*, letter, flat, or parcel) exiting from a specific destination delivery unit (DDU). The shape-mailstream is sampled prior to distribution to individual carriers. Since Delivery Point Sequenced (DPS) letters and flats sequenced on the Flat Sequencing System (FSS) arrive at the DDU late in the morning, this leaves an increasingly narrow window for the ODIS-RPW data collector to conduct sampling. The proposed alternative sampling frame would treat individual city and rural carrier routes as sample frame units. All shapes of mail would be sampled after they arrive at an individual carrier case. Sampling of cased mail would begin before the arrival of DPS and FSS mail. The alternative sampling frame would also combine mail exiting the system by means other than street delivery (*i.e.*, postal box, firm hold out, caller service, parcel post route) into a single, aggregate sampling unit. The proposed study is designed to minimize the impact on the precision of the ODIS-RPW estimates used in RPW Reporting, and provide equivalent disaggregated data for all other purposes. The proposal provides the data technician a wider window for conducting the survey. It is also less disruptive to the DDU operations, and more reliable in a 5-day delivery environment.

The Commission maintained that this proposal would improve the quality of the ODIS-RPW data in a number of ways including (1) widening the window available to data collectors to collect sample data at the redefined Mail Exit Points (MEPs) (2) improving the precision of the sample data, (3) allowing to adapt to a 5-day delivery environment if that becomes necessary, and (4) implementation of the proposal without sacrificing precession in the ODIS-RPW sample data without net increases in expenses. The Commission approved the proposal and it was implemented in the FY 2010 ACR. *See* Order No. 650.

RM2010-12: Proposals Three through Eight

Proposal Three

The Postal Service proposed to align the revenues and delivery costs for the products that use direct bundles. The alignment would be implemented by assigning the costs of direct bundles to the products that utilize city delivery. A new data element captured

as part of the City Carrier Cost System (CCCS) would allow distinguishing direct bundles from other parcels. Prior to FY 2009, it was impossible to distinguish from the CCCS the parcels that were direct bundles or the shape of the pieces that made up the bundles. Estimates for direct bundles were included the parcel cost pools, and then distributed to parcel products. The proposal would still record the parcel-shaped direct bundle as a parcel, but within the First-Class Presort Letter product so that the revenues and delivery costs would align.

The Commission agreed that the proposal would improve the Postal Service's costing by correctly assigning the costs of direct bundles to the appropriate products that incur them. The proposal would make the treatment of city delivery and rural delivery costs consistent. For these reasons, the Commission accepted this proposal and it was implemented in the FY 2010 ACR. *See* Order No. 658.

Proposal Four

The Postal Service proposed to change the way retail window acceptance costs are attributed to non-retail mail pieces with extra services attached to the host mailpiece. It proposed to assign window acceptance costs to the host mailpiece when the pieces are accepted at the window, bearing non-retail indicia and hosts any of the Extra Services (other than Registered Mail), including Certified Mail, Insured Mail, Return Receipts, Delivery Confirmation, Signature Confirmation, and Collect on Delivery (COD). Currently, when mail is accepted at a retail window and includes an extra service, the In-Office Cost System (IOCS) treats this as if a retail transaction had taken place, and thus assigns the cost of acceptance to the extra service instead of the host mailpiece, even though the actual driver of the cost of acceptance is the host mailpiece. For example, when a customer is dropping off a prepaid mailpiece that cannot be deposited in a mailbox due to weight, customs restrictions or any other reason, the proposed approach would assign the IOCS cost tally to the host mailpiece rather than to the Extra Service.

In response to the Chairman's information request concerning the implementation of the proposal, the Postal Service indicated that it intended to implement the reassignment of costs by adjusting the IOCS computer program that assigns the tally costs to extra services. No change to the Segment 3 "B" workpapers or the IOCS questionnaire would be required. The Commission accepted this proposal on the rational that it would enable allocation of the costs of retail window acceptance to the prepaid non-retail mailpiece, which is the primary driver of the cost of acceptance, rather than the extra service attached to the host mailpiece. The changes were incorporated in the FY2010 ACR. *See* Order No. 658.

