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ANNUAL COMPLIANCE REPORT, 2009

Docket No. ACR2009

UNITED STATES POSTAL SERVICE
FY 2009 ANNUAL COMPLIANCE REPORT
(December 29, 2009)

Section 3652 of title 39 requires the Postal Service to provide, within 90 days after the end of each fiscal year, a variety of data on "costs, revenues, rates, and quality of service" in order to "demonstrate that all products during such [fiscal] year complied with all applicable requirements of [title 39]." The Postal Service hereby files its Annual Compliance Report (ACR) for FY 2009.

I. Overview of Report

A. Transition Issues

The FY 2007 ACR was the first ACR ever filed by the Postal Service. It covered a fiscal year that started several months prior to the passage of the Postal Accountability and Enhancement Act (PAEA), and during which the pricing approaches approved under the former requirements of the Postal Reorganization Act (PRA) were still in effect. These circumstances gave rise to a host of transition issues, as discussed at some detail in the first ACR. FY07 ACR (Dec. 28, 2007) at 1-3. The situation improved considerably in the FY 2008 ACR, as the Postal Service was able to report product costs aligned with the new product lists for most categories. As discussed in the FY08 ACR (Dec. 29, 2008) at 1-2, however, there were still some lingering transition issues, especially since procedural rules to cover the ACR filing had yet to be finalized. This year, that milestone was achieved, but there will nonetheless still be some transitional issues as the Postal Service attempts to put the new rules into practice. It seems likely that this effort will once again provide further opportunities for all participants to learn more about the most appropriate ways for this process to be conducted.

B. Contents, Roadmap, and Methodology

Much of the information within this Report is included in materials appended as separate folders. A list of those materials is attached. The appended materials are sequentially numbered and labeled as USPS-FY09-1, USPS-FY09-2, etc. Materials in the nonpublic annex (discussed below in Part V) are labeled as USPS-FY08-NP1, USPS-FY08-NP2, etc.[1] All materials on the list (both public and nonpublic) are submitted in an electronic format, although a few are submitted in hard copy format as well. Each item includes a Word (or PDF) document with a preface explaining the purpose, background, and structure of that material, as well as its relationship with the other materials.

A separate roadmap document is included as USPS-FY09-9. The roadmap document consolidates in one place a brief description of each of the materials provided, as well as the flow of inputs and outputs among them. It also includes a discussion of any methodology changes between the FY 2009 analyses included in this Report and the Commission's methodologies in the FY 2008 Annual Compliance

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[1] In those designations, the NP is intended to signify "nonpublic."

Determination (ACD), as well as the listing of special studies and discussion of obsolescence required by new Commission rule 3050.12.

Broadly speaking, there are four distinct major sets of items included in the appended material. The first set consists of the subclass/product costing material traditionally filed in omnibus rate cases and, more recently, on an annual basis in response to the Commission's periodic reporting rules. The focus of these materials, in terms of the ultimate output, is the CRA report.[2] The second set consists of the comparable costing material with respect to international mail, filed in recent years in response to the Commission's international reporting requirements. The focus of these materials, in terms of output, is the ICRA report. The third set consists of material relating to intra-subclass cost analyses that were historically provided only in omnibus rate cases, which include those analyses necessary for an examination of workshare discounts pursuant to section 3652(b) (a topic discussed in Part II.F below). In the PAEA environment, the special cost study materials generally focus on categories below the product level. The fourth set is billing determinant information which, for both domestic and international mail, has generally been filed with the Commission on an annual basis.

Therefore, all four of these major sets of material (CRA, ICRA, cost studies, and billing determinants) are familiar to the Commission, both from prior rate cases and the FY07 and FY08 ACRs. Moreover, they are presented in formats similar (if not identical)

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[2] In the PRA environment, the basic CRA reporting level was the subclass. Under the new PAEA environment, the basic CRA reporting level is the product. While a number of current products were formerly subclasses, other products are either a portion of one old subclass, or perhaps portions of several old subclasses. In any event, basic reporting data for products are now found in the CRA (or its international counterpart, the ICRA).

to what both the Commission and other parties participating in postal rate proceedings have seen and worked with in the past. In that sense, the Postal Service has sought to maximize the ease with which these materials may be reviewed. One significant change, however, is that certain materials, which formerly were presented in one version containing information on both market dominant and competitive products, have now been split into two versions, one public, and the other nonpublic. The public versions of these materials are limited either to information on market dominant products, or to information on individual market dominant products and comparable aggregate information on competitive products as a whole (or, with respect to the Public CRA, aggregate information on five groups of competitive products). Correspondingly, the nonpublic versions are either limited to information on competitive products, or contain information on both types of products in contexts in which it is not possible to segregate the two. In the nonpublic versions, however, competitive product information is disaggregated to individual competitive products. This is discussed further in Part V below.

The methodologies employed are in general also quite familiar to the Commission and parties that have historically been involved in postal ratemaking. Because heavy reliance is placed on replicating the methodologies used most recently by the Commission, the scope of new methodologies has been minimized. Postal operations and postal data collection are not entirely static, however, and consequently some minor changes in methodology are identified and discussed. This is done in two places. First, methodology changes are identified in a separate section of the roadmap document, USPS-FY09-9. Second, they are discussed in the Word (or PDF) preface accompanying each of the appended materials; often, this preface contains a discussion that is more detailed than that contained in the roadmap document. Thus, if a change relates to an area of particular interest to the reader, it may be useful to refer to the particular item in question, rather than relying exclusively on the roadmap document. Overall, however, with some exceptions, including those which have been previously approved by the Commission in the proceedings discussed in the next paragraph, the basic costing methodologies applied are those most recently employed by the Commission.

The Postal Service filed a number of proposals to change analytic principles since the issuance of the FY 2008 ADC, most of which were intended to affect preparation of the ACR for this fiscal year. (A few were proposed data system changes intended instead to take effect in FY 2010.) Proposal One was filed as Docket No. RM2009-5 on June 22, 2009; Proposal Two was filed as Docket No. RM2009-7 on July 7, 2009; Proposals Three through Nineteen were filed as Docket No. RM2009-10 on July 28, 2009; Proposal Twenty was filed as Docket No. RM2010-1 on October 6, 2009; Proposal Twenty-One was filed as Docket No. RM2010-3 on October 20, 2009; Proposals Twenty-two through Twenty-five were filed as Docket No. RM2010-4 on October 23, 2009; Proposals Twenty-six through Twenty-eight were filed on December 1, 2009; Proposal Twenty-nine was filed on December 11, 2009; and Proposal Thirty was filed on December 22, 2009. *See* Order No. 229 (June 24, 2009); Order No. 245 (July 10, 2009); Order No. 269 (July 31, 2009); Order No. 311 (Oct. 7, 2009); Order No. 321 (Oct. 22, 2009); Order No. 327 (Oct. 29, 2009); Order No. 352 (Dec. 3, 2009); and Commission Order No. 363 (Dec. 16, 2009). Disposition of those proposals thus far were rendered in Order No. 339 (Nov. 13, 2009) (Proposals Three through Nineteen); Order No. 338 (Nov. 10, 2009) (Dismissing Proposal Twenty-one as moot following withdrawal by the Postal Service of its request), and Order No. 354 (Dec. 7, 2009) (Proposal Two). With respect to those proposals still pending, in the absence of any direction to the contrary, the Postal Service is incorporating those methodologies into the ACR. In many instances, however, the pending proposals were motivated by the realization that some change in circumstances had made it impossible to apply the established methodology without modification. In those instances, the Postal Service has no real choice but to incorporate the proposed new methodology into its ACR preparations. In other instances, to the extent possible, the Postal Service has employed toggle switches to show the effects of the pending proposal.

Finally, section 3652(g) requires the Postal Service to submit, together with this Report, a copy of its most recent comprehensive statement. A copy of its FY 2009 Comprehensive Statement can be found at usps.com, and is also filed as USPS-FY09-17 in this proceeding. Similarly, a copy of the Postal Service's annual report to the Secretary of the Treasury regarding the Competitive Products Fund, required by section 2011(i) of title 39, is filed in this proceeding as part of USPS-FY09-39, along with the other Competitive Products Fund materials provided in accordance with Commission Rules 3060.20 through 3060.23.

II. Market-Dominant Products

A. Applicable Requirements of Title 39

In its FY 2008 ACR, the Postal Service noted that the rates and fees in effect during the majority of FY 2008 were established using PRA procedures and applying

PRA standards. By FY 2009, however, rates and fees in effect during the entire fiscal year had been established under PAEA procedures.[3] Therefore, whatever consideration of transitional issues regarding rate setting standards may have been appropriate in FY 2007 and FY 2008 should no longer be necessary with respect to FY 2009.

B. Product-by-Product Costs, Revenues, and Volumes

For FY 2009, with the limited exceptions indicated below, cost, revenues, and volumes for all market dominant products of general applicability are shown directly in the FY 2008 CRA (or ICRA). The exceptions are:

International Reply Coupon Service

While the ICRA shows some revenue for this product, it does not isolate the FY 2009 costs or volumes, either inbound or outbound.

International Business Reply Mail Service

While the ICRA shows some inbound volume for this product, it does not isolate the FY 2009 costs or revenues, either inbound or outbound.

Negotiated Service Agreements (NSAs)

Information for domestic market-dominant NSAs is presented in two ways in the ACR. In the CRA, the **fiscal year** revenues, costs, and volumes have been extracted from the applicable products. That information is then aggregated and shown in two separate lines (First-Class Mail Domestic NSAs and Standard Mail Domestic NSAs) in the CRA. The breakouts of that fiscal year information are shown for each individual

[3] The only exceptions are a few carryover international rates.

NSA in USPS-FY09-30. Also shown in USPS-FY09-30 is **contract year** information for each market dominant NSA. Commission Rule 3050.21(f) requires the net benefit calculation for each NSA to be conducted based on contract years, rather than fiscal years, to accommodate NSAs in which discounts are based on volume thresholds reached during a contract year. Those net benefit calculations appear in USPS-FY09-30.

In this regard, one point bears noting. Even putting aside the distinction between contract years and fiscal years, no one should confuse the net benefit calculations presented in USPS-FY09-30 with the difference between the market dominant NSA revenues shown in the CRA and the NSA costs shown in the CRA. In a net benefit calculation (at least as applied to an NSA with volume thresholds), the relevant contribution is that obtained from incremental pieces (that would not have been mailed except for the NSA). In the CRA, however, costs and revenues are displayed for the *entire* volume relating to the NSA, including for those pieces below the threshold that would have been mailed even without the NSA. Therefore, the "implicit contribution" one could calculate by subtracting NSA costs from NSA revenues on a row in the CRA might include contribution that would have been generated even without the NSA.[4] To avoid that confusion, the CRA rows for First-Class Mail NSAs and Standard Mail NSAs show revenue and costs, but do not show contribution. Moreover, even if that

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[4] For example, as things turned out, for one NSA that was in effect in FY09, the volume thresholds were never reached, and thus the net benefit evaluation suggests no net benefit from that NSA in that period. The RPW and the CRA, however, are in essence recording volumes, revenues, and costs for that NSA throughout the fiscal year, with no certainty regarding whether any thresholds will be exceeded, any rebates will be paid, or any volume will be generated by virtue of these incentives. Consequently, volumes, revenues, and costs for that NSA are reflected in the NSA lines in the FY09 CRA, but USPS-FY09-30 shows no net benefit from that agreement for the contract year.

calculation were made, the resulting figure should not be expected to match the analytically distinct net value calculation presented in USPS-FY09-30, which is intended for each NSA to be an accurate reflection of the net value difference between a scenario in which there were no NSA, versus a scenario with the actual NSA results for the period under review.

C. Service Performance

Section 3652(a)(2)(B)(i) requires the Postal Service to provide measures of the level of service, described in terms of speed and reliability, for its market-dominant products. The enactment of the PAEA has required the Postal Service to enhance and create new measurement systems which would meet the statutory requirements. The External First-Class Measurement system (EXFC), the International Mail Measurement System (IMMS), and Delivery Confirmation service were all enhanced or expanded. These systems produce the results for single piece First-Class Mail, single-piece First-Class Mail International, and retail Package Services parcels, respectively.[5] Acting under authority of subsections 3691(b)(1)(D) and (b)(2),[6] the Postal Regulatory Commission approved the Postal Service's proposed approaches for internal measurement of the service performance of various market dominant products. These approaches include, for example, the continued use of Delivery Confirmation for parcel-shaped mail; and a hybrid system for presort First-Class Mail and Standard Mail letters and flats that relies on internal Intelligent Mail Barcode (IMb) scans in combination with

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[5] Package Services market dominant products include single-piece Parcel Post, Bound Printed Matter, and Media Mail/Library Mail. Due to their small volumes, these products are grouped together as Package Services for purposes of service performance measurement.

[6] PRC Docket No. PI2008-1, Order No. 140 (November 25, 2008).

delivery information provided by external third-party reporters. A hybrid system is also being developed for Periodicals. In the interim, data from two external and independently operated Periodical mailing systems is combined with weights and business rules applied by an external contractor. The Postal Service will continue to enhance and refine these systems.

Single-piece First-Class Mail service performance data are generated by the External First-Class Measurement system. EXFC measures delivery performance from collection box to mailbox delivery. The system is operated independently by IBM Global Business Services, using test mail pieces sent to a nationwide panel of receivers. Single-piece First-Class Mail International service performance is currently measured by the International Mail Measurement System (IMMS). This system measures the length of time it takes for the domestic leg of transit for single-piece international First-Class Mail letters. Transit time for outbound mail begins when letters are mailed from collection boxes or mail chutes in the same 3-digit ZIP Code areas tested in EXFC, and ends when the pieces are sorted at the designated international processing center in the United States. Similarly, transit time for inbound mail begins at arrival at the USPS international processing center and ends with delivery to the intended recipient.

The IMMS system results for FY 2009 are significantly lower than those of FY 2008 and reflect the impact of the Postal Service's efforts to consolidate the processing of outbound international mail. In Quarter 1 of FY09, the San Francisco International Service Center (ISC) ceased processing of outbound mail. That outbound volume was processed at the Los Angeles ISC. This was followed in Quarter 4 by the consolidation of all outbound mail processing into the New York ISC. Both of these changes were significant modifications to processing and transportation schemes, and had initial negative impacts on the on-time performance of international mail.

Service performance for retail Package Services parcels is measured using Delivery Confirmation scans. When postal retail clerks apply the Delivery Confirmation forms to parcels, they scan the Delivery Confirmation barcodes. The scans are captured via either a Point of Sale (POS) terminal at the retail counter or an Intelligent Mail handheld scanning device. Postal Service delivery personnel scan the Delivery Confirmation barcodes upon delivery or attempted delivery, either of which serves to "stop-the-clock."

The chart below provides service level information for single-piece First-Class Mail, single-piece First-Class Mail International, and Package Services:

Annual Service Performance for Market Dominant Products – FY 2009	
Mail Class	**Percent On-Time**
First-Class Mail (Note 1)	
Single-Piece Overnight	**96.1**
Single-Piece Two Day	**93.5**
Single-Piece Three Day	**90.8**
Single-Piece First-Class Mail International	**89.7**
Inbound Overnight	**93.4**
Two Day	**87.2**
Three Day	**86.6**
Outbound Overnight	**94.9**
Two Day	**92.7**
Three Day	**86.4**
Package Services – Retail Single Piece Ground (Note 2)	**63.9**

Note 1: The First-Class Mail numbers represent the performance for single-piece First-Class Mail letters, cards, and flats, plus parcels with Delivery Confirmation.

Note 2: Retail Package Service composite performance measured by Delivery Confirmation. This includes single-piece Parcel Post, Bound Printed Matter, Library and Media Mail.

In FY 2009, a number of major changes were implemented in the external measurement systems for domestic and international Single-Piece First-Class Mail, the most significant of which was the expansion of their geographic coverage. The External First-Class Mail Measurement System (EXFC), which measures the on-time performance of domestic single-piece First-Class Mail letters, cards, and flats, and the International Mail Measurement System (IMMS), which measures the performance of the domestic leg of international single-piece First-Class Mail letters, were both expanded from coverage of 463 3-digit ZIP Code areas to 892 3-digit ZIP Code areas. These systems now measure virtually all 3-digit ZIP Codes in the United States and its territories, including Guam, Puerto Rico, and the U.S. Virgin Islands. In both the EXFC and IMMS systems, on-time performance in the expansion ZIP Codes lagged behind performance in the core 463 ZIP Codes from the outset of FY 2009. While this still remained true at the close of the fiscal year, the gap in performance between core and expansion ZIP Codes has continually decreased as performance in the expansion ZIP Codes improved.

An additional challenge to performance revolved around the introduction of the modern First-Class Mail service standards. Both EXFC and IMMS were affected by this change. The EXFC system also changed its design to reflect single-piece First-Class Mail volume flows and characteristics rather than total First-Class Mail, which includes Presort FCM. This change not only affected the ZIP Code to ZIP Code volume flow for EXFC test pieces, but also the mail characteristics. To better reflect the single-piece First-Class Mail make-up, a higher proportion of postcards and flats were included, as well as higher proportions of handwritten pieces as opposed to machine printed. These mail types traditionally have lower on-time performance than letters and machine printed pieces, respectively, posing an additional challenge to maintaining the exceptionally high level of overall on-time performance results in FY2008.

Several new reports were created to assist field managers in closing the performance gap between core and expansion ZIP Codes. Use of these reports assisted the field in identifying opportunities for improvement and resulted in a significant decrease in the performance gap over the course of FY 2009 across all service standards. The overnight performance gap between core and expansion ZIP Codes decreased from 13.5 percent to only 0.7 percent by the end of FY 2009. The Postal Service continues to focus on service improvement and bringing the performance in the expansion areas up to the high levels of performance previously experienced in the core ZIP Code areas.

D. Customer Satisfaction with Market Dominant Products for FY 2009

Section 3652(a)(2)(B)(ii) requires the Postal Service to provide measures of the degree of customer satisfaction with the service provided for its market dominant products, also known as mailing services. The table below reflects the combined Customer Satisfaction Measurement survey data responsive to the requirements of this portion of the statute. The results represent data from both residential and business customer segments. For each row of data, the table indicates the mailing service and the corresponding customer rating (the combined rating of Excellent, Very Good, and Good).