Proposal Five

The Postal Service proposed to change the methodology of distributing relevant rural carrier collection costs (Cost Segment 10) for prepaid Parcels that weigh less than or equal to two pounds. It would use the new information collected through the Rural Carrier Cost System (RCCS) for this purpose. The amounts recorded under the newly-established prepaid Parcels less than or equal to two pounds category on the form would be added to the estimates for the Letters, Cards, and Flats category. No change would be necessary to the method in which the respective collection estimates are entered in workbook I-Forms, worksheet I-CS10RCS columns

11 and 12, which flow through the model and into the CS10 workbook.

In response to the Chairman's information request, the Postal Service noted that the proposal would address the inconsistency between the costing method utilized in CS10 and the way in which rural carriers are compensated for collected pieces. A rural carrier receives Letter/Flat credit for prepaid Parcels two pounds or less, but CS10 currently treats those pieces as Collected Parcels. The proposed change in methodology shifts volumes from the Collected Parcels cost pool to the Collected Letters/Flats cost pool, changing the distribution factors in each cost pool, after which the costs are assigned to products based on their new respective distribution factors.

The Commission noted that rural carrier costs would be reduced due to this proposal since the level of attributable costs is largely determined based on the interaction between the RMC and contractually negotiated evaluation factors in the rural carriers contract. However, the proposal will make the cost distribution method utilized in CS10, which is based on the RCCS data, consistent with the way in which rural carriers are compensated for collected pieces. It will result in a more accurate allocation of rural carrier costs to products and a more accurate count of Parcels Accepted. The Commission accepted this change and it was employed in FY 2010. *See* Order No. 658.

Proposal Six

The Postal Service sought to incorporate the In-Office Cost System (IOCS) tally analysis into the International Cost and Revenue Analysis (ICRA) model by eliminating one step from the two step procedure. The current two step procedure involves producing an ICRA and then adjusting the ICRA results to reflect the IOCS tally analysis. This change in the calculation procedure would separately incorporate the Inbound Processing and Carrier In-Office costs for Canada, Developing Countries and Industrialized Countries into the ICRA model using the IOCS. The Postal Service proposed to calculate inbound mail costs according to a methodology developed by the Commission that uses an analysis of IOCS tallies and to incorporate that methodology into the ICRA.

Currently, the Postal Service calculates the system average attributable cost for each of the categories of inbound mail in the ICRA. It also prepares a separate analysis of IOCS tallies. The Commission uses the IOCS tally analysis, as well as the volume data from the ICRA to calculate separate Mail Processing (*i.e.*, CS2 and CS3) and In-Office Delivery (*i.e.*, CS6) unit costs for each category of inbound mail by terminal dues regime.

For purposes of analyzing the financial performance of inbound international mail categories, the Commission considers the development of inbound mail costs by terminal dues group to be a more accurate estimate of inbound costs than the system average reported in the ICRA. Therefore, the Commission approved the proposed change and it was incorporated in the FY 2010 ACR. To facilitate the review of the Postal Service's calculations, the Commission recommended that the Postal Service continue to accompany the ICRA with a separate IOCS tally analysis through the filing of the FY 2011 ACR. *See* Order No. 658.

Proposal Seven

The Postal Service proposed to introduce a mailflow-based model of mail processing costs for Standard

Parcels and Not Flat Machinables (NFMs). This model was intended to disaggregate the CRA costs for Standard Mail Parcels and NFMs, producing separate cost estimates for machinable, irregular and NFM price categories by presort and entry level. In the past, the rate differences for Standard Parcels and NFMs have been supported by a cost analysis that estimated the additional mail processing costs required to process parcels and NFM mail pieces in comparison to an average Standard Mail flat. This new model will not change the aggregate costs for parcel and NFMs. Instead, it will disaggregate by mail characteristics those aggregate costs. Cost sheets that depict the mail processing operations required to process each parcel up to the point that the mail has been sorted to the carrier level at delivery units have been developed for each price category. These model cost estimates are then used to "de-average" an overall mail processing cost estimate by shape into price category cost estimates for machinable, irregular, and NFM parcels.