Customer Satisfaction with Mailing Services -- FY 2009

Market Dominant Products (Mailing Services)	Combined Customer Ratings % Rated E/VG/G
First-Class Mail	85.7%
Standard Mail	83.7%
Periodicals	85.4%
Single-Piece Parcel Post	83.7%
Media Mail	87.3%
Bound Printed Matter	86.4%
Single-Piece International	85.0%
Library Mail	90.3%

Overview

The Customer Knowledge Management (CKM) group in Consumer Affairs at Postal Service headquarters was responsible for survey measurement of the level of customer satisfaction with market dominant products during FY 2009 for USPS customers. Surveys were administered across each quarter of the year for two customer groupings – Residential/Small Business customers and Large Commercial Business customers.

Background

During FY 2009, the Gallup Organization continued as the supplier for all customer satisfaction survey measurement on behalf of the Postal Service in its final contract year. At the same time, the Postal Service began a transition from the long standing customer satisfaction based measure to a customer experience based measure through the competitive procurement process. Given the final year of contracted supplier services and the planned investment in a new measurement system for FY 2010, the existing survey operations infrastructure was utilized during FY 2009 to reach out to all customer segments to meet the requirement to measure the degree of customer satisfaction with market dominant products provided to customers. Based on self-identified usage, Residential/Small Business customers and Large Commercial Business customers were provided the opportunity to indicate their rate of satisfaction with each market dominant product, including First-Class Mail, Standard Mail, Periodicals, Single-Piece Parcel Post, Media Mail, Bound Printed Matter, Single-Piece

Methodology

The Gallup Organization conducted two online surveys on behalf of the Postal Service across each of four quarters during FY 2009 to capture customer ratings of satisfaction with market dominant products. Existing survey processes were leveraged to optimize resources and outreach to the Postal customer base. Each potential respondent received an invitation to participate in an online survey, either by mail for large commercial customers or on their Point of Sale (POS) receipt from their visit to a Post Office for retail customers. The invitation contained instructions and a website address for the customer to visit if they chose to participate in the online survey. Each of the two surveys contained the same question set and language for satisfaction with market dominant products. Respondents were first asked if they had ever used the market dominant product. Then, those who answered affirmatively were asked to rate their satisfaction with each product selected, using a five-point adjectival rating scale for the following response categories: Excellent, Very Good, Good, Fair or Poor.

In contrast to the one time panel study conducted in FY 2008 for Residential and Small Business customers, the POS receipt invitation survey approach was well positioned to reach out to this customer base that frequently visits Post Offices (and other postal retail units) to purchase products and services. General Customer Satisfaction survey data collected during FY 2009 indicate that about 81 percent of Residential customers and 82 percent of Small Business customers visit the Post Office at least one a month. In addition, about 25 percent of both Residential customers and Small Business customers reported visiting the Post Office 3 to 5 times per month. Increased frequency and outreach made the POS receipt invitation survey a good business choice to achieve the goal of measuring satisfaction with market dominant products during a year of transition.

Survey Results -- Ratings for Market Dominant Products During FY 2009

The Gallup Organization obtained a total of about 5,400 completed surveys for Large Business customers, and 5,700 completed surveys for Residential and Small Business customers throughout the year. The number of responses by question varied based on product usage with First-Class Mail, Standard Mail, and Single-Piece Parcel Post being most widely used across both segments. Generally, Large Business customers cited reliability and value for the price most often when describing the reason for rating each product at the level reported. In contrast, Residential and Small Business customers cited reliability of service most often as their reason for rating, followed by a fairly even distribution of such additional reasons as accuracy of delivery, speed of delivery and value for the price. The difference in descriptions of the reason for customer ratings is due to the primary role of Large Business customers as senders of mail and Residential/Small Business customers as receivers of mail. Individual product ratings by customer survey type are presented in the narrative below. For simplicity of presentation, combined Excellent, Very Good and Good ratings will be referred to "favorable ratings" in the narrative below. Additional tables are provided with more detailed results by response categories for FY 2009 in USPS-FY09-38.

First-Class Mail — 77.4 percent of Residential/Small Business customers and 94.1 percent of Large Business customers reported favorable ratings of First-Class Mail service. The combined average favorable rating score for First-Class Mail service was 85.7 percent for FY 2009. First-Class Mail is the most widely used market dominant product based on customer survey self-identified usage across customer segments.

Standard Mail — 76.5 percent of Residential/Small Business customers and 90.8 percent of Large Business customers reported favorable ratings of Standard Mail service. The combined average favorable rating score for Standard Mail service was 83.7 percent for FY 2009.
Periodicals — 83.6 percent of Residential/Small Business customers and 87.1 percent of Large Business customers reported favorable ratings of Periodicals service. The combined average favorable rating score for Periodicals service was 85.4 percent for FY 2009.
Single-Piece Parcel Post — 76.6 percent of Residential/Small Business customers and 90.8 percent of Large Business customers reported favorable ratings of Single-Piece Parcel Post service. The combined average favorable rating score for Single-Piece Parcel Post service was 83.7 percent for FY 2009.
Media Mail — 83.4 percent of Residential/Small Business customers and 91.3 percent of Large Business customers reported favorable ratings of Media Mail service. The combined average favorable rating score for Media Mail service was 87.3 percent for FY 2009.
Bound Printed Matter — 84.9 percent of Residential/Small Business customers and 88.0 percent of Large Business customers reported favorable ratings of Bound Printed Matter service. The combined average favorable rating score for Bound Printed Matter service was 86.4 percent for FY 2009.
Single-Piece International Mail — 78.0 percent of Residential/Small Business customers and 92.0 percent of Large Business customers reported favorable ratings of Single-Piece International Mail service. The combined average favorable rating score for Single-Piece International Mail service was 85.0 percent for FY 2009.
Library Mail — 86.7 percent of Residential/Small Business customers and 93.9 percent of Large Business customers reported favorable ratings of Library Mail service. The combined average favorable rating score for Library Mail service was 90.3 percent for FY 2009. Library Mail has the lowest frequency of self-identified usage for market dominant products based on customer survey results across customer segments.

Comparison of Results Across Fiscal Years

Ratings between FY 2008 and FY 2009 are visibly different at face value. Changes in survey methodology, mode and frequency may be the source of some of the differences in results for product ratings when comparing year to year for both combined results and results by customer groupings. For example, the telephone survey mode used for most of the Large Commercial Business customer interviews during FY 2008 may be contrasted with the online survey mode that was adopted in FY 2009 to reduce cost and optimize the final year of CSM survey operations. Industry research indicates that surveys conducted by telephone interview tend to yield more favorable results than online or paper surveys. Therefore, this mode effect may have contributed to the differences in rating scores across the two fiscal years being compared for Large Commercial Business customers. While differences in scores may have resulted from changes in methodology, mode or approach in each survey conducted for Residential/Small Business and Large Commercial Business customers, it should also be noted that the interim approach adopted in FY 2009 represents an evolution of measurement during a year of transition that expanded outreach and frequency of measure for the entire customer base.

Measurement of Satisfaction with Market Dominant Products for FY 2010.

The Postal Service has implemented a new approach in FY 2010 for measuring the customer experience and satisfaction with products and services. The Customer Experience Measurement (CEM) program will expand the measure of satisfaction with market dominant products into each of three ongoing surveys of randomly selected Residential, Small/Medium Business, and Large Business customer segments. The approach adopted under the new CEM program is expected to yield more distinctive and representative results for satisfaction across the three customer segments. Once again, survey results from FY 2009 may not be strictly comparable to survey results for FY 2010, but the benefits gained through the evolution of the measurement process will outweigh comparability through the more representative nature of the results.

E. Product Analysis

FIRST-CLASS MAIL

First-Class Mail is considered by many as the “flagship” product of the Postal Service. Any matter eligible for mailing (except Standard Mail entered as Customized Market Mail) is eligible for mailing via First-Class Mail service. A critical feature of First-Class Mail is that it is confidential and sealed against postal inspection except as authorized by law. This product is used by households for personal and business correspondence and transactions such as bill-paying. Business users may choose First-Class Mail because of its reliability and service standard, which is higher than Standard Mail and the other market dominant mail classes. Mail containing personal information is required to be sent First-Class Mail, Express Mail, or Priority Mail, unless it meets the Standard Mail, Periodicals, or Package Services preparation requirements for incidental First-Class Mail attachments or enclosures. Express Mail and Priority Mail, designated as competitive products, are more expensive and offer equal or faster service or other features.

Presort prices are available to First-Class Mail customers mailing letters, postcards, flats and parcels with a minimum volume requirement of 500 pieces per mailing. Presort Letters and Cards has more volume than any other in the product and includes incentives to reduce costs and increase efficiency through worksharing, which is discussed in more detail in Section II.F.

Overall First-Class Mail volumes declined at a faster pace in 2009 than in any other year since the Postal Reorganization of 1971. First-Class Mail volumes were most significantly affected by the economic recession but electronic diversion, which is an ongoing structural problem, continued to erode mail usage.

In FY 2009, First-Class Mail volume declined an unprecedented 7.9 billion pieces or 8.6 percent. Single-Piece Letters and Cards volume declined by 10.5 percent or 3.7 billion pieces, while Presort Letters and Cards declined by 7.7 percent or approximately 4 billion pieces. By far the biggest percentage decline was in Flats (15.2 percent), although the overall volume is relatively small for this product.

The cost coverage for First-Class Mail is generally higher than other market dominant classes and, of all mail classes, First-Class Mail traditionally has made the highest contribution to covering institutional costs due to the combination of the high volume of First-Class Mail and its high cost coverage. This is a reflection of the high value of service in terms of delivery, privacy, and other features of First-Class Mail. In addition, many ancillary services are available to First-Class Mail customers. By providing a high-value service to both consumer and business customers, First-Class Mail also promotes the public policies of title 39.

The pricing for Single-Piece Letters and Cards is important to ensuring the simplicity of the price structure and maintaining identifiable relationships among the various classes of mail for postal services. Given the value of First-Class Mail, the higher coverage was deemed by the Commission to be appropriate in the prior pricing regime, and remains appropriate. The continued health of First-Class Mail is of critical importance to the Postal Service, both to assure adequate revenues and, given its large volume and contribution, to help create price predictability and stability by providing a solid and reliable base.

Table 1: First-Class Mail Volume, Revenue, and Cost by Product								
Product	Volume (Million)	Revenue ($Million)	Attribu-table Costs ($Million)	Contri-bution ($Million)	Revenue / Piece ($)	Cost / Piece ($)	Unit Contri-bution ($)	Cost Cover-age (%)
Single-Piece Letters/Cards	31,633	13,754	8,342	5,411	0.435	0.264	0.171	164.9
Presorted Letters/Cards	47,934	16,282	5,607	10,675	0.340	0.117	0.223	290.4
Flats	2,684	3,540	2,158	1,382	1.236	0.753	0.483	164.1
Parcels	581	1,114	1,095	19	1.918	1.886	0.032	101.7
Domestic NSA First-Class mail *	301	99	38	61	0.329	0.127	0.202	258.7
First-Class Mail fees		167						
Total Domestic First-Class Mail (incl. fees)	83,314	34,955	17,240	17,715	0.420	0.207	0.213	202.8
Outbound Single-Piece First-Class Mail Int'l	456	756	468	288	1.657	1.026	.631	161.6
Inbound Single-Piece First-Class Mail Int'l	440	161	267	(105)	0.367	0.606	(0.239)	60.5
Total First-Class Mail	84,210	35,873	17,975	17,898	0.426	0.213	0.213	199.6

* NSA First-Class Mail volume is included in Table 1 to match First-Class volumes reported elsewhere in this filing. NSAs are discussed separately under the heading of Negotiated Service Agreements.

As shown in Table 1, in FY 2009, First-Class Mail covered its attributable costs, and made a significant contribution toward the Postal Service's institutional costs. In the most recent price adjustment for First-Class Mail (Docket No. R2009-2), the weighted average class price increase was 3.770 percent, within the cap of 3.8 percent.

First-Class Mail Products

First-Class Mail has six products: Single-Piece Letters/Postcards; Presorted Letters/Postcards; Flats; Parcels; Outbound First-Class Mail International; and Inbound Single-Piece First-Class Mail. Table 1 shows that (with the exception of Inbound

Single-Piece First Class Mail) each of these products covered its attributable costs and made a contribution to institutional costs during FY 2009.

1. Single-Piece Letters/Postcards

This product consists of letter-shaped single-piece First-Class Mail and single-piece First-Class Mail cards. The cost coverage for this product in FY 2009 was 164.9 percent, which is reasonable given the value of First-Class Mail service. However, this product has experienced large volume drops, larger than the First-Class Mail class average. As discussed above, the generally poor economic environment and the ready availability of electronic alternatives are the primary reasons for this decline.

2. Presorted Letters/Cards

This product consists of letter-shaped presorted First-Class Mail, and presorted First-Class Mail cards. As noted above, the minimum volume requirements for eligibility is 500 pieces per mailing.

The cost coverage for First-Class Mail Presorted Letters/Cards was 290.4 percent, which is reasonable given the value that this product accords to business mailers who meet the presort requirements. In FY 2009 product volume declined 7.7 percent. While it is the largest product within First-Class Mail, continued presort volume declines create significant financial concerns for the Postal Service. The First-Class Mail Fall Incentive program was designed to help maintain and encourage presort volume, and the Postal Service is looking at other programs to promote use of Presorted First-Class Mail Letters and Cards.

In Docket No. R2009-2, the Postal Service increased prices for presort mail by 3.02 percent, which was less than the price cap of 3.8 percent. To provide additional options for customers, some presortation requirements were made optional.

The passthroughs for all categories were near 100 percent in the development for the prices implemented in May 2009 [Notice of Market-Dominant Price Adjustment filed on February 10, 2009]. Worksharing in First-Class Mail is discussed further in Section II.F of this report.

3. Flats

The First-Class Mail Flats product includes both single-piece and bulk mailings. Although most mail in this category is single-piece, presort prices are offered for Mixed ADC, ADC, 3-digit, and 5-digit sortation. Worksharing in First-Class Mail is discussed further in Section II.F of this report.

The product's cost coverage was 164.1 percent.

4. Parcels

The First-Class Mail Parcels product includes both single-piece and presort parcels (5-digit, 3-digit, ADC). Most parcels are mailed at single piece prices. Worksharing in First-Class Mail is discussed further in Section II.F of this report.

The product's cost coverage was 101.7 percent.

5. Outbound Single-Piece First-Class Mail International

Outbound First-Class Mail International consists of Single-Piece Letters, Postcards, Flats, and Parcels. The product's cost coverage was 161.6 percent in FY 2009.

6. Inbound Single-Piece First-Class Mail International

Inbound Single-Piece First-Class Mail International consists of single-piece Letters, Postcards, Flats, and Parcels sent from foreign postal administrations for delivery in the U.S. The Postal Service does not independently determine these rates. Over a four-year period, rates for this product are set according to a Universal Postal Union (UPU) terminal dues formula established in the Universal Postal Convention. Because the UPU flat rate per kilogram and domestic rate-referencing formula are not cost-based, the FY 2009 cost coverage for this product was 60.5 percent. Nevertheless, the Postal Service is examining the merits of undertaking to improve cost coverage via bilateral agreements for some of its largest flows in the coming calendar year. Further, new, higher terminal dues rates under the Universal Postal Convention will go into effect on January 1, 2010.[7]

STANDARD MAIL

Standard Mail is primarily used by businesses for advertising purposes. The class is also used by nonprofit customers for fundraising activities. It consists mainly of circulars and catalogs, but also includes some merchandise. Any item whose content is not unique to the recipient can be sent using Standard Mail. Standard Mail is a

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[7] In addition, Inbound Single-piece First-Class Mail International at Non-UPU Rates are the result of a negotiation with Canada Post Corporation. New, higher rates were implemented in January 2009 in Docket No. R2009-1, and so the first quarter of the fiscal year would have been tendered at lower rates. The Postal Service is once again proposing an increase in southbound letter post from Canada in Docket No. R2010-2 to begin in January 2010. As shown in workpapers presently before the Commission, the financial performance for this product is estimated to be above cost for the 12 month period beginning January 2010.

commercial bulk mail class and requires a permit and a minimum of 200 pieces or 50 pounds of mail per mailing. Standard Mail pieces must weigh less than 16 ounces and must be presorted.

Standard Mail provides a lower level of service, speed and privacy, and requires greater mailer preparation, than First-Class Mail, and mail processing and delivery can be deferred to meet the Postal Service's operational needs. Consistent with its lower value of service, mailers pay lower prices than for First-Class Mail. In general, business mailers use Standard Mail to send items of lower intrinsic importance and value as well as items that do not require expeditious delivery, taking advantage of the class's lower prices. And, while Standard Mail has a complex pricing structure, its principal users are sophisticated businesses that are able to handle that complexity. Moreover, the complexity of the pricing structure allows the Postal Service to flexibly tailor pricing to meet the complex needs of its customers—thereby encouraging mail use—and to encourage efficient use of the mail.

Table 2: Standard Mail Volume, Revenue, and Cost by Product

Product	Volume (Million)	Revenue ($Million)	Attributable Costs ($Million)	Contribution ($Million)	Revenue / Piece ($)	Cost / Piece ($)	Unit Contribution ($)	Cost Coverage (%)
HD / Sat. Letters	5,085	682	318	364	0.134	0.063	0.072	214.4
HD / Sat. Flats & Parcels	12,357	1,972	826	1,146	0.160	0.067	0.093	238.8
Carrier Route	9,857	2,272	1,578	694	0.231	0.160	0.070	144.0
Letters	46,224	8,710	5,033	3,677	0.188	0.109	0.080	173.2
Flats	7,794	2,866	3,488	(622)	0.368	0.448	(0.080)	82.2
Parcels & NFMs	679	632	840	(208)	0.931	1.237	(0.306)	75.2
Domestic NSA Standard Mail *	710	142	89	54	0.200	0.125	0.075	160.3

Standard Mail Fees		88						
Total Standard Mail (incl. fees)	82,706	17,364	12,172	5,192	0.210	0.147	0.063	142.7
Former Regular & Nonprofit Regular **	55,032	12,271			0.223			
Former ECR & Nonprofit ECR **	27,299	4,926			0.180			

* NSA Standard Mail volume is included in Table 2 to match Standard Mail volumes reported elsewhere in this filing. NSAs are discussed separately under the heading of Negotiated Service Agreements.
** These are included to allow comparison with former subclass-level data.