The Commission concurred that the proposal is an improvement over the current approach. Nevertheless, the Commission found that the classification of the cost pools can be improved by adhering to the principles outlined in Docket No. RM2006-1. In RM2006-1, the Commission introduced a revised cost pool classification methodology for the letter mail processing cost models. The Postal Service did not agree with the Commission's cost pool classification applied to the letter and flats models, and thus did not believe it should be applied to the parcel model. Specifically, it did not agree with the approach that distributes non-modeled costs for a particular shape according to the ratio of proportional and fixed costs for that shape. According to the Postal Service, the issue is primarily one of determining whether a particular kind of "unexpected" cost is appropriate to "piggyback." Treating "unexpected" costs as worksharing related is less appropriately applied to parcel sorting that IOCS data indicate are sorted in a non-parcel mailstream. The Postal Service argues that it is less likely that parcels are actually sorted outside the parcel mailstream less than letters and flats would be sorted outside their intended mailstreams. On the other hand, although the processing of parcels outside their intended mailsteam may be less frequent than for letters or flats, the Commission suggests that it can't be completely ruled out. The Commission found that the Postal Service's rationale was not convincing for disregarding sorting costs for parcels that are reported to have occurred in a mailstream meant to process a different shape. It is more reasonable to piggyback non-modeled costs consistently in letter, flat, and parcel cost models.

The Commission approved the proposal with the following modification of the cost pool allocation. The Commission recommended assigning parcel sorting cost pools as proportional, a group of cost pools is treated as fixed, and allied, support and unexpected costs are piggybacked. The Commission noted that the issue of the appropriate treatment of non-modeled costs would be examined in greater depth in Docket No. RM2010-13, Consideration of Technical Methods to be Applied in Workshare Discount Design. *See* Order No. 658.

Proposal Eight

Surpluses and deficits of mail equipment occur in postal facilities, and empty equipment is transported from surplus to deficit sites. The Postal Service proposed to allocate transportation costs of empty

equipment to postal products using a distribution factor that is based on the aggregate pound-miles traveled on modes of transportation sampled by the Transportation Cost System (TRACS). Such costs are incurred in the general ledger accounts 53191 and 53192 for highway and rail transportation, respectively. According to the proposal, the total pound-miles for each product is computed and its share of the aggregate total provides each product's share of the costs of transporting empty equipment. The same distribution factors would be applied for both highway and rail costs. In the past, these costs were distributed to products based on the overall distribution of transportation costs in CS14. This approach assigns a higher proportion of the costs to products that use more air transportation since air transportation costs are generally higher than surface transportation costs on a per pound basis. The proposed change in methodology would assign these costs based on appropriate transportation cost driver, pound-miles, that more accurately reflects the incurrence of costs for transporting empty equipment. As described in the Postal Service's response to the Chairman's information inquiry on October, 25 2010, the distribution factors would include pound-miles of Commercial Air, UPS, FedEx Day, FedEx Night, Intra-SCF, Inter-SCF, Intra-BMC, and Inter-BMC.

The Commission agreed with the Postal Service that the use of transportation equipment by postal products is the most direct cost driver of empty equipment transportation cost. Therefore, distribution factors that are based on the aggregate pound-miles traveled on modes of transportation is an appropriate measure of a product's share of that cost driver. The Commission accepted the proposal and the changes were implemented in the 2010 ACR. See Order No.658.

RM2011-5 Proposals Nine through Twelve

These proposals were submitted to the Commission on December 20, 2010. Consequently, the Commission did not have adequate time to solicit comments and complete its review before issuance of the Annual Compliance Determination. The Postal Service, however, included them in its Annual Compliance Review.

Proposal Nine

The Postal Service proposed to incorporate new input data and a new bundle sorting cost methodology into the First-Class Mail presort letters and Standard Mail presort letters mail processing cost models. The following six types of new input data would be incorporated into these models: (1) automation density table, (2) manual density table, (3) post office box destination percentage, (4) plant carrier route finalization percentage, (5) manual incoming secondary and post office box walling productivities, and (6) remote bar code system (RBCS) leakage rate.

The Postal Service also proposed a new bundle sorting methodology in the above models. The reason for this change is that a very small percentage of letters are now entered as bundles. Bundle sorting operations that exclusively process letter bundles are rare. As a result, letter bundles are either processed with flat bundles or in manual piece distribution centers. The new methodology uses data from the manual density table to estimate the number of bundle handlings, and plant productivity for manually sorting bundles of 503 pieces per hour, which was developed in a 2008 field study (USPS-FY08-14 Table FS-1).

On February 16, 2011, the Chairman filed an information request to the Postal Service regarding

this proposal. The Postal Service responded to the information request on February 25, 2011. The Commission is currently reviewing the proposal.

Proposal Ten

The Postal Service proposed to modify the assignment of clerk and mailhandler labor costs of Inbound International mail to the three country groups (*i.e.*, Canada, Industrialized Countries, and Developing Countries) within In-Office Cost System (IOCS) so that normal downstream Cost and Revenue Analysis (CRA) and International Cost and Revenue Analysis (ICRA) processes can automatically distribute costs to those country groups using a methodology that is consistent with other mail products. This proposal extends proposal six in Docket RM2010-12 to incorporate the methodology change of using results of mail processing model within the ICRA.

Prior to the FY 2010, the assignment of such costs to country groups was implemented using only direct mailpiece tally data from the IOCS data system. This approach ignored the impact of downstream processing steps that distribute mixed mail and allied costs back to products based on factors such as cost pools, container types and shape. The Commission is currently reviewing this proposal.

Proposal Eleven

The Postal Service proposed to change the methodology for reporting International Money Transfer Services (IMTS) separately for Inbound and Outbound products. This proposal addresses the Commission's recommendation in Order No. 391 for these products. This proposal would not have cost impacts on the CRA report for IMTS products, but there would be two lines in the ICRA report, *i.e.*, one for Outbound and another for inbound IMTS. The sum of the two lines would add up to the currently reported IMTS line in the CRA report. This change in methodology is implemented based on information from the Point of Sale System (POS), the In-Office Cost System (IOCS) and Chapter 9 in Docket No. ACR2009, Library Reference USPS-FY09-NP5. In a response to the Chairman's information request, the Postal Service noted that the POS keeps track of the volume for cashed paper money orders, and can distinguish between domestic and international money orders cashed. Addressing the Commission's concern regarding the relatively small number of IOCS tallies for IMTS and the consequent volatility of the data, the Postal Service plans to consider increasing the sample size in a manner similar to other international products. It will also investigate other alternatives, such as engineering-based estimates of time required for IMTS-Outbound and -Inbound transactions. The Commission is currently reviewing the proposal.

Proposal Twelve

The Postal Service proposed to develop alternative data inputs to the Media Mail/Library Mail processing cost model, the Bound Printed matter transportation cost model, and the Bulk Parcel Return Service (BPRS) cost model. The proposal addresses the Commission's concern in the FY2009 ACD that the use of the Intra- and Inter-BMC volume split for Parcel Post single-piece was no longer appropriate since this distinction no longer exists for Parcel Post single-piece.

The Postal Service noted that the Parcel Post single-piece Intra-NDC volume percentage could be obtained by dividing the sum of the volumes for zones 1, 2, and 3 by the total volume because, based on FY 2008 data, 96 percent of the mail volume

was found in these zones. This estimate could be obtained annually from Parcel Post volume, cubic feet, and weight data, and then incorporated into future versions of the Media Mail / Library Mail mail processing cost model. The CS14.3 data that were used to calculate the zone related percentages are available from ACR USPS-FY09-32. These data would be used to estimate the zone-related percentages in future versions of the Bound Printed Matter transportation cost model. BPRS parcels are returned Standard Mail machinable parcels. The Postal Service proposed to use data from the Standard Mail destination entry cost model (USPS-FY09-13) to estimate the Bulk Parcel Return Service (BPRS) transportation and delivery costs.