As shown in Table 2, in FY 2009 Standard Mail covered its attributable costs and made a significant contribution toward covering the Postal Service's institutional costs. In May 2009, Standard Mail prices on average were increased by 3.781 percent, within the Standard Mail cap of 3.862 percent (including banked authority from 2008). Standard Mail is used by both commercial mailers and by qualified nonprofit mailers who receive preferred pricing. By law, when the Postal Service adjusts Standard Mail prices, the average revenue per piece for Standard Mail sent by nonprofit mailers must be 60 percent of the average revenue per piece for Standard Mail sent by commercial customers. When the Postal Service adjusted its prices in May 2009, the ratio was 60.2 percent. For all of FY 2009 the ratio was 59.9 percent.

In FY2009 Standard Mail instituted separate pricing for the Full Service Intelligent Mail program.[8] All non-parcel-shaped Standard Mail (except Saturation flats) which meet specific barcode and other requirements may elect this pricing.

[8] Although notice of the pricing and Commission review occurred in FY 2009, implementation of the full service IMb pricing did not begin until FY 2010.

Standard Mail Products

The Standard Mail class has six products: Letters; Flats; NFMs and Parcels; Carrier Route Letters, Flats and Parcels; High Density and Saturation Letters; and High Density and Saturation Flats and Parcels. Each product includes both commercial and nonprofit mail. Table 2 shows that each of these products, except Flats and NFMs/Parcels, covered its attributable costs and made a contribution toward institutional costs. In both of the last two fiscal years, these two products did not cover costs. This is of concern to the Postal Service; however, FY 2009 was an extremely difficult year economically for the Postal Service as a whole, and for Standard Mail in particular. Every Standard Mail product suffered a loss in its cost coverage in FY 2009 compared to FY 2008.

This difficult economy presents challenges for customers. Price increases, however, were limited by the price cap. Additional price increases may cause further erosion of volume. The Postal Service must move carefully to ensure that there is no further weakening of Standard Mail.

The following sections discuss each product in greater detail. Cost coverages by product are noted in each product section below.

1. High Density and Saturation Letters

The Standard Mail High Density and Saturation Letters product is used by businesses to send geographically targeted messages to potential customers. It is used to communicate messages that do not require the most expeditious, and therefore more expensive, mail processing and delivery. Consistent with this lower level of service, its prices are below the prices for First-Class Mail Letters. High Density and Saturation

Letters serve an advertising market in which business customers have many alternative options to convey their messages. The Postal Service has long recognized this fact when pricing this product. To retain and grow the volume of High Density and Saturation Letters, the Postal Service has maintained its price below the price of regular Standard Mail Letters, despite the fact that both categories of letters are increasingly processed and delivered via the same channels.

In recognition of its market characteristics, the Postal Service increased High Density and Saturation Letters prices an average of 1.248 percent in May 2009, well below the average increase for Standard Mail. This product has the lowest overall price offered by the Postal Service to send advertising mail. Nevertheless, based upon FY 2009 costs, the High Density and Saturation Letters product covered its attributable costs with a coverage of 214.4 percent, thereby making a contribution toward the Postal Service's institutional costs.

High Density and Saturation Letters are eligible for price discounts for drop shipping. Mailers who do this extra work pay lower prices consistent with the costs their worksharing avoids for the Postal Service. In the most recent price adjustment for High Density and Saturation Letters in May 2009, the passthroughs of the drop ship avoided costs for High Density and Saturation Letters were all below avoided costs. Worksharing in Standard Mail is discussed further in Section II.F of this report.

The Standard Mail High Density and Saturation Letters product meets the public's need for a business-oriented, lower value, lower priced alternative to First-Class Mail letters to reach geographically concentrated customers with advertising messages. The product is reasonably and fairly priced for the value its customers receive, bears a fair share of the institutional cost burden of the Postal Service, and is available to business customers without undue discrimination. Therefore, Standard Mail High Density and Saturation letters promote the policy goals of title 39.

2. High Density and Saturation Flats/Parcels

The Standard Mail High Density and Saturation Flats and Parcels product is used by businesses predominantly to send geographically targeted messages to potential customers. It is also used occasionally to distribute product samples to geographically concentrated markets. This product is used to communicate messages or deliver samples that do not require the most expeditious, and therefore more expensive, mail processing and delivery. Consistent with this lower level of service, its prices are below the prices for First-Class Mail flats and parcels. High Density and Saturation Flats and Parcels serve an advertising market in which business customers have many alternative options to convey their messages or distribute samples. The Postal Service has long recognized this fact when pricing this product.

In recognition of its market characteristics, the average price of High Density and Saturation Flats and Parcels was increased by 2.233 percent in the May 2009 price adjustment, below the average increase for Standard Mail.[9] This product has the lowest overall price offered by the Postal Service to send advertising flats or product samples. Nevertheless, based upon FY 2009 costs, the High Density and Saturation Flats and

[9] After filing the notice of price adjustment for all Standard Mail in February, the Postal Service revised High Density Flats prices in response to mailers' concerns. In July, the Postal Service reduced High Density Flats prices from an overall increase of 6.3 percent to 4.1 percent, closer to the average increase for Standard Mail (See Docket No. R2009-4).

Parcels product covered its attributable costs with a coverage of 238.8 percent, thereby making a reasonable contribution toward the Postal Service's institutional costs.

High Density and Saturation Flats and Parcels are eligible for price discounts for drop shipping. Mailers who do this extra work pay lower prices consistent with the costs their worksharing avoids for the Postal Service. In the most recent Standard Mail price adjustment in May 2009, the passthroughs of the drop ship avoided costs for High Density and Saturation Flats were below 100 percent, and the passthroughs for High Density and Saturation Parcels were above 100 percent.[10] The Commission found that the High Density and Saturation Flats and Parcels price changes were consistent with the standards of the PAEA. Worksharing in Standard Mail is discussed further in Section II.F of this report.

The Standard Mail High Density and Saturation Flats and Parcels product meets the public's need for a business-oriented, lower value, lower priced alternative to First-Class Mail flats and parcels options to reach geographically concentrated customers with advertising messages and lightweight merchandise samples. High Density and Saturation Flats and Parcels are required to be sequenced in delivery order (or to be addressed using sequenced detached address labels), allowing the Postal Service to deliver them more efficiently. The product is reasonably and fairly priced for the value its customers receive; it bears a fair share of the institutional cost burden of the Postal Service; and is available to business customers without undue discrimination.

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[10] These passthroughs were measured using Standard Mail average avoided costs, following the Commission-approved methodology. Since that time the Commission has approved a revised methodology that gives drop ship avoided costs by shape. The discounts for High Density and Saturation parcels were below parcel-specific drop ship avoided costs.

Therefore, Standard Mail High Density and Saturation flats and parcels promote the policy goals of title 39.

3. Carrier Route (Letters, Flats and Parcels)

Although it also includes both letter- and parcel-shaped mail, the Standard Mail Carrier Route product consists predominantly of catalogs and other advertising flats sent by businesses and having a minimum address density of ten pieces per carrier route. There are relatively few letters and almost no parcels in this product.

The Carrier Route product allows businesses to send customers promotional material that does not require the most expeditious mail processing and delivery. This allows the Postal Service to reduce its costs compared to products like First-Class Mail letters, flats, and parcels; consistent with these lower costs, Standard Mail Carrier Route prices are lower than the prices for similarly-shaped First-Class Mail. Although mail pieces in this product are required to be presorted by carrier routes, delivery point sequencing has reduced the value of carrier route presorting for letters. The planned deployment of FSS equipment is expected to have similar consequences for flat-shaped mail also. This calls into question the current large price differences between Carrier Route mail pieces and similar pieces in the most heavily presorted categories of other Standard Mail products.

Carrier Route mail pieces are eligible for drop shipping discounts. Mailers who do this extra work pay lower prices consistent with the costs their worksharing avoids for the Postal Service. In the most recent price adjustment for Standard Mail, in May 2009, the passthroughs of the drop ship avoided costs for Carrier Route letter- and flat-shaped mail pieces were all below 100 percent whereas the passthroughs for parcel-shaped pieces were at or above 100 percent based on average Standard Mail avoided costs (see footnote 3). The Commission found that the Standard Mail Carrier Route Letters, Flats and Parcels price changes were consistent with the standards of the PAEA. Worksharing in Standard Mail is discussed further in Section II.F of this report.

In the May 2009 price adjustment, Standard Mail Carrier Route pieces received an increase of 4.310 percent, above the average increase for Standard Mail as a whole, but higher than the increase for the Standard Mail Flats product. The higher increase for Carrier Route recognized, in part, that the price gap between Carrier Route Flats and regular Flats was out of alignment, given the similar content of the two products and the anticipated reduced value of the carrier route presorting. Although slightly above the average, this increase balanced the need to avoid rate shock and the need for greater efficiency.

Table 2 shows that, based upon FY 2009 costs, the Carrier Route Letters, Flats, and Parcels product covered its attributable costs with a cost coverage of 144.0 percent. This cost coverage shows that the Carrier Route product made a reasonable contribution toward the Postal Service's institutional costs.

The Standard Mail Carrier Route Letters, Flats and Parcels product helps to meet the need for a business-oriented, lower value, lower priced alternative to First-Class Mail letters, flats and parcels. The Standard Mail Carrier Route product is reasonably and fairly priced for the value its customers receive, bears a fair share of the institutional cost burden of the Postal Service, and is available to business customers without undue discrimination. Therefore, this product promotes the policy goals of title 39.

4. Letters

The Standard Mail Letters product is used primarily for demographically targeted advertising, including fundraising by nonprofit organizations. It provides a way for businesses to communicate with customers, or potential customers, that does not require the most expeditious, and therefore, more expensive, mail processing and delivery. Consistent with these features, its prices are below the prices for First-Class Mail letters. In the May 2009 price adjustment, Standard Mail Letters received an increase of 3.829 percent. This increase, only slightly above the average increase for Standard Mail as a whole, should not have caused rate shock or any undue hardship for letters mailers. Based upon FY 2009 costs, the Letters product covered its attributable costs with a coverage of 173.2 percent, thereby making a reasonable contribution toward the Postal Service's institutional costs.

Standard Mail Letters are eligible for price discounts for presorting, prebarcoding and drop shipping. Mailers who do this extra work pay lower prices consistent with the costs their worksharing avoids for the Postal Service. In the most recent price adjustment for Standard Mail Letters in May 2009, the passthroughs of the worksharing avoided costs for Standard Mail Letters were all at or below 100 percent. The Commission found that the Standard Mail Letters price changes were consistent with the standards of the PAEA. Worksharing in Standard Mail is discussed further in Section II.F of this report.

Overall, the Standard Mail Letters product meets the public's need for a business-oriented, lower value, lower priced alternative to First-Class Mail letters. Standard Mail Letters' pricing meets all the requirements specific to this product described in the law. The Standard Mail Letters product is reasonably and fairly priced for the value its customers receive, bears a fair share of the institutional cost burden of the Postal Service, and is available to business customers without undue discrimination. Therefore, Standard Mail letters promote the policy goals of title 39.

5. Flats

The Standard Mail Flats product consists primarily of advertising flyers and catalogs that are demographically targeted. It is primarily used by businesses selling merchandise and for fundraising by nonprofit organizations. Like Standard Mail Letters it allows businesses to send existing or potential customers promotional material that does not require the most expeditious, and therefore, more expensive, mail processing and delivery. Consistent with these features, Standard Mail Flats prices are below the prices for First-Class Mail flats. In the May 2009 price adjustment, Standard Mail Flats received an increase of 2.306 percent. This increase, which was below the average increase for Standard Mail as a whole (3.781 percent), considered the substantial 2007 price increases for Standard Mail Flats and recognized the difficult economic challenges faced by the catalog industry. The Postal Service, in announcing this modest increase, also considered alternatives that catalog mailers have to contact their customers.

Table 2 shows that the Flats product had a cost coverage of 82.2 percent in FY 2009. The Postal Service believes that future pricing and product actions need to take these data into consideration to ensure that this product covers its costs and makes an appropriate contribution toward institutional costs. Again, this year presented extraordinary economic challenges. The 22 percent volume drop for Flats played a large role in the financial fortunes for this product, which makes it even more important that the Postal Service move with discretion when attempting to shore up the Flats coverage. It must consider the health of the industry and pursue a long run approach to address the issue. The fact that Flats volume dropped more than Letters, even though Letters had the larger price increases, bolsters the argument that these groupings are indeed distinct products, and that ECP principles should, at the most, be considered as one factor in context of other pricing considerations when setting prices based on shape.

Standard Mail Flats are eligible for price discounts for presorting, prebarcoding and drop shipping. Mailers who do this extra work pay lower prices consistent with the costs their worksharing avoids for the Postal Service. In Docket No. R2009-2, the Commission found that the Standard Mail Flats price changes were consistent with the standards of the PAEA. Worksharing in Standard Mail is discussed further in Section II.F of this report.

The Standard Mail Flats product meets the public's need for a business-oriented, lower value, lower priced alternative to First-Class Mail flats. The Standard Mail Flats product is available to customers without undue discrimination, and promotes the policy goals of title 39.

6. Parcels and Non-Flat Machinables (NFMs)

The Standard Mail Parcels and NFMs product consists of parcel-shaped pieces that do not meet the eligibility standards for letters or flats. It is primarily used by businesses fulfilling merchandise orders and for fundraising by nonprofit organizations. Like other Standard Mail products, it provides an option for businesses to send customers merchandise and promotional material that do not require the most expeditious, and therefore more expensive, mail processing and delivery. Consistent with these features, Standard Mail Parcels and NFMs prices are below the prices for First-Class Mail and Priority Mail parcels.

In the May 2009 price adjustment, Standard Mail Parcels and NFMs prices increased 16.425 percent on average. This increase was well above the average increase for Standard Mail as a whole (3.781 percent), and was given because the Postal Service was concerned that Standard Mail parcel-shaped pieces were not adequately covering their attributable costs. As seen in Table 2, the concerns were justified. Based upon FY 2009 costs, the Parcels and NFMs product coverage was 75.2 percent. The Postal Service believes that future pricing and product actions need to take these data into consideration to ensure that this product covers its costs and makes an appropriate contribution toward institutional costs.

Like other Standard Mail products, Parcels and NFMs are eligible for price discounts for presorting, prebarcoding, and drop shipping. Mailers who undertake this extra work pay lower prices consistent with the costs their worksharing avoids for the Postal Service. In Docket No. R2009-2, the Commission found that the Standard Mail Parcels and NFMs price changes were consistent with the standards of the PAEA. Worksharing in Standard Mail is discussed further in Section II.F of this report.

The Standard Mail Parcels and NFMs product meets the public's need for a business-oriented, lower value, lower priced alternative to First-Class Mail and Priority Mail parcels. It is available to customers without undue discrimination, and promotes the public policy goals of title 39.

Standard Mail Incentive Programs

Saturation Mail Incentive Program: The Saturation Mail Incentive Program began with the price change on May 11, 2009. Over 330 customers registered for the program, but because it is based on total annual volumes, the results of the program are not yet known. Based on preliminary pro-forma analysis of data through the end of FY 2009, however, approximately one-third of the customers were on pace to earn rebates. Many of these customers appear to have taken advantage of the opportunity to expand their campaigns into new markets. In fact, some particularly rapid growers had already exceeded their annual thresholds by the end of FY 2009, even though less than half of the program period had elapsed. If current trends continue, rebates are expected to be paid on volume equivalent to about 37 percent of the threshold volume of customers who qualify, or approximately 10 percent of total participating volume.

Standard Mail Volume Incentive Pricing Program: The Standard Mail Volume Incentive Pricing Program (the “Summer Sale”) ran between July 1 and September 30, 2009. The Postal Service is still verifying volumes and paying rebates, but expects to file the data collection report requested by the Commission in late January. Preliminary results indicate that over 902 million pieces over volume thresholds were mailed by nearly 800 customers. The Postal Service has paid, or anticipates paying, $65 million in rebates on postage of $143 million for those pieces. An estimated 530 million of these pieces were incremental, while the remainder would have been sent in the absence of an incentive. This represents about $55 million in new revenue to the Postal Service and also provided a boost to customers during a severe economic downturn.

PERIODICALS

The Periodicals Mail class consists of magazines, newspapers, or other periodicals that meet the specific criteria for eligibility, including applicable editorial content, circulation, advertising, and other requirements established by law. Eligible publications include general publications, publications requested by the recipient, and publications of institutions and various government agencies, as well as foreign publications. The Periodicals Mail class exists as a preferred class of mail because of periodicals' high intrinsic worth, specifically their educational, cultural, scientific, and informational value, which benefits both individuals and society.

In the most recent price adjustment in Docket No. R2009-2, Periodicals prices increased by 3.961 percent. The increase is slightly greater than the CPI-U cap of 3.8 percent because it reflects the Postal Service's decision to use most of the banked (unused) price adjustment authority generated in the previous year's annual adjustment for Periodicals (Docket No. R2009-2, Notice of Market Dominant Price Adjustment, p. 32). However, Periodicals Mail has not been covering its attributable costs, and the cost coverage declined further in FY 2009. This presents a challenge to the Postal Service and mailers, since the Periodicals class does not satisfy section 3622(c)(2) of title 39, and publishers' margins are typically very low. In addition, the industry itself is facing challenges such as electronic alternatives, the high costs of paper and other nonpostal costs, and a substantial decline in advertising during the current economic downturn.

The Postal Service, Periodicals publishers and mailers, and the Commission have recognized the special role and current situation of Periodicals. The Postal Service continues to pursue operational efficiencies, as well as opportunities to fine-tune prices that signal the appropriate level of cost-reducing behavior.[11]

Table 3: Periodicals Mail Volume, Revenue, and Cost by Product

Product	Volume (Million)	Revenue ($Million)	Attribu-table Costs ($Million)	Contri-bution ($Million)	Revenue / Piece ($)	Cost / Piece ($)	Unit Contri-bution ($)	Cost Cover-age (%)
Within County Periodicals	859	91	105	(14)	0.105	0.122	(0.017)	86.3
Outside County Periodicals	7,094	1,932	2,575	(643)	0.272	0.363	(0.091)	75.0
Fees		15						
Total Periodicals Mail (incl.fees)	7,953	2,038	2,680	(642)	0.256	0.337	(0.081)	76.1

Periodicals Products

The Periodicals Mail class has two products: Within County Periodicals and Outside County Periodicals. Table 3 shows that neither product covered its attributable costs in FY 2009, and that total Periodicals' coverage was 76.1 percent. As discussed above, efforts are underway to determine what steps can be taken to improve Periodicals' contribution. As with the Standard Flats product, the precipitous volume decline exacerbated the financial situation for these products. Although Periodicals is challenged in terms of cost coverage, its important role in allowing for dissemination of educational, cultural, scientific, and information value to the recipient of mail matter is vital, and promotes the public policies of title 39.