On January 11, 2011, the Chairman filed an information request to the Postal Service. The Postal Service provided the requested information on January 19, 2011. Up on further review, the Chairman requested the Postal Service for more information on March 1, 2011. The Commission is still reviewing the proposal.

RM2011-6 Proposals Thirteen and Fourteen

The Postal Service filed these proposals on December 22, 2010. It also implemented these proposals in the 2010 Annual Compliance Review. However, the Commission did not have adequate time to solicit comments and complete its review of these proposals before issuance of the Annual Compliance Determination.

Proposal Thirteen

The Postal Service proposed to develop a new Parcel Select/Parcel Return Service (PRS) mail processing cost model. It noted that the mail processing cost model has been continuously modified as both the price structure and the cost and revenue analysis (CRA) requirements have changed. Most of the input data, nevertheless, have not been updated for several years. In addition, several of the productivity values that support the model were established from old studies.

The proposed model would be developed based on data that was collected for the Standard Mail parcel/ Non-flat Machinable (NFM) processing cost model as filed in RM2010-12 Proposal Seven, and the Parcel Select arrival profile data that were collected from PS forms 3605 and 8125 in FY 2009. This cost model would apply a methodology similar to that used for other mail processing cost models. Model cost estimates are developed that represent the mail processing tasks required to process the mail for each price category. The model cost estimates and the mail volume estimates for each price category are then used to de-average a CRA cost-by-shape estimate into CRA-adjusted price category cost estimates. The Postal Service noted that the proposed approach would decrease the mail processing unit cost estimates for price categories that require more processing steps, and increase the cost estimates for DDU and RDU. However, all of the changes in cost estimate are at the price category level. The overall costs reported in the CRA would not be affected for any of the products.

On March 1, 2011, the Chairman filed an information request to the Postal Service regarding the proposed cost model. The proposal is currently under review.

Proposal Fourteen

The Postal Service proposed to develop a modified Parcel Select/Parcel Return Service (PRS) transportation cost model. The proposed modification has five components: (1) present transportation

cost estimates only for current price categories, (2) use 2010 PostalOne! data for estimating the cost of transportation legs for the non-dropship price categories, (3) incorporate the official revenue, pieces, and weights (RPW) volumes into the analysis, (4) Use the method that was applied for distributing the Parcel Select transportation costs for distributing Parcel Return Service transportation costs, and (5) use a new methodology to estimate the return network distribution center (RNDC) cubic foot miles by zone. The Postal Service noted that it could not provide estimates of the impact of the changes because it utilized data that was not fully available in FY 2009. The Commission is currently reviewing the proposal

Management Operational Data System

The Management Operating Data System (MODS) collects and reports mail piece handlings and workhours by highly disaggregated MODS pools. For purposes of analyzing the product shares of attributable mail processing costs, it breaks costs out into approximately 40 MODS cost pools, each intended to reflect a discrete mail processing technology. This detailed functional breakdown also plays a role in the distribution of attributable mail processing costs to products. IOCS tallies reflecting the relative labor hours spent processing the various products are compiled by MODS cost pools. Attributable costs from each pool are then distributed to products in proportion to the product shares of IOCS tallies that are recorded in each pool. In an even more detailed set of cost pools, the ratio of MODS piece handlings to workhours is used to calculate mail processing productivities. These productivities are used to calculate the avoided costs on which discounts are based.

Comments from Participants

Only the Public Representative filed comments directly related to MODS data. The Public Representative (PR) claims that such a high percentage of MODS data is erroneous that the productivity data that is derived from them is suspect. It also says the calculation of the premium pay adjustment to attributable mail processing costs depends on the accuracy of MODS data, and is suspect as well. This, it says, would put at risk the accuracy to the calculation that seeks to identify the extent of any cross subsidy of competitive products by market dominant products. Public Representative Comments in Response to Order No. 636 at 22.

According to the Public Representative, MODS data have the following flaws: 1) they have high levels of measurement error; 2) the data are aggregated before being corrected for data errors; and 3) the decreasing sample size may result in a loss of precision and accuracy. The Public Representative also contends that "this continued decrease in the number of observations used in recent years may be a significant change in analytic principles" and should follow rule 39 C.F.R. § 3050.11 establishing procedures to change analytic principles relating to the Postal Service's periodic reports. Public Representative Comments at 23-25. The Public Representative also complains that FY 2010 Annual Compliance Report Costs for FSS Mail Processing were not reported, and is concerned that manual flats productivity is decreasing while the proportion of manual flats processing relative to automated mail processing is increasing. *Id.* at 20-21.

Commission Analysis

In its reply comments, the Postal Service states that the FSS data were included in AFSM 100 data because the FSS program is still in its roll-out period, and any productivities that would be separately reported would be misleading. In the preface to USPS-FY10-LR-7 at 2, the Postal Service states that "In FY 2010, the FSS operations continue to be (as they were in past years) listed with the AFSM operations until the FSS hours become substantial enough at some time in the future to have their own separate cost pool." The Commission assumes that data reported separately for FSS operations will be provided in the Postal Service's ACR for FY 2011.

The Postal Service provides persuasive arguments that the decline in total MODS observation counts are due to operational changes rather than an analytical change in periodic reporting. It identifies as the main sources of decline, the retirement of UFSM 1000 equipment and the winding down of the Return to Sender operations. Postal Service Reply Comments at 7-8. The Postal Service also explains that the proportion of manual flats processing has increased relative to automated processing because the inefficient FSM 1000 operations is being rapidly phased out. Because more of the workload of the FSM 1000 in absolute terms is being shifted to the AFSM 100 than is being shifted to manual processing, it concludes that the net effect is to increase overall flat processing productivity. *Id.* at 9-11.

The most significant criticism by the Public Representative relative to MODS data is the potential effect of the high percentage of erroneous data on the productivities that are used to calculate the cost avoidances that underlie workshare discounts. A 2007 audit by the Postal Service Inspector General[2] found that the proportion of MODS data that was obviously erroneous was 39 percent. It concluded that there would not be a legitimate reason for this quantity of anomalous data entries. IG Report at 7. The Commission recently analyzed outgoing piece handling MODS data in Docket No. N2010 to verify the day-to-day variation in mail processing operations productivities on which the Postal Service based its estimate of the amount it would save by eliminating Saturday street delivery. It found that more than a third of those data were obviously erroneous.

The errors that can be identified by inspection consist of illogical observations, including observations of zero workhours associated with positive piece handlings in a particular operation, zero piece handlings associated with positive workhours, and negative workhours or negative piece handlings.[3] The Postal Service has informally informed the Commission that a minority of observations where zero workhours are paired with positive piece handlings or positive workhours are paired with zero piece handlings are not unexpected. The fact remains that a very high percentage of such observations where this pairing is unexpected remains.

The Postal Service contends that most of the MODS data that is obviously erroneous is due to erroneous clock rings at the three-digit operation level. It argues that the data is not actually used to calculated MODS operation productivities until such operation-by-operation data is aggregated to form broader cost

[2] Audit Report – Management Operating Data System (Report Number MS-AR-07-003).

[3] Observations where First Handled Pieces (FHP) exceed Total Handled Pieces (THP), which made up part of the 39 percent of obviously erroneous data found by the IG no longer occur because First Handled Pieces are no longer directly measured.

pools. There the inaccurate clock rings are likely to be harmless, because, it assumes, the clock rings are likely to be accurate for the broader cost pools for which productivity is actually calculated. It argues, also, that screening of data that is obviously erroneous can cure the effect of erroneous observations. It emphasizes that MODS productivities are based on sums of MODS observations, and argues that whatever sample error exists at the disaggregated level is cured by aggregation, since there is no reason to expect that the erroneous data is significantly biased. Postal Service Reply Comments at 5-6.