[11] As announced on October 15, 2009, the Postal Service will not increase prices for market dominant products in calendar year 2010.

1. Within County Periodicals

Within County Periodicals prices are lower than Outside County prices. Within County prices are available for Periodicals that are entered in the county where they are published for delivery within that county. Other detailed requirements apply.

As shown in Table 3, Within County Periodicals' cost coverage was 86.3 percent in FY 2009.

2. Outside County Periodicals

Periodicals Mail that is not eligible for Within County Periodicals prices must pay Outside County prices. Certain categories, such as Nonprofit, Classroom, or Science of Agriculture publications, are separately authorized to qualify for Periodicals prices. Given the general societal benefit of information dissemination, discussed above, there are other special provisions, including a discount for certain Outside County periodicals of limited circulation.

As shown in Table 3, Outside County Periodicals' cost coverage was 75.0 percent in FY 2009.

PACKAGE SERVICES

The Package Services class is comprised primarily of parcels and mainly used to ship merchandise packages, but it also includes some catalogs and other bound printed items that are too heavy to be sent as Standard Mail. Any item that is not required to be sent as First-Class Mail, or to be entered as Periodicals, can be sent using one or more of the Package Services products. Package Services is used by both commercial mailers and by households, and has products and mail categories designed to meet the needs of each group of mailers. Package Services mail may weigh up to 70 pounds, except for mail entered as Bound Printed Matter Parcels or Bound Printed Matter Flats, which have lower, 15-pound, weight limits.

Package Services products provide a lower level of service and speed, and in some cases require greater mailer preparation than First-Class Mail, and mail processing and delivery can be deferred to meet the Postal Service's operational needs. Package Services mail can also be opened for postal inspection. Consistent with this lower value of service, mailers receive lower prices than First-Class Mail and Priority Mail. In general, mailers often use Package Services products to send items of lower intrinsic value and importance as well as items that do not require expeditious delivery, taking advantage of the class's lower prices.

In May 2009 Package Services prices increased 3.800 percent. This increase was only slightly below the class 3.825 percent cap (including available banked authority). As shown below in Table 4, the Package Services class failed to cover its attributable costs in FY 2009. The cost coverage for the domestic products in the class as a whole was 96.9 percent.

Table 4: Package Services Volume, Revenue and Cost by Product

Product	Volume (Million)	Revenue ($Million)	Attributable Costs ($Million)	Contribution ($Million)	Revenue / Piece ($)	Cost / Piece ($)	Unit Contribution ($)	Cost Coverage (%)
Single-Piece Parcel Post	81	699	761	(62)	8.663	9.432	(0.769)	91.9
Bound Printed Matter Flats	239	206	119	87	0.865	0.498	0.367	173.7
Bound Printed Matter Parcels	271	363	371	(8)	1.340	1.371	(0.032)	97.7
Media Mail/Library Mail	140	397	472	(75)	2.836	3.371	(0.535)	84.1
Fees		4						
Inbound Surface	0.9	12.9	12.3	0.6	14.664	13.951	0.712	105.1

Parcel Post								
Total Package Services Mail (incl. fees)	731	1,683	1,736	(53)	2.286	2.360	(0.074)	96.9

Package Services Products

The Package Services mail class has five products: Single-Piece Parcel Post; Bound Printed Matter Flats; Bound Printed Matter Parcels; Media Mail/Library Mail; and Inbound Surface Parcel Post (at UPU rates). Three of the four domestic products (Single-Piece Parcel Post, BPM Parcels and Media Mail) had cost coverages below 100 percent, leading Package Services to fail to cover its attributable costs for the first time. Among the domestic products, only BPM Flats covered its costs.

1. Single-Piece Parcel Post

Any mailable matter that is not required to be sent using First-Class Mail, or to be entered as Periodicals, can be sent using Single-Piece Parcel Post. This product meets the needs of businesses and households for a lower cost way to ship parcels that do not require the most expeditious, and therefore more expensive, mail processing and delivery. Consistent with this lower value of service, the prices for Single-Piece Parcel Post are below the prices for retail Priority Mail. In the May 2009 price adjustment, Single-Piece Parcel Post received an increase of 4.45 percent. This was slightly higher than the average increase for Package Services (3.8 percent) because the Postal Service was concerned that Single-Piece Parcel Post was not adequately covering its costs. Table 4 shows that Single Piece Parcel Post had a coverage of 91.9 percent in FY 2009. This was little changed from the previous fiscal year (91.8 percent) under extremely challenging economic conditions. Although the higher prices were in effect for only a short period of the fiscal year, they may have helped keep the cost coverage from dipping below the previous year’s level. Had the higher May 2009 prices been in place for all of FY 2009, the cost coverage might have improved more from FY 2008, but it is likely that Single-Piece Parcel Post would still have failed to cover its costs adequately. The Postal Service believes future pricing and product actions need to take these data into consideration to improve Single-Piece Parcel Post’s cost coverage.

The May 2009 increase, though above the Package Services average, was still moderate. Furthermore, Single-Piece Parcel Post has a price structure that, for the most part, is simple and conceptually easy for relatively unsophisticated retail customers to understand. For its single pricing category, prices vary by weight and distance. Prices are presented in an easy to read table that is convenient for users. Single-Piece Parcel Post has no worksharing pricing categories, and no special mail preparation is required to use this product.

In May, the Single-Piece Parcel Post rate structure was further simplified. The Intra-BMC and Inter-BMC price categories were merged to create a single price at each weight level, and in each zone. This same structure applies to Priority Mail and our competitors’ prices, and the pricing is clearer and more readily understandable to retail customers. As part of the pricing simplification, the non-machinable surcharge was also incorporated into the Single-Piece Parcel Post prices.

In 2009 the Postal Service also revised and simplified the way Alaska Bypass mail is accepted and rated. Bypass mail pieces are parcels at Parcel Post rates destined for remote parts of Alaska that do not pass through the usual postal facilities. Bypass shippers prepare the parcels on pallets originating in Anchorage or Fairbanks for transport by intra-Alaskan carriers. New procedures eliminate the requirement that goods be combined into distinct packages. The new procedures also allow mailers to divide the total weight of palletized items by 70 to determine the minimum number of packages that could have been created. The Postal Service then applies for the appropriate zone the 70-pound Single-Piece Parcel Post price to this quantity. The Postal Service believes this will achieve operational benefits and reduce shippers' costs, offsetting some of the price increases that resulted from the merging of the Intra-BMC and Inter-BMC categories.

Overall, Single-Piece Parcel Post meets the public's need for a business- and consumer-oriented, lower value and lower priced alternative to Priority Mail. Single-Piece Parcel Post thus promotes the policy goals of title 39.

2. Bound Printed Matter Flats

Like Media Mail (discussed below), Bound Printed Matter (BPM) Flats is a content-restricted product. This product is a commercial product that is used by businesses to send large catalogs and similar flat-shaped flexible items that are too heavy to be sent using Standard Mail. Unlike Media Mail, BPM Flats are mainly advertising matter, and are not typically used for personal, literary, or educational correspondence. BPM Flats mail pieces may weigh up to 15 pounds, though most heavier pieces do not qualify as flats and must be mailed using the BPM Parcels product.

The BPM Flats product meets the needs of businesses seeking to send customers promotional material that does not require the most expeditious mail processing and delivery. This allows the Postal Service to reduce its costs compared to products like Priority Mail. Consistent with these lower costs, BPM Flats prices are lower than the prices for similarly-shaped Priority Mail. Mailers can lower their cost of mailing even further by drop shipping, presorting, or prebarcoding their mail pieces. Mailers who do this extra work pay lower prices consistent with the costs their worksharing avoids for the Postal Service. In the most recent price adjustment for BPM Flats, in May 2009, the passthroughs of the worksharing avoided costs for BPM Flats mail pieces were all at or below 100 percent, with one exception (the DBMC discount). In Docket No. R2009-2, the Commission accepted the Postal Service's justification and found that the BPM Flats price changes, including worksharing discounts were consistent with the standards of the PAEA. Worksharing in BPM Flats is discussed further in Section II.F of this report. The BPM Flats rate design is more complex than that of Media Mail or Single Piece Parcel Post, but it is a business product and its users are overwhelmingly sophisticated commercial mailers for whom the complexity of the pricing schedules should pose no problems.

BPM flats prices decreased by 2 percent in the May 2009 price adjustment, whereas other Package Services products' prices increased, for three reasons. First, as shown in Table 4, BPM Flats has a healthy cost coverage, while other Package Services products do not. The Postal Service has long had concerns that several Package Services products were not adequately covering their attributable costs. Because Package Services prices as a whole were constrained by the cap (3.825 percent for the May 2009 change), significant above-average increases for products with poor or no cost coverage could only be implemented if BPM Flats prices were given a price decrease. Second, the Postal Service began to realign BPM Flats and BPM Parcels prices in Docket No. R2001-1 so that they would better reflect their costs.

Although these two categories now constitute separate products, the Postal Service believed that the price differences between BPM Flats and BPM Parcels could stand further adjustment. Third, the Postal Service believed that using its pricing flexibility to hold down prices for BPM Flats would encourage volume growth in this profitable and operationally efficient category of mail.

Table 4 shows BPM Flats covered its attributable costs with a cost coverage of 173.7 percent in FY 2009, an increase, despite the reduction in prices. This cost coverage shows that BPM Flats made a reasonable contribution toward the Postal Service's institutional costs.

The BPM Flats product helps to meet the public's need for a business-oriented, lower value, lower priced alternative to Priority Mail to send large catalogs that cannot be sent using Standard Mail. BPM Flats is reasonably and fairly priced for the value its customers receive, bears a fair share of the institutional cost burden of the Postal Service, and is available to business customers without undue discrimination. Therefore, BPM Flats promotes the policy goals of title 39.

3. Bound Printed Matter Parcels

Bound Printed Matter (BPM) Parcels is a content-restricted product with the same content requirements as BPM Flats. This product is a commercial product that is used by businesses to send books, directories, and large catalogs that are too heavy to be sent using Standard Mail, and too rigid or too thick to qualify as BPM Flats. Unlike Media Mail, BPM Parcels may contain advertising matter. BPM Parcels mail may weigh up to 15 pounds.

The BPM Parcels product mainly meets the needs of businesses seeking to fulfill customer orders for books and large catalogs that do not require the most expeditious mail processing and delivery. This lower level of service allows the Postal Service to reduce its costs compared to products like Priority Mail. Consistent with its lower costs and value, BPM Parcels prices are lower than the prices for similarly-shaped Priority Mail. Mailers can lower their cost of mailing even further by drop shipping, presorting, or prebarcoding their mail pieces. Mailers who do this extra work pay lower prices consistent with the costs their worksharing avoids for the Postal Service. In the most recent price adjustment for BPM Parcels, in May 2009, the passthroughs of the worksharing avoided costs for BPM Parcels mail pieces were all at or below 100 percent (with the exception of the DBMC discount). In Docket No. R2009-2, the Commission accepted the Postal Service's justification and found that the BPM Parcels price changes, including worksharing discounts, were consistent with the standards of the PAEA. Worksharing in BPM Parcels is discussed further in Section II.F of this report. The BPM Parcels rate design is more complex than that of Media Mail or Single Piece Parcel Post, but it is a business product and its users are overwhelmingly sophisticated commercial mailers for whom the complexity of the pricing schedules should pose no problems.

In the May 2009 price adjustment, the Postal Service increased the prices of BPM Parcels by 2.504 percent on average. This increase was slightly below the average increase for Package Services as a whole (3.800 percent) for several reasons. First, the Postal Service believed that BPM Parcels were covering their costs, whereas there were concerns that other Package Services products like Media Mail and Single

Piece Parcel Post were not. At the same time, the Postal Service wished to improve the cost coverages of parcels in general, including BPM Parcels, so BPM Parcels' prices were increased while BPM Flats were not, as shown in Table 4. Based on FY 2009 cost data, BPM Parcels as well as Single-Piece Parcel Post and Media Mail failed to cover their costs. Because Package Services prices as a whole were constrained by the cap (3.825 percent for the May 2009 change), above-average increases for the weaker products could only be implemented if other product prices were given increases below the cap. Therefore, the Postal Service increased BPM Parcels prices (as compared to BPM Flats, which was give a price decrease), by less than the cap to send price signals to BPM Parcels and Flats mailers to encourage profitable mail volume and operational efficiency. While the cost coverage for BPM Parcels shown in Table 4 did not remain positive as the Postal Service had hoped, the Postal Service is aware that the May price increase was in effect for less than half the fiscal year. Had the current prices been in effect for the full year, it is expected that BPM Parcels might have come closer to covering its attributable costs and might possibly even have made some contribution toward institutional costs.

The BPM Parcels product helps to meet the public's need for a business-oriented, lower value, lower priced alternative to Priority Mail to send books and large catalogs that cannot be sent using Standard Mail or BPM Flats products. The BPM Parcels product is reasonably and fairly priced for the value its customers receive, and bears a reasonable share of the institutional cost burden of the Postal Service, given the price increase constraints on Package Services as a whole, and is available to business customers without undue discrimination. Therefore, BPM Parcels promote the policy goals of title 39.

4. Media Mail/Library Mail

Media Mail is a content-restricted product. By law, its content is restricted to books, noncommercial films, computer-readable media, and similar media items that typically have educational, cultural, scientific or informational value. Media Mail items cannot contain advertising, other than incidental announcements of books. This product is used by businesses and by the general public to send books and eligible media or other permitted items either for business, or for personal, educational, or literary purposes. Media Mail also has a preferred-price category, Library Mail. Libraries, educational institutions and certain other nonprofit organizations use Library Mail to send eligible items to their customers.[12] By law, Media Mail prices are unzoned and do not vary by distance.

Media Mail meets the needs of businesses, households, and eligible organizations for a low cost way to ship eligible materials that do not require the most expeditious, and therefore more expensive, mail processing and delivery. Consistent with this lower value of service, the prices for Media Mail are below the prices for retail Priority Mail and Single Piece Parcel Post. In the May 2009 price adjustment, Media Mail received an increase of 7.468 percent. This was higher than the average increase for Package Services because the Postal Service was concerned that Media Mail was not adequately covering its costs. Table 4 shows that Media Mail's coverage was 84.1 percent in FY 2009. Even had the May 2009 prices been in place for all of FY 2009, it is

[12] Library Mail has similar, though not identical, content restrictions to Media Mail.

likely Media Mail's measured costs would have fallen short of revenue. The Postal Service believes that future pricing and product actions need to ensure that Media Mail will make a reasonable contribution toward the Postal Service's institutional costs in the future while being mindful of the constraints imposed by the price cap for the class.

The May 2009 increase, though well above the Package Services average, was still moderate. Media Mail has a simple price structure. Within each pricing category, the prices vary only by weight. Media Mail has two worksharing pricing categories to meet the needs of business mailers, in addition to its single piece category that is used by both businesses and consumers. Media Mail users are eligible for price discounts for presorting and prebarcoding. Mailers who do this extra work pay lower prices. The discounts for basic presorting and for prebarcoding are consistent with the costs their worksharing avoids for the Postal Service. In the most recent price adjustment for Media Mail in May 2009, the passthrough of the worksharing avoided costs for 5-digit presorting exceeded the 100 percent passthrough limit; in Docket No. R2009-2, the Commission accepted the Postal Service's justification for this passthrough and found that the Media Mail price changes were consistent with the standards of the PAEA. Worksharing in Media Mail is discussed further in Section II.F of this report.

By law, Library Mail prices are to be 95 percent of Media Mail prices. The current prices meet this requirement.

Media Mail meets the public's need for an affordable business- and consumer-oriented, lower value, lower priced alternative to Priority Mail and Single Piece Parcel Post to mail books and other eligible matter. Its pricing meets all the requirements specific to this product described in the law. It is available to customers without undue discrimination, and its pricing reasonably and fairly reflects the value its customers receive and the educational, cultural, scientific and informational value of its content. In general, Media Mail promotes the policy goals of title 39.

5. Inbound Surface Parcel Post (at UPU rates)

The Inbound Surface Parcel Post inward land rate (ILR) is priced by the UPU Postal Operations Council, which annually calculates the ILR according to cost-inflation (CPI-U) and USPS provision of value-added services such as track and trace, home delivery, published service standards, liability acceptance, and availability of an internet-based inquiry system. This year, this product showed positive contribution. ILRs for this product were increased in January 2009 as permitted by the UPU Parcel Regulations.

SPECIAL SERVICES

Table 5: Special Services Mail Volume, Revenue and Cost by Product

Product	Volume (Million)	Revenue ($Million)	Attributable Costs	Contribution	Revenue / Piece	Cost / Piece	Unit Contribution	Cost Coverage
ANCILLARY SERVICES								
Certified Mail	266	729.8	659.5	70.3	2.739	2.475	0.264	110.7
COD	1	7.6	6.6	1.0	7.451	6.497	0.953	114.7
Insurance	44	129.1	116.9	12.2	2.949	2.670	0.279	110.4
Registered Mail	3	49.9	50.6	(0.7)	15.684	15.898	(0.233)	98.7
Stamped Envelopes	0	16.5	5.0	11.5	N/A	N/A	N/A	330.0
Stamped Cards	0	0.7	1.1	(0.4)	N/A	N/A	N/A	63.6
Other Domestic Ancillary Services	1,302	751.5	519.7	231.8	0.577	0.399	0.178	144.6
Total Domestic Ancillary Services	1,616	1,685.1	1,359.4	325.7	N/A	N/A	N/A	124.0
Int'l Ancillary Services	1.7	25.6	37.4	(11.8)	1.518	2.215	(.697)	68.6
SPECIAL SERVICES								

Address List Services	0	0	0	0.0	0.373	0.368	0.005	103.0
Change of Address Credit Card Authentication	9	9.1	1.3	7.8	1.011	0.144	0.997	700.0
Confirm	N/A	2.4	3.0	(0.6)	N/A	N/A	N/A	75.0
Int'l Reply Coupon Service	N/A	0.04						
Int'l Business Reply Mail Service	0.16	0.23			1.401			
Money Orders	135	191.1	146.1	45.0	1.415	1.082	0.333	130.8
Post Office Box Services	N/A	817.1	632.3	184.8	N/A	N/A	N/A	129.2
Caller Service	N/A	94.8	34.1	60.7	N/A	N/A	N/A	278.0
Total Special Services Mail	1,762	2,825.2	2,213.6	611.6	N/A	N/A	N/A	127.6

Special Services Products

Special Services includes a broad spectrum of products. Ancillary Services is a product comprised of the many services that may be obtained in conjunction with other products. The other products within Special Services are generally "stand-alone" in that they can be purchased without necessarily paying postage for any other product. Rather than recite the policy goals for each of the products in the sections below, it is noted that the many services meet the specific needs of customers, are priced in a manner that is fair for the value they provide, and cover their attributable costs. Thus, Special Services generally promote the policy goals of title 39.