The Postal Service's argument with respect to productivity calculations is valid as far as it applies. MODS data that contain large proportions of sample error at the disaggregated level could still be reliable at a certain level of aggregation if there were no bias. However, whether the level of aggregation that is used in the workshare discount cost avoidance models is sufficient to overcome the very high proportion of error in MODS observations is something that warrants more concrete demonstration. Coefficients of variation might be calculated that would give the postal community the basis for assuming that the Postal Service's assurances are valid. The Postal Service has not yet provided that calculation.

There is another issue that would have to be addressed before an appropriate calculation of CVs would settle the question of whether productivities based on MODS data are reliable. Most of the obvious errors in MODS data are errors that reveal themselves because they report illogical results. These are different from measurement errors, some of which can be tentatively identified by their unexpectedly extreme values. Observations with illogical values, such as those described by the IG report, are non-sample error. There is no assurance that non-sample error is unbiased unless the process that produced the error is known. Therefore, there is no assurance that a dataset with high proportions of non-sample error can be made accurate or reliable simply by aggregating the data.

The Commission agrees with the Postal Service that this is the kind of issue that should be resolved in a rulemaking designed to address the issue in depth. *Id.* at 8. A closely related issue is the method by which the Postal Service now estimates First Handled Pieces and Subsequent Handled Pieces for manual mail processing operations. It currently infers mail volume processed as FHP and projects manual subsequent handling pieces (SHP) using annual surveys of flow densities. See MODS Handbook M32, section 3-2. The validity of the assumptions upon which this system of inferences is based should also be evaluated in a rulemaking designed to address the issue of the quality of the MODS data. The pending strategic rulemaking (Docket No. RM2011-3) is an appropriate context to examine this issue.

Appendix D

Abbreviations and Acronyms

Long Version	Abbreviation/Acronym
Annual Compliance Report	ACR
area distribution center	ADC
automated area distribution center	AADC
Automated Flat Sorting Machine	AFSM
Automated Package Processing System	APPS
Automated Tray Handling System	ATHS
City Carrier Cost System	CCCS
Civil Service Retirement System	CSRS
Collect on Delivery	COD
2010 Comprehensive Statement on Postal Operations	2010 Comprehensive Statement
Consumer Price Index for all urban consumers	CPI-U
Consumer Price Index for all workers	CPI-W
cost and revenue analysis	CRA
Cost of Living Adjustments	COLA
Customer Experience Measurement	CEM
delivery point sequence	DPS
delivery point sequenced	DPS'd
Destinating Sectional Center Facilities	DSCF
destination delivery units	DDU
destination bulk mail center	DBMC
detached address label	DAL
educational, cultural, scientific or informational [value]	ECSI
enhanced carrier route	ECR
Equal Employment Opportunity	EEO
External First-Class Measurement System	EXFC
Flats Sequencing System	FSS
Global Express Guaranteed	GXG

Long Version	Abbreviation/Acronym
Government Performance and Results Act of 1993	GPRA
Integrated Financial Plan	IFP
Intelligent Mail Barcode	IMb
International Cost and Revenue Analysis	ICRA
International Customized Mail	ICRA
International Mail Measurement System	IMMS
International Priority Airmail	IPA
International Surface Airlift	ISAL
irregular pieces and packages	IPPs
letter post	LC/AO
Labor Distribution Code	LDC
Mail Classification Schedule	MCS
Mailers Technology Advisory Council	MTAC
Management Operating Data System	MODS
mixed area distribution center	MADC
multiline optical character reader information service system	MLOCR-ISS
Negotiated Service Agreement	NSA
Network Distribution Center	NDC
Office of Personnel Management	OPM
Occupational Safety and Health Administration	OSHA
Operating Income and Deliveries per work hour	DPWH
Origin Destination Information System Revenue, Pieces, and Weight System	ODIS-RPW
personal computer software and solution	PC SAS
Postal Accountability and Enhancement Act	PAEA
Postal Reorganization Act	PRA
qualified business reply mail	QBRM
Quality Link Measurement System	QLM
Remote Encoding Center	REC
Point of Service	POS
Postal Service Retirement Health Benefits Fund	PSRHBF
Premium Forwarding Service	PFS
Priority Mail International	PMI
Rapid Information Bulletin Board System	RIBBS
Revenue, Pieces, and Weights	RPW
Rural Carrier Cost System	RCCS
Sarbanes-Oxley Act	SOX
Short Run Marginal Cost	SRMC
Small Parcel Bundle Sorter	SPBS
software and solution	SAS
Total Factor Productivity	TFP
unit delivery costs	UDC
United States Postal Service Annual Compliance Report	ACR
Universal Postal Union	UPU
Voice of the Employee	VOE