As shown in Table 5 above, Special Services covered their costs in FY2009. The weighted-average class increase for Special Services in Docket R2009-2 was 3.759 percent.

1. Ancillary Services

The Ancillary Services are those special services that may only be used in conjunction with another product. Some of the services are quite small (*e.g.*, Stamped

Cards has less than $0.7 million in revenue), whereas others such as Certified Mail contributed $730 million in revenue. Total revenues for all Ancillary Services in FY 2009 were $1.7 billion.

2. International Ancillary Services

International Ancillary Services generated $25.6 million in revenue in 2009, but overall these services did not generate positive contribution. This is in part due to the fact that rates for inbound ancillary services such as registered mail are generally the result of the Universal Postal Convention. The Postal Service does not independently determine these rates in the absence of a bilateral agreement. Market dominant special services are largely composed of registered mail, and hence registry costs heavily influenced the performance of market dominant international ancillary services collectively. The Postal Service notes that as a result of operational changes in the handling of inbound registered mail, costs have been reduced significantly over FY2008. Inbound registered mail rates will increase on January 1, 2010 as a result of changes to the Universal Postal Convention.

3. Address List Services

The Postal Service provides address list services to decrease the amount of undeliverable mail and to help mailers enter mail that has better address hygiene. Total revenue for Address List Services was $33,971.

4. Caller Service

Caller Service includes revenues from both Caller Service and Reserve Number products. Caller Service allows business customers to pick up their box mail at a post office call window or loading dock when the office is open. Caller Service customers may choose when to pick up their mail and, accordingly, can have increased access to their mail even if the box section is not open.

Reserve Numbers allow a company to reserve a box number for future Caller Service use. Caller Service and Reserve Number revenues were $94.8 million in FY2009.

5. Change-of-Address Credit Card Authentication

To ensure that Change of Address Requests made either over the phone or via the Internet are valid, the Postal Service charges a fee of $1 to a credit card to ensure that the address for which the change is requested matches the address on the credit card used to pay the $1 fee. In FY 2009, customers paid $9.1 million, but the Postal Service accrued only a portion of that revenue, since some of it is retained by the Credit Card vendors for administering this service.

6. Confirm

Confirm allows subscribers to monitor letters and flats as they are processed. Confirm service generated $2.4 million in revenue in FY 2009.

7. International Reply Coupon Service

International Reply Coupon Service generated $39,064 in 2009.

8. International Business Reply Mail Service

International Business Reply Mail Service generated $230,477 in revenue in 2009.

9. Money Orders

The three types of Postal Service Money Orders (APO/FPO, up to $500 and over $500) generated a combined $191.1 million in revenue in 2009.

10. Post Office Box Service

Post Office Box Service includes revenues from Post Office Box rentals. Post Office Boxes are available in 5 different rental sizes and have seven different fee groups. Box rentals accounted for $817.1 million in revenues in 2009.

Negotiated Service Agreements

The Postal Service had a total of four Market Dominant Negotiated Service Agreements (NSAs) that were in effect for some part of FY 2009. The four were Bank of America, Bookspan, Bradford Group, and Lifeline Screening. Of these, three customers —Bank of America, Bradford Group, and Lifeline Screening—qualified for discounts, but Bookspan did not. Details are provided in USPS-FY09-30.

The three tiered-discount NSAs in effect in FY 2009 (Bookspan, Bradford Group, and Lifeline Services) were intended to improve the net financial position of the Postal Service by driving the growth of profitable volume (and thus increasing overall contribution to institutional costs), and on the whole, they succeeded. By providing discounts on incremental pieces above a threshold, these NSAs encouraged customers to mail more pieces than they otherwise would have. Because those pieces still provided additional contribution to institutional costs, even after discounts were included, the NSAs contributed to the improvement of the net financial position of the

Postal Service. The data in USPS-FY09-30 show that the amount of rebates paid pursuant to the NSAs in the contract years ending in FY 2009 was $388 thousand. Using the valuation method traditionally employed by the Postal Service, the calculations in USPS-FY08-30 show a cumulative net benefit (after rebates are deducted) of $1.8 million. Using the Panzar/Wolak approach employed by the Commission to evaluate the Bookspan, Bradford Group, and Lifeline Screening NSAs, however, the cumulative net benefit is $328 thousand. Either way, the cumulative net effect of all three NSAs was not sufficient to materially alter the reported overall contribution or cost coverage for Standard Mail.

The NSA with Bank of America was intended to improve the operating efficiency of the Postal Service by providing incentives to Bank of America for improved mail processing performance and reduced rates of forwarded, returned, and undeliverable-as-addressed mail. The net cost of this NSA to the Postal Service was around $25 million. In part, this resulted from the large costs incurred to administer the project (note that in the FY 2008 ACR, the Postal Service depreciated these costs based on the projected life of the agreement; since the agreement was terminated after one year, the entire cost has been included in the current estimate – approximately $10 million in costs are attributable to IT hardware for which the Postal Service has no alternative use). The NSA failed to produce measurable mail-processing efficiency improvements, although as noted by the Commission in the FY 2008 Annual Compliance Determination, "[t]he estimate may overstate the net loss in contribution by assuming that the agreement caused the read/accept rate for Bank of America's mail to decrease, leading to higher costs." The NSA did successfully speed Bank of America's uptake of

IMb technology. As with the volume-growth NSAs, however, this loss should not materially affect the overall contribution or cost coverage of either First-Class Mail or Standard Mail.

The Postal Service has no reason to believe that any of these NSAs caused unreasonable harm in the marketplace. With respect to Bookspan, Bradford Group, and Lifeline Services, the scale of the agreements was sufficiently small to make market effects unlikely, and similar functionally-equivalent NSAs were, or could have been, made available to similarly-situated mailers. While the Bank of America agreement was larger in scale, the size of the relevant market was likewise commensurately larger, such that, on balance, any actual effect on the market would be unlikely.

F. Workshare Discounts

With respect to each market-dominant product for which a workshare discount was in effect during the reporting year, section 3652(b) requires the Postal Service to report certain information about those discounts. Specifically, the PAEA requires that the Postal Service provide:

> (1) The per-item cost avoided by the Postal Service by virtue of such discount.
>
> (2) The percentage of such per-item cost avoided that the per-item workshare discount represents.
>
> (3) The per-item contribution made to institutional costs.

The data for workshare discounts can be found in USPS-FY09-3.[13] In that document, the workshare discounts are shown as the difference between the current prices of the workshared piece and a benchmark piece. Passthroughs are calculated

[13] USPS-FY09-3 cites to the applicable cost studies that have also been filed.

for each discount as the ratio of the discount to the avoided cost. Per-item unit contribution is addressed at the product level in the CRA, reflecting data availability at this time.

As in the 2008 ACR, the analyses presented in USPS-FY09-3 show the required information for workshare discounts within each market-dominant product. They do not analyze inter-product or non-workshare price differences.[14] However, in recognition that the Commission does not agree, the Postal Service has provided within this Annual Compliance Report additional worksheets for First-Class Mail and Standard Mail to reflect both of the concepts of worksharing that are currently under review in Docket No. RM2009-3. For instance in First-Class Mail Presort Letters and Cards, the discounts and cost avoidances are calculated with a BMM benchmark, as specified by the methodology used in the Annual Compliance Determination (ACD). (ACR 2008, March 30, 2009). The discounts and cost avoidances without using a benchmark from another product – i.e., Bulk Metered Mail (BMM) – are also shown. The Postal Service's presentation of an alternative using the BMM benchmark is in no way intended to supersede its positions as stated in Docket No. RM2009-3, but to be responsive to the 2008 ACD. Similarly, cost and price differences and “passthroughs” are presented for former Standard Mail ECR density tiers, again as a response to the Commission’s views as expressed in the 2008 ACD.

When selecting the relevant price relationships within each product for purposes of complying with section 3652(b), the Postal Service was guided by the definition of

[14] There is a difference of opinion over whether certain cost and price differences constitute worksharing as defined by the PAEA. These issues are the subject of the rulemaking in Docket No. RM2009-3, currently under consideration by the Postal Regulatory Commission.

worksharing established by the PAEA. Section 3622(e)(1) clearly defines the term "workshare discount" as "rate discounts provided to mailers for the presorting, prebarcoding, handling, or transportation of mail. . . . " In Order No. 43, the Commission explicitly provided that "workshare discounts, as defined in the PAEA, do not include shape-based differences."[15] The Postal Service analyses therefore present cost differences resulting from the four listed worksharing activities, and, as in the 2008 ACR, do not compare rate differences to cost differences arising from nonworksharing attributes such as shape.

For example, within the First-Class Mail Presorted Letters/Postcards product, the cost difference between automation letters sorted to the 3-digit and 5-digit levels is analyzed in USPS-FY09-3 because it is due to worksharing activities; in this case presortation and prebarcoding. However, within that same product, cost differences between letters and postcards are not presented. In addition, consistent with section 3652(b), the Postal Service does not provide an analysis of the cost difference between the First-Class Mail Presorted Letters/Postcards and First-Class Mail Flats products.

Furthermore, in evaluating passthroughs for the 2009 ACR, the Postal Service notes that changes in costs between FY 2008 and FY 2009 result in some passthroughs increasing and some decreasing. In fact, some discounts now have passthroughs below 100 percent when the passthroughs estimated for the May price change (Docket No. R2009-2) were 100 percent, and some discounts now have passthroughs greater than 100 percent. Overall, any evaluation of the statutory appropriateness of passthroughs needs to be made in the context not only of the

[15] Order No. 43 (Oct. 29, 2007) at 42.

calculated cost avoidance, but also considering all of the statutory criteria, such as the objective that prices be predictable and stable. An increase or decrease in a passthrough based on the cost avoidance calculated for a given fiscal year does not in itself trigger the requirement for an immediate price change. Rather, it is an indication that a specific discount / cost avoidance relationship needs to be fully re-evaluated in the context of all of the statutory criteria. This re-evaluation will be undertaken by the Postal Service when it prepares its next price adjustment, and will then be reviewed by the Commission. This is consistent with the fact that section 3622(e) must, for reasons discussed previously by the Postal Service in its response to CIR No. 1 in Docket No. R2008-1, be applied over the long-term, as a principle that should guide pricing over a series of price adjustments. This comprehensive, long-term approach is especially critical given the fragility of the current business environment and the desirability of maintaining and encouraging mail usage.

FIRST-CLASS MAIL

1. Single-Piece Letters / Postcards

The First-Class Mail single-piece letters and cards product has just one worksharing discount, which is applicable to both Qualified Business Reply Mail (QBRM) letters and QBRM cards. The calculated passthrough in this report is 95.8 percent because of a small change in the estimate of avoided cost. In Docket No. R2009-2, the Postal Service passed through 100 percent of the avoided costs for both QBRM Letters and Cards.

2. Presorted Letters / Cards

The issues of the BMM benchmark and whether inter-product cost avoidances comply with the limitations of U.S.C. § 3622(e) are subjects of Docket No. RM2009-3. As the Postal Service awaits the Commission's ruling on this subject, the current ACR reporting (i.e., USPS-FY09-3) includes two separate analyses for FCM Bulk Letters and Cards. "FCM Bulk Letters and Cards 1" reports the passthroughs based on the method established by the Commission in the Annual Compliance Determination (ACR 2008, March 30, 2009) using the BMM benchmark for both Mixed AADC Automation Letters as well as Nonautomation Presort Letters, while "FCM Bulk Letters and Cards 2" uses the methodology preferred by the Postal Service based on its interpretation of the law that inter-product passthroughs are not subject to the limitations of U.S.C. § 3622(e). The Postal Service provides an explanation and justification of the passthroughs for both approaches.

Out of nine passthroughs in "FCM Bulk Letters and Cards 1," four exceed 100 percent. The BMM benchmark to Mixed AADC Automation Letters passthrough is 126.1 percent, down from approximately 129 percent in Docket No. R2009-2. In its reply comments filed on September 11, 2009, the Postal Service discussed the practical difficulties that arise from the integer constraint on the First-Class Mail stamp price and strict adherence to 100 passthrough of inter-product cost avoidances. See Docket No. R2009-2, USPS Reply Comments at 4-10. Once the First-Class Mail stamp price is determined to be 44 cents (as was the case in Docket No. R2009-2), keeping this passthrough at 100 percent would either lead to violating the inflation cap or changes in prices of additional ounces or other shapes solely to meet the cap requirement. This would defeat the notion of pricing flexibility, the hallmark of PAEA

The 110 percent passthrough of avoided cost for AADC Automation Letters arises because of a two-tenth of a cent reduction in avoided cost between the FY2008 and FY2009 estimate. In Docket No. R2009-2, the Commission reviewed this discount and found that it produced a passthrough of 100 percent.

The passthrough for 3-Digit Automation Cards is 200 percent of avoided cost. This is because the cost avoidance for 3-Digit Automation Cards compared to AADC Automation Cards changed from 0.16 cents to 0.13 cents. Since bulk mail prices are rounded to a tenth of a cent, the rounded amount declined from 0.2 cents to 0.1 cents, literally doubling the passthrough. Thus, a small reduction in cost avoidance between the FY2008 and FY2009 estimates cause this passthrough to double from 100 percent to 200 percent. In Docket No. R2009-2 the Postal Service estimated this passthrough to be 100 percent. The Commission's review supported this assertion.

The passthrough for 5-Digit Automation Cards is 108.3 percent. Once again this results from a small reduction in cost avoidance between FY2008 and FY2009. This discount was reviewed by the Commission in R2009-2 and found to comply with the 100 percent passthrough requirement.

The explanation of passthroughs below refers to the "FCM Bulk Letters and Cards 2" sheet. Out of eight passthroughs within this product, two are exactly 100 percent; one is below 100 percent; and the other five are above 100 percent, due primarily to changes when the costs were updated. In Docket No. R2009-2, Notice of Market Dominant Price Adjustment , there were only two passthroughs that exceeded

100 percent: Nonautomation Presort Letters and Nonautomation Presort Cards. In its review of that Notice, for Nonautomation Presort Letters and Cards, the Commission noted that using its methodology would not result in discounts exceeding the avoided costs. (Docket No. R2009-2, Order 191 at 25, footnote 3).

The new passthroughs use the current discounts, as in Docket No. R2009-2. However, taking the updated FY2009 calculated cost avoidances into account results in a change in the percentage passthroughs, even though they remain the same in nominal terms. The result is that several passthroughs now exceed 100 percent: Automation AADC Letters; Nonautomation Presort Letters; 3-Digit & 5-Digit Automation Cards; and Nonautomation Presort Cards.

The 110 percent passthrough of cost avoidance between Mixed AADC Automation Letters and AADC automation Letters, 200 percent passthrough between AADC and 3-Digit Automation Cards and the 108.3 passthrough between 3-Digit and 5-Digit Cards were discussed above in the explanations provided for “FCM Bulk Letters and Cards 1” sheet.

Nonautomation Presort Letters and Cards prices are set by applying the value of the barcode to the respective Mixed AADC price. This incremental cost was passed through at greater than 100 percent in order to keep a reasonable price difference between Mixed AADC Automation price and the Nonautomation Presort price for Letters and Cards. This difference also helps to promote efficiency gains through the automation program. For Nonautomation Presort Letters this difference (Nonautomation Presort Letters – Mixed AADC Automation Letters) increased slightly from 2.5 cents to 3.2 cents. For Nonautomation Presort Cards, even with the higher passthrough, the difference shrunk from 1.9 cents (Docket No. R2008-1) to 1.5 cents (Docket No. R2009-2).

3. Flats

First-Class Mail Automation Flats passthroughs for ADC Automation Flats, 3-Digit Automation Flats, and 5-Digit Automation Flats, were 145.2 percent, 100 percent and 100 percent, respectively. The Postal Service referred to the change in cost methodology and its impact on cost estimates (Docket No. RM2008-2, Proposal 8) in its Notice of Market Dominant Price Adjustment. (Docket No. R2009-2 at 30). Even with one of the passthroughs significantly above 100 percent, most price increases for Automation Flats were relatively high.

This report uses the current discounts and the updated FY2009 cost avoidances. The cost avoidance for ADC Automation Flats compared to Mixed ADC Automation Flats shrunk from 8.4 cents to 4.5 cents between FY2008 and FY2009, causing the 145.2 percent passthrough of cost avoidance to increase to 271.1 percent. The two more finely sorted presort levels, 3-Digit and 5-Digit Automation Flats, experienced a slight increase in cost avoidance levels, thereby reducing the 100 percent passthroughs to 95.3 percent and 95.9 percent for 3-Digit and 5-Digit Automation Flats, respectively.

4. Parcels

The resulting passthroughs within this product are both lower than 100 percent, as they were in Docket No. R2009-2. Given that First-Class Mail parcels' cost coverage is just above 100 percent, higher passthroughs for this product are not necessary or desirable at the present time.

STANDARD MAIL

1. Letters and Flats

Two presort passthroughs within the Letters product and three within the Flats product exceed 100 percent: (1) the presort discount for nonautomation 3-digit nonmachinable letters compared to nonautomation ADC nonmachinable letters, (2) the presort discount for nonautomation 5-digit nonmachinable letters compared with nonautomation 3-digit nonmachinable letters, (3) the presort discount for automation ADC flats compared to Mixed ADC flats, (4) the presort discount for automation 3-digit flats compared to ADC flats, and (5) the presort discount for 5-digit nonautomation flats compared to 3-digit nonautomation flats. All five of these discounts were set equal to 100 percent of their respective avoided costs when prices were changed in May, 2009. Since the 2008 ACR the avoided costs for these categories have decreased, in some cases significantly, pushing the passthroughs over 100 percent.[16]

Because all of these passthroughs were at 100 percent when the discounts were announced in Docket No. R2009-2, there was no need to cite an exemption to the passthrough limitation. The increases in the passthroughs in all these cases are due to lower estimated avoided costs between FY 2008 and FY 2009. These new cost measurements, and other factors, will be considered in the next price change. If the Postal Service were seeking an exemption from the requirements of section 3622(e) for these discounts between now and the next general price change, it would justify them under section 3622(e)(2)(D). The Postal Service believes it would not lead to efficient

[16] In the case of the automation ADC flats discount, the estimated avoided costs round to zero, so a passthrough cannot be calculated.

operations to change price signals for mailer behavior between general price changes whenever estimated avoided costs decrease. Moreover, immediately tracking changes in avoided costs that occur between price changes would disrupt the predictability and stability in prices (Objective 2) that the current system for regulating prices was set up to achieve.

In addition to these presorting discounts, the prebarcoding discounts for Letters and Flats also exceed estimated avoided costs. As in the May 2009 price change, the “avoided costs” for prebarcoding mixed AADC automation letters compared to mixed AADC nonautomation machinable letters are negative. As discussed in Docket No. R2009-2 (Notice of Market Dominant Price Adjustment, pp. 34-35), the Postal Service once again does not accept that these anomalous cost figures give a true reading of the costs avoided by prebarcoding automation letters. If the Postal Service were required to justify the current automation discount based on the latest avoided costs estimates it would continue to appeal to section 3622(e)(2)(D) for the same reasons cited in Docket No. R2009-2.

The prebarcoding discount for mixed ADC automation flats compared to mixed ADC nonautomation flats is 200 percent of current avoided costs. When this discount was set in May, the passthrough was 221.4 percent. The excess passthrough was justified under section 3622(e)(2)(D) (see Docket No. R2009-2, Notice of Market Dominant Price Adjustment, p. 32) as a means to support the implementation of the FSS program. . If the Postal Service were required to justify the current automation discount based on the latest avoided costs estimates it would continue to appeal to section 3622(e)(2)(D) for the same reasons cited in Docket No. R2009-2.

2. Parcels and NFMs

Two presort discounts for Standard Mail Parcels and NFMs have passthroughs that exceed 100 percent. These are the presort discounts between (1) BMC machinable parcels and mixed BMC machinable parcels and, (2) between 5-digit machinable parcels and BMC machinable parcels. These discounts also exceeded avoided costs when prices were changed in May 2009. At that time the Postal Service justified the then current discounts by appeal to section 3622(e)(2)(D) and the Commission accepted that justification. If the Postal Service were required to justify these discounts based on the latest avoided costs estimates it would continue to appeal to section 3622(e)(2)(D) for the same reasons cited in Docket No. R2009-2 (see Notice of Market Dominant Price Adjustment, pp. 38-39).

3. High Density and Saturation Letters; and High Density and Saturation Flats and Parcels

These former Enhanced Carrier Route products have pricing categories that the Postal Service does not believe meet the definition of worksharing discount categories described in section 3622(e)(1) and so are not regulated under section 3622(e)(2). The Commission has disagreed with the Postal Service's view in previous proceedings and has established a rulemaking docket (Docket No. RM2009-3) to resolve this issue. Pending resolution of this issue, the Postal Service is providing the information that would be required for these price relationships as if they were regulated under section 3622(e).

Two of the price differences in these products exceed the cost differences estimated by the Postal Service: (1) the difference between High Density and Saturation letters, and (2) the difference between Carrier Route and High Density parcels. Both of these have anomalous estimated cost differences, where the category with the higher address density has a higher unit cost than the category with the lower address density. When these prices were changed in May 2009, these cost differences were also negative (see Docket No. R2009-2, Response to CHIR4, ChIR4.Q7.Appendix.B.xls, worksheet tab ChIR4-Q7 Resp.). Under these circumstances, any positive price difference would be mathematically greater that the (negative) estimated cost difference. At that time, the Postal Service justified the pricing differences using 3622(e)(2)(D) and 3622(e)(3)(A) (see Docket No. R2009-2, Response to CHIR4, Question 7c.) and the Commission accepted the Postal Service's justifications. If the Postal Service were required to justify these price differences based on the latest cost difference estimates it would continue to appeal to the same sections of 3622(e) for the reasons cited in Docket No. R2009-2.

PERIODICALS

While the Postal Service recognizes the importance of cost data with regard to Periodicals, section 3622(e)(2)(C) of title 39 exempts passthroughs for discounts "provided in connection with subclasses of mail consisting exclusively of mail matter of educational, cultural, scientific and informational value" from the 100 percent passthrough standard of section 3622(e). However, for reasons of openness and transparency the Postal Service discusses Periodicals passthroughs below.

1. Outside County

In the May price adjustment, of the eighteen passthroughs listed as "presorting", five were over 100 percent. Using the costs presented in this ACR, the number of passthroughs exceeding 100 percent remains the same.

For presorted flats there were two passthroughs that were slightly above 100 percent in the R2009-2 filing. Nonmachinable Nonautomation ADC Flats compared to Nonmachinable Nonautomation Mixed ADC Flats was 103.6 percent, while the passthrough for Nonmachinable Automation ADC Flats compared to Nonmachinable Automation Mixed ADC Flats was 105.6 percent. Given FY 2009 cost data, both of these passthroughs in the current filing are below 100 percent (95 percent and 79 percent, respectively). The passthrough for 3-digit sort compared to ADC sort for Nonmachinable Nonauto flats has gone up from 77.9 percent (R2009-2) to 164.4 percent in the current filing due to the updated cost studies. Similarly, for Nonmachinable Automation flats the 3-digit to ADC passthrough is 162.2 percent in the current filing compared to 92.3 percent in Docket No. R2009-2.

Passthroughs for automation letters are significantly above 100 percent.

2. Within County

The FY 2009 Within County cost avoidances are based on proxies from other classes of mail. While suitable for pricing purposes, these costs are not specific to Within County. There is one passthrough that is over 100 percent: 3- digit Automation Letter to Basic Automation Letter.

PACKAGE SERVICES

1. Media Mail

Media Mail has two presorting discounts and Library Mail has one presorting discount with passthroughs that exceed 100 percent: (1) the presort discount between Basic and Single Piece Media Mail, (2) the presort discount between 5-digit and Basic Media Mail, and (3) the presort discount between 5-digit and Basic Library Mail.

When prices were changed in May 2009, the discount between Basic presorted and Single Piece Media Mail was set at 100 percent of avoided costs, so there was no need to cite an exemption to the passthrough limitation in Docket No. R2009-2. Since the 2008 ACR, the avoided costs for this category have decreased, pushing the passthrough over 100 percent. This new cost estimate, and other factors, will be considered in the next price change. If the Postal Service were seeking an exemption from the requirements of section 3622(e) for this discount between now and the next general price change, it would justify it under section 3622(e)(2)(D). The Postal Service believes It would not lead to efficient operations to change price signals for mailer behavior between general price changes whenever estimated avoided costs decrease. Moreover, immediately tracking changes in avoided costs that occur between price changes, would disrupt the predictability and stability in prices (Objective 2) that the current system for regulating prices was set up to achieve. The Postal Service could also justify these discounts under section 3622(e)(2)(C), owing to the restrictions of Media Mail and Library Mail to content with ECSI value.

The 5-digit presort discounts for both Media Mail and Library Mail exceeded 100 percent of avoided costs in Docket No. R2009-2. The Postal Service justified these passthroughs under sections 3622(e)(2)(B) and 3622(e)(2)(C) of title 39, as explained in the Notice of Market Dominant Price Adjustment (at pp. 41-42).

The Commission accepted the Postal Service's justification and these presort discounts were implemented on May 11, 2009. Based on the avoided cost estimates in this ACR, the passthroughs for both discounts are now lower than when these prices were set, albeit still over 100 percent. The previous justifications for these discounts still apply.

2. BPM Flats and BPM Parcels

Bound Printed Matter Flats and Bound Printed Matter Parcels products each have two drop ship discounts that exceed their avoided costs. In each product the DBMC and DDU discounts exceed the estimated avoided costs

When prices were changed in May 2009, the discount between DDU and non-drop shipped BPM (both Flats and Parcels) were set at 100 percent of avoided costs, so there was no need to cite an exemption to the passthrough limitation in Docket No. R2009-2. Since the 2008 ACR the avoided costs for these categories have decreased, pushing the passthrough over 100 percent. These new cost estimates, and other factors, will be considered in the next price change. If the Postal Service were seeking exemptions from the requirements of section 3622(e) for these discounts between now and the next general price change, it would justify them under section 3622(e)(2)(D). The Postal Service believes it would not lead to efficient operations to change price signals for mailer behavior between general price changes whenever estimated avoided costs decrease. Moreover, immediately tracking changes in avoided costs that occur between price changes, would disrupt the predictability and stability in prices (Objective 2) that the current system for regulating prices was set up to achieve.

In the May 2009 price change, the BPM Flats and BPM Parcels DBMC discounts both exceeded their respective avoided costs. The Postal Service justified these discounts using section 3622(e)(2)(B) and the Commission accepted that justification. Avoided costs have increased between ACR 2008 and ACR 2009, pushing down the passthroughs to the extent that they are now only slightly over the 100 percent limit. The Postal Service believes that adjusting these prices outside of the next general price increase would unduly disrupt its customers' businesses to achieve a questionable gain. Therefore, if the Postal Service were required to seek an exemption from the requirements of section 3622(e) for this discount between now and the next general price change, and if the conditions for justification under section 3622(e)(2)(B) no longer applied, it would justify the exemptions under section 3622(e)(2)(D).

III. Competitive Products

A. Applicable Requirements of title 39

In its FY 2008 ACR, the Postal Service noted that the rates and fees in effect during the majority of FY 2008 were established using PRA procedures and applying PRA standards. By FY 2009, however, rates and fees in effect during the entire fiscal year had been established under PAEA procedures.[17] Therefore, whatever consideration of transitional issues regarding rate setting standards may have been appropriate in FY 2007 and FY 2008 should no longer be necessary with respect to FY 2009.

[17] The only exceptions are a few carryover international rates.

B. Product-by-Product Costs, Revenue, and Volumes

For FY 2009, cost, revenues, and volumes for competitive products of general applicability are directly shown in the FY 2009 CRA (or ICRA). In the Public CRA (USPS-FY09-1), the total competitive products row shown last year has been disaggregated into five groups – Total Express Mail, Total Priority Mail, Total Ground, Total International Competitive, and Competitive Services. The constituent products for each of those groups are listed in a table in the attached Application for Non-Public Treatment of the Non-Public Annex. Those groups are further disaggregated in the Nonpublic CRA (USPS-FY09-NP11). For competitive products not of general applicability, available data on international customized mailing agreements (ICMs) for FY 2009 are presented in the ICRA materials within USPS-FY09-NP2. For domestic competitive products not of general applicability, information for FY 2009 is provided in USPS-FY09-NP27.

C. Section 3633 Standards

The competitive product pricing standards of section 3633 have been implemented by the Commission at 39 C.F.R. § 3015.7. This section discusses the available FY 2009 data with reference to those standards.

First, subsection 3633(a)(1) states that competitive products should not be cross-subsidized by market-dominant products. The Commission's regulations define the most appropriate test for this standard as the incremental cost test for the aggregation of competitive products.[18] Simply stated, if the aggregate revenues from competitive products equal or exceed the aggregate incremental costs of competitive products, then

[18] *See* 39 C.F.R. § 3015.7(a).

competitive products overall are not being cross-subsidized by market-dominant products. Last year, no such measure of incremental costs for competitive products was available. Under these circumstances, the regulations specify use of a proxy, consisting of competitive products' attributable costs, supplemented by any causally-related group-specific costs (for the group of competitive products).[19] This year, like last year, the Postal Service has endeavored to identify causally-related group-specific costs for competitive products, and they are presented in FY09-NP10.

But this year, the Postal Service is also presenting an estimate of the incremental costs for competitive products, albeit an incomplete one. As explained in the Petition for Proposal Twenty-two (filed on Oct. 23, 2009), the Postal Service is presenting what can be termed a "hybrid" estimate of incremental costs, in which an estimate of the aggregate incremental costs of domestic competitive products (including group specific costs) is added to the estimate of the attributable costs for international competitive products. The "hybrid" characterization reflects the blending of an actual estimate of domestic incremental costs with an attributable cost proxy for international incremental costs. The need for the "hybrid" approach is caused by the structure of the ICRA, which precludes direct application of the incremental cost model to international products. But, as demonstrated in Proposal Twenty-two, the "hybrid" estimate is nonetheless an improvement over the full proxy used last year of attributable costs for both domestic and international competitive products, plus group specific costs. The "hybrid" approach provides stronger protection against cross-subsidy than the full proxy approach.

[19] *Id.*

The incremental cost for domestic competitive products, and the hybrid incremental cost for the group of all competitive products, are presented below:

INCREMENTAL COST CALCULATION FOR TOTAL COMPETITIVE PRODUCTS[1]

	Attributable Cost	Group Specific	Incremental	Hybrid Incremental
Domestic Competitive Mail	$ 5,119,566	$ 44,074	$ 5,254,269	$ 5,254,269
International Competitive	$ 1,055,189	$ -	na	$ 1,055,189
Total Competitive	$ 6,174,755	$ 44,074	na	$ 6,309,458

[1]Incremental Cost is calculated for total Domestic Competitive Mail, plus attributable cost for International Competitive products.
Source: USPS-FY09-NP10.

The total competitive hybrid incremental cost is $6,309,458 thousand, which is the sum of the hybrid incremental costs for domestic competitive mail and the hybrid incremental costs for international competitive. The Commission currently uses attributable cost plus group specific cost for the cross-subsidy test. That proxy would provide a cost floor of $6,218,829 thousand ($6,174,755 + $44,074). The hybrid provides a preferred cost floor because it includes at least some properly calculated incremental costs, and is a better approximation of the true incremental costs required for the test. [20]

The hybrid incremental costs of $6.309 billion are well below total competitive products revenue of $8.133 billion (shown on page 3 of USPS-FY09-1). Therefore, based on these estimates, it is clear that competitive products in FY09 were not cross-subsidized by market dominant products, and thus were in compliance with subsection 3633(a)(1).

[20] As demonstrated in Proposal Twenty-two, the resulting hybrid will be greater than the group's overall attributable cost (while not overstating the incremental costs for competitive products). This means that the hybrid is a preferred cost floor for performing a cross subsidy test.

Second, subsection 3633(a)(2) requires that each competitive product cover its attributable costs. Comparing the revenue of each competitive product shown in the Nonpublic CRA (USPS-FY09-NP11) with its attributable costs suggests that all of the competitive products are covering their attributable costs, with the exception of: Inbound International Expedited Services 1 and 2; Inbound Surface Parcel Post at Non-UPU Rates (e.g., Canada Post Southbound surface parcels); International Money Transfer Service (IMTS); Competitive Registered Mail; Competitive Insurance; Competitive Return Receipt; and competitive International Business Reply Service negotiated service agreement (NSA) contracts. The Postal Service furnishes the following comments on each such product:

Product	Comment
Inbound International Expedited Services 1 and 2	Inbound International Expedited Services 1 and 2 (inbound EMS) are reported in aggregate. As per Docket No. CP2009-12, inbound EMS charges were raised in January 2009, and hence the rate increase for CY2009 would not be reflected in the first quarter of the postal fiscal year. Moreover, the Postal Service is again raising Inbound International Expedited Services 2 rates this coming January as per Docket No. CP2009-57. Further, estimates for the Inbound International Expedited Services 3 in Docket No. CP2010-12 (e.g., the bilateral agreement with China Post Group) were determined by the Commission to satisfy the statutory pricing criteria for competitive products. It should be noted that the results are based on the booked revenue version of the IRCA. The booked version reflects an accounting estimate using prior year volumes and current year rates. For some volume, adjustments are made for more current volume trends. Booked revenue also includes prior period adjustments. The Postal Service notes that the imputed version of the ICRA report shows positive contribution for this product, and in the future, the Postal Service plans on reporting more imputed-like revenues beginning in FY2010.

Inbound Surface Parcel Post at Non-UPU Rates (e.g., Canada Post Southbound surface parcels)	These rates are the result of a negotiation with Canada Post Corporation. As explained in Docket No. CP2009-9 and MC2009-8, new, higher rates were implemented in January 2009, and so the first quarter of the fiscal year would have been tendered at lower rates. The Postal Service is once again proposing an increase in inbound surface parcel rates for Canada Post to begin in January 2010 in Docket No. CP2010-13, and the financial workpapers submitted by the Postal Service in that docket show positive contribution under the new rates for CY2010.
International Money Transfer Service (IMTS)	In the FY2008 Annual Compliance Determination at p. 88, the Commission recognized that the Postal Service was in the process of analyzing IMTS "to better estimate volume variable (and product-specific) costs by identifying 'specific cost drivers' for this service." In Docket No. MC2009-19, the Postal Service filed statements attesting to the ongoing efforts to measure and estimate IMTS costs correctly.[21] In addition, in Docket No. RM2010-4 (Proposal Twenty-three), the Postal Service proposed a methodological change to provide consistency in the treatment of volume-variable costs between domestic and international money orders for window services. Because of efforts to understand the actual financial situation for IMTS, the Postal Service believes that it would be premature to adjust prices for IMTS until further analysis of the product's financial performance can be completed.
Competitive Registered Mail	The rates for this service are generally the result of the Universal Postal Convention. The Postal Service does not independently determine these rates.
Competitive Return Receipt	The rates for this service are generally the result of the Universal Postal Convention. The Postal Service does not independently determine these rates.
Competitive Insurance	The rates for this service are generally the result of the Universal Postal Convention. The Postal Service does not independently determine these rates.
International Business Reply	The Postal Service expects to propose price increases for the two competitive IBRS contracts (see Docket Nos.

[21] Supplemental Response of the United States Postal Service to Order No. 154, PRC Docket No. MC2009-19, July 15, 2009, Attachment A (statement of Virginia Mayes); Request of the United States Postal Service to Add Postal Products to the Mail Classification Schedule in Response to Order No. 154, PRC Docket No. MC2009-19, March 10, 2009, Attachments G (statement of Pranab Shah) and H (statement of Jeff Colvin).

Service (IBRS) NSA Contracts	CP2009-20 and CP2009-22) because the terms of these contracts conclude at the end of February 2010. Further, the contingency rate for the remaining customer recently filed in Docket No. CP2010-17 shows positive cost coverage.