Appendix E

Commenters— 2010 Annual Compliance Determination

Commenter	Comment Citation	Citation Short Form
Alliance of Nonprofit Mailers	Reply Comments of Alliance of Nonprofit Mailers on Preferred Rates February 17, 2011	ANM Reply Comments
American Catalog Mailers Association	Comments of the American Catalog Mailers Association (ACMA) February 2, 2011	ACMA Comments
	Reply Comments of the American Catalog Mailers Association (ACMA) February 17, 2011	ACMA Reply Comments
American Postal Workers Union, AFL-CIO	Initial Comments of American Postal Workers Union, AFL-CIO February 3, 2011	APWU Comments
Association for Postal Commerce	Comments of the Association for Postal Commerce in Response to Order No. 636 February 2, 2011	PostCom Comments
Association for Postal Commerce and Alliance of Nonprofit Mailers	Reply Comments of the Association for Postal Commerce and Alliance of Nonprofit Mailers in Response to Order No. 636 February 17, 2011	PostCom/ANM Reply Comments
Condé Nast Publications	Comments on the Postal Service Annual Compliance Report as Regards to Periodical Mailing and Cost Coverage February 2, 2011	Conde Nast Comments
Greeting Card Association	Reply Comments of the Greeting Card Association February 17, 2011	GCA Reply Comments

Commenter	Comment Citation	Citation Short Form
L.L. Bean, Inc.	Initial Comments of L.L. Bean, Inc.	LL Bean Comments
	February 2, 2011	
	Reply Comments of L.L. Bean, Inc.	LL Bean Reply Comments
	February 17, 2011	
Magazine Publishers of America, Inc., Alliance of Nonprofit Mailers, American Business Media	Comments of Magazine Publishers of America, Inc., Alliance of Nonprofit Mailers and American Business Media	MPA et al. Comments
	February 2, 2011	
	Reply Comments of Magazine Publishers of America, Inc., Alliance of Nonprofit Mailers and American Business Media	MPA et al. Reply Comments
	February 17, 2011	
National Association of Presort Mailers	Reply Comments of the National Association of Presort Mailers on USPS FY 2010 Annual Compliance Report	NAPM Reply Comments
	February 23, 2011	
National Postal Policy Council	Comments of the National Postal Policy Council on Annual Compliance Review	NPPC Comments
	February 2, 2011	
Public Representative	Public Representative Comments in Response to Order No. 636	PR Comments
	February 2, 2011	
	Public Representative Reply Comments in Response to Order No. 636	PR Reply Comments
	February 17, 2011	
Time Inc.	Initial Comments of Time Inc. on USPS FY 2010 Annual Compliance Report	Time Comments
	February 2, 2011	
	Reply Comments of Time Inc. on USPS FY 2010 Annual Compliance Report	Time Reply Comments
	February 17, 2011	
United States Postal Service	Reply Comments of the United States Postal Service	Postal Service Reply Comments
	February 17, 2011	
Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc.	Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Initial Comments on the United States Postal Service FY 2010 Annual Compliance Report	Valpak Comments
	February 2, 2011	
	Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Reply Comments on the United States Postal Service FY 2010 Annual Compliance Report	Valpak Reply Comments
	February 17, 2011	

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