Third, subsection 3633(a)(3) states that competitive products must collectively cover what the Commission determines to be an appropriate share of the Postal Service's institutional costs. In its regulations, the Commission has determined that an appropriate minimum share is 5.5 percent of total institutional costs.[22] Page 3 of USPS-FY09-1 shows total institutional cost of $28.907 billion. Applying the 5.5 percent to that figure yields a target contribution of $1.590 billion. To evaluate achievement relative to that target, we once again refer to page 3 of USPS-FY09-1, and subtract total competitive attributable costs of $6.175 billion from total competitive product revenue of $8.133 billion, leaving an aggregate competitive product contribution of $1.958 billion. The target is exceeded, and the requirement of subsection 3633(a)(3) has been met.

IV. Market Tests

The only "market tests of experimental products" offered under the provisions of section 3641 in FY 2009 was the Collaborative Logistics market test. Collaborative Logistics was authorized by the Commission in Order No. 211, Docket No. MT2009-1 (May 7, 2009). The Postal Service filed its first Quarterly Report regarding this test on October 28, 2009. The Postal Service has had a Collaborative Logistics program in the past, and lessons learned have framed the business rules in this market test. The core business rules include components like palletized shipments only, on a space available basis, on a time definite schedule aligned with existing mail transportation schedules.

[22] *See* 39 C.F.R. § 3015.7(c).

All of the customer outreach, field operations integration, identification of available space and transit times, and pricing negotiations are conducted by the Business Opportunity Development group in Postal Headquarters. Movements of freight are tracked through a variety of measures, and facilitated by a Shared Transportation Control Center (STCC). Service performance to the transit times in our customer agreements has been excellent, with only two pallets from the initiation of the test through the end of the fiscal year missing the agreed upon delivery target. For the quarter and partial quarter of FY 2009 that the test was operational, total volume (measured as pallet positions sold) was 1,510, and total revenue was $53 thousand, which exceeded total costs. The actual total cost figure is presented under seal in the Preface to USPS-FY09-NP27. The Postal Service is unaware of any indications that the test has created an inappropriate competitive advantage for the Postal Service or any mailer. Given the relatively small scope of the program during its first partial start-up year, it would seem unlikely that any competitive effects of any kind would have been discernible during FY 2009.

V. Nonpostal Services

New Commission Rule 3050.21(i) requires the ACR to include estimates of the costs, volumes, and revenues for nonpostal services. Not only was this rule not adopted until well into this fiscal year, however, but any putative list of nonpostal services would likewise have been highly speculative at the beginning of FY09, pending completion of Docket No. MC2008-1. Even now, the issues emanating from that proceeding on nonpostal services are not entirely resolved. As a consequence, the Postal Service is still lacking in the ability to provide the specified estimates as outputs of its broader cost and revenue reporting systems. The available information is therefore somewhat *ad hoc* in nature. But to the extent that the Postal Service routinely endeavored to provide the best available information in this regard during rate cases, comparable information is provided in the following table.[23]

The programs or offerings included as entries on this table include some which the Commission has approved as grandfathered nonpostal services, some former "nonpostal" services now approved as postal services, and some section 411 agreements formerly included within reports for what were generically referred to "nonpostal" services. In other words, the inclusion of a program or offering on this table is not intended to signify anything other than these are the types of entries typically found in similar previous presentations regarding what were regarded as "nonpostal" services in rate cases. Moving forward, the Postal Service expects to treat each of these programs or offerings (with the possible exception of Licensing, which is currently one of the subjects of appellate court litigation) in accordance with Order No. 154 (Dec. 19, 2008) in Docket No. RM2008-1, as revised in Errata issued Jan. 9, 2009. Because Order No. 154 indicated that certain offerings would be treated as competitive, however, the cost data for those offerings have been redacted on the following table. The unredacted version of the table is filed, under seal, as part of the Preface document of USPS-FY09-NP30. For each item for which costs have been redacted, however, the revenues do exceed the costs.

[23] For the most recent example, see Page 17 of Attachment G to the Request, Docket No. R2006-1 (May 4, 2006).

FY 2009 "NONPOSTAL" PRODUCTS ($000)			
Product		**FY 2009**	
Migratory Bird Stamps	Revenue	$210	
	Expenses	$439	
	Net Income (Loss)	($229)	
	Volume(000)	609	
Passports	Revenue	$182,637	
	Expenses	$112,688	
	Net Income (Loss)	$69,949	
	Volume(000)	7,305	
Passport Photos	Revenue	$49,751	
	Expenses	FY09-NP27	
	Net Income (Loss)	FY09-NP27	
	Volume(000)	3,317	
Retail	Revenue	$12,087	
	Expenses	FY09-NP27	
	Net Income (Loss)	FY09-NP27	
	Volume(000)	671	
ReadyPost	Revenue	$111,985	
	Expenses	FY09-NP27	
	Net Income (Loss)	FY09-NP27	
	Volume(000)	50,217	
FedEx Dropboxes	Revenue	$24,634	
	Expenses	FY09-NP27	
	Net Income (Loss)	FY09-NP27	
Meter Manufacturers Program	Revenue	$17	
	Expenses	FY09-NP27	
	Net Income (Loss)	FY09-NP27	
Electronic Postmark (EPM)	Revenue	$450	
	Expenses	FY09-NP27	
	Net Income (Loss)	FY09-NP27	
MoverSource	Revenue	$37,019	
	Expenses	$1,272	
	Net Income (Loss)	$35,747	
Note: MoverSource Revenue is net of Gross Revenue and Alliance expenses			

	Licensing Programs		Revenue	$2,154	
			Expenses	FY09-NP27	
			Net Income (Loss)	FY09-NP27	
	Hybrid Mail		Revenue	$744	
			Expenses	FY09-NP27	
			Net Income (Loss)	FY09-NP27	

V. Nonpublic Annex

Section 3652(f)(1) contemplates the use of a nonpublic annex for documents or other materials that the Postal Service considers exempt from public disclosure, pursuant to 39 U.S.C. § 410(c) and 5 U.S.C. § 552(b). In particular, section 410(c)(2) exempts from mandatory disclosure "information of a commercial nature…which under good business practice would not be publicly disclosed." The FY07 ACR had a nonpublic annex containing, generally speaking, the following: 1) the billing determinants for domestic and international competitive products, 2) the ICRA, and all supporting documentation underlying the ICRA, and 3) data for international customized agreements with customers. In addition to those types of materials, the FY08 nonpublic annex also included *nonpublic* versions of the CRA and Cost Segments and Components reports that provided disaggregated as well as aggregated information for competitive products, plus versions of the CRA "B" workpapers, the CRA model, the files relating to the costing data systems (IOCS, CCCS, RCCS, and TRACS), and special cost study workpapers or other similar background materials which contained sensitive disaggregated information on competitive products. Additionally, though, the FY08 ACR also included *public* versions of those materials, which provided detailed information on market dominant products, but in which information on competitive products (if any) had been aggregated.

For this year, in accordance with section 3652(f)(1) of title 39, a complete listing of what is within the FY09 nonpublic annex is provided in the attached list of documents. *See,* Attachment A. In general, the FY09 nonpublic annex contains the same type of materials which were provided in the FY08 nonpublic annex. There are some important differences, however, regarding this year's split of materials between public and nonpublic documents and files. First, in the Public CRA, rather than aggregating all competitive product information into one row, that row has been disaggregated into five rows, each presenting information for a group of competitive products. The five groups are Total Express Mail, Total Priority Mail, Total Ground, Total International Competitive, and Competitive Services. The rows in the Nonpublic CRA which have been rolled up into each of those five rows in the Public CRA are listed in a table in the attached Application for Non-Public Treatment of the Nonpublic Annex. *See* Attachment Two, page 11. Second, the nonpublic annex this year includes information on individual domestic competitive product Negotiated Service Agreements (NSAs). Last year there was no comparable information to report, but this year, those data are provided in USPS-FY09-NP27. Third, because they were prepared on very short notice, last year's public versions of certain supporting documentation (e.g., CRA model, B workpapers, etc.) did not necessarily flow smoothly. This year, great effort was devoted to preserving linkages in the public versions, and the situation in that regard should be substantially improved. Once again, however, to preserve a unified set of source documents, the data reported in the ACR come from the non-public versions. Should any discrepancies arise between public and nonpublic versions because of issues such as rounding, the nonpublic versions would take precedence.[24]

Of course, another major difference between this year and last with respect to the nonpublic annex is the promulgation of the Commission's final rules on treatment of confidential material. Docket No. RM2008-1, Order No. 225 (June 19, 2009). As a consequence of those new rules, the Postal Service is providing the attached Application for Nonpublic Treatment of Materials regarding the nonpublic annex. Perhaps more importantly, however, eligible individuals who seek to examine what has been filed in the nonpublic annex may expect to get a prompt response to a request to view such materials under standard protective conditions. See Commission Rule 3007.40.

While the new rules establish the process by which issues of confidentiality are addressed, they should not alter the importance of the statutorily-recognized need to protect sensitive commercial information. The continued confidentiality of these types of data, for example, remains essential to the Postal Service's ability to negotiate international customized mailing agreements (ICMs), other bilateral and multilateral agreements with foreign postal administrations, and vendor arrangements that support international services. For ICMs and foreign post arrangements, revenue, piece, and weight data have also historically been treated as commercially sensitive and confidential. This treatment reflects the Postal Service's assessment that public

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[24] As it did last year, the Postal Service encourages any participant having difficulties working with any of its documentation, public or nonpublic, to contact Postal Service counsel to initiate informal dialogue to resolve any problems as quickly as possible. Given short timeframes, joint efforts at direct cooperation would seem to have the highest probability of promptly resolving technical difficulties, to the mutual benefit of all concerned.

disclosure of actual data concerning agreements, as well as retail services that compete with offerings by freight forwarders and other private international delivery companies, would interfere with the Postal Service's ability to compete for customers. This practice was consistently followed by the Postal Service in the numerous ICMs and other competitive agreements filed with the Commission during the course of this fiscal year.

Of course, while ICMs have been common in the past for international competitive products, the Postal Service has only rather recently under the PAEA begun to negotiate similar contract pricing arrangements with respect to domestic competitive products. Domestic customers for competitive products who under the PRA could influence the postal prices they paid only by participation in postal rate proceedings can now directly negotiate with the Postal Service for what they view as more favorable rates for their particular circumstances. Access to virtually any cost information on competitive products may give them an advantage in the negotiation process which, by definition, could act to the detriment of the Postal Service during that same negotiation process. These developments require reassessment to achieve an equilibrium that respects the Postal Service's enhanced competitive role, and the Commission's new responsibilities. Indeed, the language of the PAEA calls for such an equilibrium.[25]

Costing information for products as a whole, or for specific product features, tend to be highly confidential in the business world, and the Postal Service should be able to protect them in accordance with industry standards. The ability of the Postal Service to negotiate favorable contracts could be severely compromised if costing information becomes available either to the customers with whom the Postal Service is negotiating,

[25] *See, e.g.,* 39 U.S.C. § 3652(e)(1).

or to competitors who might also be seeking to negotiate contracts with the same customers. Postal Service's competitors, for example, could use such information to target their efforts and undercut the Postal Service's prices. The Postal Service is aware of no competitor or private shipping company of comparable size and scope that releases cost information regarding specific products to the public.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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December 29, 2009

Attachment One

LIST OF MATERIALS
PROVIDED BY THE UNITED STATES POSTAL SERVICE
FOR PURPOSES OF THE
FISCAL YEAR 2008 ANNUAL COMPLIANCE REPORT

Number	
USPS-FY09-1	FY 2009 Public Cost and Revenue Analysis (PCRA) Report
USPS-FY09-2	FY 2009 Public Cost Segments and Components Report
USPS-FY09-3	FY 2009 Discounts and Passthroughs of Workshare Items
USPS-FY09-4	FY 2009 Domestic Market Dominant Billing Determinants
USPS-FY09-5	Cost Segment and Components Reconciliation to Financial Statements and Account Reallocations (Reallocated Trial Balances) (Public Version)
USPS-FY09-6	General Classification of Accounts (Formerly Handbook F-8)
USPS-FY09-7	Cost Segment 3 Cost Pools & Other Related Information (Public Portion)
USPS-FY09-8	Equipment and Facility Related Costs
USPS-FY09-9	FY 2009 ACR Roadmap Document
USPS-FY09-10	FY 2009 Special Cost Studies Workpapers - Letter Cost Models (First and Standard)
USPS-FY09-11	FY 2009 Special Cost Studies Workpapers - Flat Cost Models (First and Standard) & Periodicals Cost Model

USPS-FY09-12	Standard Mail Hybrid/Parcel Cost Study
USPS-FY09-13	FY 2009 Special Cost Studies Workpapers - Drop Ship Cost Avoidances for Periodicals and Standard Mail
USPS-FY09-14	Mail Characteristics Study (Public Portion)
USPS-FY09-15	FY 2009 Special Cost Studies Workpapers – Bound Printed Matter Mail Processing Cost Model / Media Mail – Library Mail Mail Processing Cost Model
USPS-FY09-16	FY 2009 Special Cost Studies Workpapers - Bound Printed Matter Transportation Costs / Bulk Parcel Return Service Cost Model
USPS-FY09-17	2009 Comprehensive Statement of Postal Operations
USPS-FY09-18	FY 2009 ECR Mail Processing Unit Costs
USPS-FY09-19	FY 2009 Delivery Costs By Shape
USPS-FY09-20	FY 2009 Window Service Cost by Shape
USPS-FY09-21	FY 2009 QBRM and BRM Costs
USPS-FY09-22	FY 2009 Bound Printed Matter Mail Processing Costs
USPS-FY09-23	MODS Productivity Data
USPS-FY09-24	FY 2009 Non-Operation Specific Piggyback Factors (Public Portion)
USPS-FY09-25	FY 2009 Mail Processing Piggyback Factors (Operation Specific)

USPS-FY09-26	FY 2009 Mail Processing Costs by Shape (Public Portion)
USPS-FY09-27	FY 2009 Nonprofit Mail Cost Approximations
USPS-FY09-28	FY 2009 Special Cost Studies Workpapers – Special Services (Public Portion)
USPS-FY09-29	FY 2009 Special Cost Studies Workpapers – Alternative FCM Workshare Estimates
USPS-FY09-30	FY 2009 Market Dominant NSA Materials
USPS-FY09-31	FY 2009 CRA Model (Model Files, Cost Matrices, and Reports) (Public Version)
USPS-FY09-32	FY 2009 CRA “B” Workpapers (Public Version)
USPS-FY09-33	Rule 3050.14 Alternative Format Report for Market Dominant Products
USPS-FY09-34	City Carrier Cost System (CCCS) Statistical and Computer Documentation (Public Version)
USPS-FY09-35	Rural Carrier Cost System (RCCS) Statistical and Computer Documentation (Public Version)
USPS-FY09-36	Transportation Cost Systems (TRACS) Statistical and Computer Documentation (Public Version)
USPS-FY09-37	In-Office Cost System (IOCS) Statistical and Computer Documentation (Public Version)
USPS-FY09-38	USPS Market Dominant Product Customer Satisfaction Measurement Survey Instruments and Results
USPS-FY09-39	FY 2009 Competitive Products Fund Reporting Materials

USPS-FY09-40 2009 Rural Mail Count

USPS-FY09-41 International Market Dominant Billing Determinants

BELOW ITEMS WILL BE DESIGNATED AS <u>NONPUBLIC ANNEX</u>:

USPS-FY09-NP1	FY 2009 Domestic Competitive Product Billing Determinants
USPS-FY09-NP2	FY 2009 International Cost and Revenue Analysis (ICRA) report (Hard Copy & Excel)
USPS-FY09-NP3	FY 2009 International Cost Segments and Components Report (Hard Copy & Excel)
USPS-FY09-NP4	FY 2009 ICRA Domestic Processing Model (Cost Matrices, Reports, Control File, & Changes)
USPS-FY09-NP5	FY 2009 ICRA Overview/Technical Description
USPS-FY09-NP6	FY 2009 International Cost Segment Spreadsheets
USPS-FY09-NP7	Cost Segment 3 International Subclass Costs by Cost Pools (Volume Variable Cost Pools)
USPS-FY09-NP8	FY 2009 International Competitive Billing Determinants
USPS-FY09-NP9	FY 2009 Miscellaneous International Data
USPS-FY09-NP10	FY 2009 Competitive Product Incremental and Group Specific Costs
USPS-FY09-NP11	FY 2009 Nonpublic Cost and Revenue Analysis (NPCRA) Report (Hard copy & Excel)

USPS-FY09-NP12	FY 2009 Nonpublic Cost Segments and Components Report (Hard copy & Excel)
USPS-FY09-NP13	FY 2009 CRA Model (Model Files, Cost Matrices, and Reports)
USPS-FY09-NP14	FY 2009 CRA “B” Workpapers (Nonpublic Version)
USPS-FY09-NP15	FY 2009 Special Cost Studies Workpapers – Parcel Select/Parcel Return Service (PRS) Mail Processing Cost Model
USPS-FY09-NP16	FY 2009 Special Cost Studies Workpapers - Parcel Select/Parcel Return Service (PRS) Transportation Cost Model
USPS-FY09-NP17	FY 2009 Special Cost Studies Workpapers - Parcel Select / Parcel Return Service (PRS) Cube-Weight Relationship Estimation
USPS-FY09-NP18	Cost Segment 3 Cost Pools & Other Related Information (Nonpublic Portion)
USPS-FY09-NP19	FY 2009 Non-Operation Specific Piggyback Factors (Nonpublic Portion)
USPS-FY09-NP20	FY 2009 Mail Processing Costs by Shape (Nonpublic Portion)
USPS-FY09-NP21	In-Office Cost System (IOCS) Statistical and Computer Documentation (Nonpublic Version) (Source Code and Data on CD-ROM)
USPS-FY09-NP22	City Carrier Cost System (CCCS) Statistical and Computer Documentation (Nonpublic Version) (Source Code and Data on CD-ROM)

USPS-FY09-NP23	Rural Carrier Cost System (RCCS) Statistical and Computer Documentation (Nonpublic Version) (Source Code and Data on CD-ROM)
USPS-FY09-NP24	Transportation Cost Systems (TRACS) Statistical and Computer Documentation (Nonpublic Version) (Source Code and Data on CD Rom)
USPS-FY09-NP25	Mail Characteristics Study (Nonpublic Portion)
USPS-FY09-NP26	FY 2009 Special Cost Studies Workpapers – Special Services (Nonpublic Portion)
USPS-FY09-NP27	2009 Competitive NSA Materials
USPS-FY09-NP28	Rule 3050.14 Alternative Format Report for Competitive Products
USPS-FY09-NP29	Cost Segment and Components Reconciliation to Financial Statements and Account Reallocations (Reallocated Trial Balances) (Nonpublic Version)

APPLICATION OF THE UNITED STATES POSTAL SERVICE FOR NONPUBLIC TREATMENT OF MATERIALS

In accordance with 39 C.F.R. § 3007.21 and Order No. 225,[1] the United States Postal Service (Postal Service) hereby applies for nonpublic treatment of certain materials filed under seal with the Commission. The materials covered by this application consist of the entire Nonpublic Annex of the FY09 ACR. The Nonpublic Annex includes 29 separate folders, as shown on the List of Materials provided as Attachment 1 to the ACR. As is apparent from that List, the majority of these folders have a corresponding public folder. In many instances, a set of material has been divided into a portion that relates to Market Dominant products, and a portion that relates to Competitive products. In those instances, the public folder includes the portion of material relating to Market Dominant products, and the nonpublic folder includes the portion of materials relating to Competitive products. In many other instances, two versions of materials are prepared. The nonpublic versions present summary information, or contain the background material from which summary information has been developed, in which Competitive product data have been disaggregated to the product level. The corresponding public versions present summary information, or contain the background material from which summary information has been developed, in which Competitive product data have been aggregated above the product level. In still other instances, a nonpublic folder contains information about Competitive products, and there is no corresponding public folder, because there is no corresponding need for similar information relating to Market

[1] PRC Order No. 225, Final Rules Establishing Appropriate Confidentiality Procedures, Docket No. RM2008-1, June 19, 2009.

Dominant products. As an example, Commission Rule 3015.7(a) calls only for the incremental costs of Competitive products, so there is a nonpublic folder on the incremental costs of Competitive products, but there is no need for a corresponding public folder on the incremental costs of Market Dominant products. In general, except for the five groups of Competitive products for which cost data are shown in the Public CRA, all disaggregated cost information relating to Competitive products, and all background data used to develop disaggregated cost information on Competitive products, are filed under seal in the Nonpublic Annex.

(1) The rationale for claiming that the materials are nonpublic, including the specific statutory basis for the claim, and a statement justifying application of the provision(s);

The materials designated as nonpublic consist of commercial information concerning postal operations and finances that under good business practice would not be disclosed publicly. Based on its long-standing and deep familiarity with postal and communications business and markets generally, and its knowledge of many firms, including competitors, mailers, and suppliers, the Postal Service does not believe that any commercial enterprise would voluntarily publish information pertaining to the costs, volumes, revenues, and markets for its competitive products, as well as inbound market dominant products for which rates are negotiated with other postal operators. In the Postal Service's view, this information would be exempt from mandatory disclosure pursuant to 39 U.S.C. § 410(c)(2) and 5 U.S.C. § 552(b)(3) and (4).[2]

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[2] In appropriate circumstances, the Commission may determine the appropriate level of confidentiality to be afforded to such information after weighing the nature and extent of the likely commercial injury to the Postal Service against the public interest in maintaining the financial transparency of a government establishment competing in commercial markets. 39 U.S.C. § 504(g)(3)(A). The Commission has indicated that

(2) Identification, including name, phone number, and email address for any third-party who is known to have a proprietary interest in the materials, or if such an identification is sensitive, contact information for a Postal Service employee who shall provide notice to that third party;

The Postal Service believes that the only third parties that have a proprietary interest in the materials submitted in connection with the FY 2009 Annual Compliance Report are (1) entities, including foreign postal operators, holding competitive negotiated service agreements (NSAs) in FY 2009 for which data are reported on a contract-specific basis, (2) FedEx Express with respect to data concerning Global Express Guaranteed (GXG), (3) the Canada Post Corporation (CPC), (4) Correos de México, and (5) other foreign postal operators who tendered postal items to the Postal Service, or to whom the Postal Service tendered items, in FY 2009 at rates not of general applicability. Except with respect to the fourth category as described below, the Postal Service gives notice that it has already informed each third party, in compliance with 39 C.F.R. § 3007.20(b), of the nature and scope of this filing and its ability to address its confidentiality concerns directly with the Commission.

Various materials contain data specific to customers holding competitive NSAs, such as Priority Mail and/or Express Mail contracts, Parcel Select contracts, Parcel Return Service contracts, Global Expedited Package Services contracts, Global Plus 1 and 2 Contracts, Global Direct Contracts, Inbound Direct Entry agreements, Inbound International Expedited Services 1, the Royal Mail Inbound Air Parcel Post Agreement, Direct Entry Parcels contracts, and International Business Reply Service competitive

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"likely commercial injury" should be construed broadly to encompass other types of injury, such as harms to privacy, deliberative process, or law enforcement interests. PRC Order No. 194, Second Notice of Proposed Rulemaking to Establish a Procedure for According Appropriate Confidentiality, Docket No. RM2008-1, Mar. 20, 2009, at 11.

contracts. For certain of the NSA customers for which the Postal Service has already disclosed the counter-party's identity, the Postal Service identifies the following contacts:

- For the Inbound Direct Entry Contract with New Zealand Post Limited: Rachael Manson, Client Solutions Manager, +64 4496 4334, rachael.manson@nzpost.co.nz;
- For the Inbound Direct Entry Contract with China Post Group: Mr. Zhu Lei, Deputy Manager, International Operations, China Post EMS and Logistics Corporation (China Post Group), +86 10 67 077 331, zhulei@ems.com.cn;
- For the Inbound Direct Entry Contract with Hongkong Post: Jeremy Wan, Senior Manager, International Letters, +852 2921 6026, jeremy_wan@hkpo.gov.hk;
- For the Inbound Direct Entry Contract with P&T Express Service Joint Stock Company: Ms. Dang Thi Bich Hoa, General Director, +84 3 757 5577, hoadb@ems.com.vn;
- For the Royal Mail Inbound Air Parcel Post Agreement: Iain Johnson, Director, International Products, Parcelforce Worldwide (Royal Mail Group Limited), +44 1908 687 261, iain.johnson@parcelforce.co.uk.

Due to language and cultural differences as well as the sensitive nature of the Postal Service's rate relationship, the Postal Service proposes that a designated Postal Service employee serve as the point of contact for any notices to China Post Group regarding Inbound International Expedited Services 1.[3] The Postal Service identifies as

[3] The Postal Service acknowledges that 39 C.F.R. § 3007.21(c)(2) appears to contemplate only situations where a third party's identification is "sensitive" as permitting the designation of a Postal Service employee who shall act as an

an appropriate contact person Kang Zhang, General Manager, Business Development, Asia/Pacific. Mr. Zhang's telephone number is (202) 268-8918, and his email address is kang.zhang@usps.gov. Because the Postal Service maintains that the remaining competitive NSA customers' identities are commercially sensitive and should not be publicly disclosed, the Postal Service employee responsible for providing notice to these third parties is Eric Koetting, Attorney, Pricing and Product Support. Mr. Koetting's telephone number is (202) 268-2992, and his email address is eric.p.koetting@usps.gov.

The International Cost and Revenue Analysis (ICRA) report and supporting documentation contain data specific to GXG service, which the Postal Service offers in partnership with FedEx Express.[4] The Postal Service identifies James H. Ferguson, Staff Vice President, Customer and Business Transactions, FedEx Corp. & General Counsel, FedEx Corporate Services, Inc., as the appropriate contact on behalf of FedEx Express. Mr. Ferguson's telephone number is (901) 434-8600, and his email address is jferguson1@fedex.com.

The International Cost and Revenue Analysis (ICRA) report contains data for various products that is specific to CPC. These data pertain to various categories of inbound mail that CPC tenders in a "customer" capacity and to categories of outbound

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intermediary for notice purposes. To the extent that the Postal Service's response might be construed as beyond the scope of this exception, the Postal Service respectfully requests a waiver that would allow it to designate a Postal Service employee as the contact person under these circumstances, in light of the practical considerations outlined herein.

[4] Although FedEx Express might have a proprietary interest in data reflecting charges between the Postal Service and FedEx Express and possibly data showing volume or weights for GXG, the Postal Service maintains that the Postal Service is the only party with a proprietary interest in revenue data reflecting GXG transactions between the Postal Service and its customers.

mail that CPC delivers for the Postal Service in a "supplier" role, in both cases pursuant to CPC's negotiated bilateral agreement with the Postal Service. The Postal Service identifies Dave Eagles, Director, International Relations, Canada Post Corporation, as the appropriate contact on behalf of CPC. Mr. Eagles' telephone number is (613) 734-6043, and his email address is dave.eagles@canadapost.ca. CPC has requested that any communications regarding confidential treatment of these data be sent with a courtesy copy to Dennis Jarvis, Director, International Business, Canada Post Corporation. Mr. Jarvis's telephone number is (613) 734-8149, and his email address is dennis.jarvis@canadapost.ca.[5]

The ICRA report also contains inbound and outbound international mail data specific to Correos de México, the public postal operator for Mexico, and in which Correos de México might be deemed to have a proprietary interest. For the same reasons as for Inbound International Expedited Services 1, the Postal Service proposes that a designated Postal Service employee serve as the point of contact for any notices to the relevant postal operator. The Postal Service identifies as an appropriate contact person Guadalupe Contreras, Acting Business Systems Manager, International Postal Affairs. Ms. Contreras's phone number is (703) 292-4098, and her email address is guadalupe.n.contreras@usps.gov.

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[5] In the event of a request for early termination of non-public treatment under 39 C.F.R. § 3007.31, a preliminary determination of non-public status under 39 C.F.R. § 3007.32, or a request for access to non-public materials under 39 C.F.R. § 3007.40, the Postal Service notes, on CPC's behalf, that differences in the official observation of national holidays might adversely and unduly affect CPC's ability to avail itself of the times allowed for response under the Commission's rules. In such cases, CPC has requested that the Postal Service convey its preemptive request that the Commission account for such holidays when accepting submissions on matters that affect CPC's interests. A listing of Canada's official holidays can be found at http://www.pch.gc.ca/pgm/ceem-cced/jfa-ha/index-eng.cfm.

Finally, the ICRA report contains rate information and other information that might be deemed proprietary to postal operators whose governments are members of the UPU. For the same reasons as for Inbound International Expedited Services 1, the Postal Service proposes that a designated Postal Service employee serve as the point of contact for any notices to the relevant postal operators. The Postal Service identifies as an appropriate contact person Brian Hutchins, Manager, International Postal Relations. Mr. Hutchins' phone number is (703) 292-3591, and his email address is brian.hutchins@usps.gov. In view of the practical difficulties, the Postal Service has not undertaken to inform all affected postal operators about the nature and scope of this filing and about the ability to address any confidentiality concerns directly with the Commission as provided in 39 C.F.R. § 3007.20(b). To the extent that the Postal Service's filing in the absence of actual notice might be construed as beyond the scope of the Commission's rules, the Postal Service respectfully requests a waiver that would allow it to forgo providing a notice to each postal operator. It is impractical to communicate with dozens of operators in multiple languages about this matter.

(3) A description of the materials claimed to be nonpublic in a manner that, without revealing the materials at issue, would allow a person to thoroughly evaluate the basis for the claim that they are nonpublic;

The materials in the Nonpublic Annex fall into several categories. The first category is the Nonpublic CRA, and all of the background materials feeding into the Nonpublic CRA. These materials, in general, show cost information at the product level, including disaggregated information for Competitive products. These materials are found in folders USPS-FY09-NP11, USPS-FY09-NP12, USPS-FY09-NP13, USPS-FY09-NP14, USPS-FY09-NP18, USPS-FY09-NP21, USPS-FY09-NP22, USPS-FY09-

NP23, USPS-FY09-NP24, USPS-FY09-NP26, USPS-FY09-NP27, and USPS-FY09-NP28. Descriptions of the contents of these folders can be found in the roadmap document, filed as USPS-FY09-9. The roadmap indicates the corresponding public folder which contains information similar to that in nonpublic folder, except that, in the public folder, the cost information for Competitive products is generally aggregated into one Competitive products row. Therefore, examination of the corresponding public folder should allow a person to understand the nature of the contents of the nonpublic folder, and evaluate accordingly.

A second category consists of Special Cost Studies materials that provide cost information below the product level for Competitive products. These materials are found in folders USPS-FY09-NP15, USPS-FY09-NP16, USPS-FY09-NP17, USPS-FY09-NP19, USPS-FY09-NP20, and USPS-FY09-NP25. Again, descriptions of the contents of these folders can be found in the roadmap document, filed as USPS-FY09-9. The roadmap indicates the corresponding public folder which contains information similar to that in the nonpublic folder, except that, in the public folder, the cost information below the product level relates to Market Dominant, rather than Competitive products. Therefore, examination of the corresponding public folder should allow a person to understand the nature of the contents of the nonpublic folder, and evaluate accordingly.

A third category consists of the International CRA (ICRA) and the supporting documentation. These materials are found in folders USPS-FY09-NP2 through USPS-FY09-NP7, and USPS-FY09-NP9. Collectively, they present the inputs and the analyses used to attribute and distribute costs to International products. In general, the

ICRA follows the same basic methodologies used in the CRA -- dividing accounting data into cost segments and components, distributing the attributable costs within segments to products, and summing up the total attributable costs of a product across segments. Descriptions of the contents of the individual ICRA-related folders can be found in the roadmap document, USPS-FY09-9. There are no corresponding public folders.

A fourth category is the Competitive product billing determinants. These are found in USPS-FY09-NP1 for domestic Competitive products, and USPS-FY09-NP8 for International products. They are comparable in format to the Market Dominant billing determinants presented in USPS-FY09-4, but include the corresponding information for Competitive products. Again, examination of the corresponding public folder should allow a person to understand the nature of the contents of the nonpublic folder, and evaluate them accordingly.

Another folder in the Nonpublic Annex is USPS-FY09-NP10, which presents the application of the incremental cost methodology set forth in the Petition for Proposal Twenty-two (filed on Oct. 23, 2009, and considered as part of Docket No. RM2010-4) to Competitive products. The outputs of that application are shown in the text of the FY 2009 ACR itself, and USPS-FY09-NP10 merely provides the background materials supporting those outputs. The incremental cost model used in USPS-FY09-NP10 is quite comparable to the model employed in USPS-T-18 in Docket No. R2006-1, and the group specific costs are based on the same type of analysis considered last year by the Commission as Proposal One in Docket No. RM2008-2, and applied (to Market

Dominant products) in USPS-FY08-33. The contents of USPS-FY09-NP10 are described in the roadmap document, USPS-FY09-9.

In general, the premise of this application is that, for Competitive products and certain market dominant international products, disaggregated cost data (and detailed volume and revenue data, such as that provided in billing determinants) constitute commercially-sensitive information and should not be publicly disclosed. The Postal Service is therefore placing all such information in the Nonpublic Annex, and filing it under seal. One exception to this approach appears in the Public CRA. The Public CRA (USPS-FY09-1) presents some disaggregated data for Competitive products, but those data are not disaggregated down to the product level, as they are in the Nonpublic CRA (USPS-FY09-NP11). Instead, in the Public CRA, the Postal Service is breaking out data for Competitive products into five Competitive product groups. Those groups are Total Express, Total Priority, Total Ground, Total International Competitive, and Total Competitive Services. (The product rows in the Nonpublic CRA that are rolled up into each of the five Competitive product group rows in the Public CRA are shown in the table below.) At this level of disaggregation, the Postal Service has been unable to identify any of its major competitors that are publicly disclosing a potentially greater amount of disaggregated competitive cost data. The Postal Service maintains that the further disaggregation shown in the Nonpublic CRA should thus appropriately remain confidential. The Postal Service believes that the approach jointly embodied in its Public CRA and Nonpublic CRA prudently maximizes the amount of information available to the public, keeping such information as detailed as possible without prompting the competitive concerns outlined in the following section below.

Category in Public Version CRA	Categories Rolled in from Nonpublic Version CRA
Total Express Mail	Domestic Express Mail Domestic Express Mail Neg. Serv. Agreements
Total Priority Mail	Domestic Priority Mail Domestic Priority Mail Neg. Serv. Agreements Priority Mail Fees Priority Mail Neg. Serv. Agreement Mail Fees
Total Ground	Parcel Select Parcel Select Negotiated Serv. Agreement Mail Parcel Select Mail Fees Parcel Select Neg. Serv. Agreement Mail Fees Parcel Return Service Mail Parcel Return Serv. Neg. Serv. Agreement Mail
Total Competitive International	Outbound International Expedited Services Outbound Intl. Expedited Services NSA Mail Inbound International Expedited Services Inbound Intl. Expedited Neg. Serv. Agreements Outbound Priority Mail International Outbound Priority Mail Intl. NSA Mail Inbound Air Parcel Post Inbound Intl. Priority Mail Neg. Serv. Agreements International Priority Mail (IPA) International Surface Airlift (ISAL) International Direct Sacks M-Bags Inbound Surf. Parcel Post (at Non-UPU Rates) Outbound Intl Negotiated Serv. Agreement Mail Inbound Intl Negotiated Serv. Agreement Mail
Total Competitive Services	Premium Forwarding Service International Money Transfer Service (IMTS) International Ancillary Services

(4) Particular identification of the nature and extent of commercial harm alleged and the likelihood of such harm;

If the information that the Postal Service determined to be protected from disclosure due to its commercially sensitive nature were to be disclosed publicly, the Postal Service considers it quite likely that it would suffer commercial harm. This information is commercially sensitive, and the Postal Service does not believe that it would be disclosed under good business practices. In this regard, the Postal Service is not aware of any business with which it competes (or in any other commercial enterprise), either within industries engaged in the carriage and delivery of materials and hard copy messages, or those engaged in communications generally, that would disclose publicly information and data of comparable nature and detail.

The protected materials consist of comprehensive analytical tools and reports employed by the Postal Service for several purposes in its operations and finances. Most prominently, in the context of the ACR, they enable the Postal Service to address the issues mandated in 39 U.S.C. § 3652(a) having to do with the costs, revenues, rates, and quality of service of competitive postal products. Furthermore, many of the materials outlined in section (3) above consist of sub-reports, workpapers, and other documentation used to create the basic reports in the CRA and ICRA. These materials share the protected status and confidential nature of the basic reports, since they provide the building blocks that permit compilation of the data and statistics and would permit competitors to gain the same types of knowledge, understanding, and insights at finer levels of detail. The Postal Service believes that this information would lead to competitive harm, if publicly disclosed.

As explained below, the data and information considered to be non-publc can be classified in several general groupings: product cost information; general product volume and revenue information; product billing determinants; and information pertaining to service and pricing agreements with particular mailers (NSAs). The following describes generally the expected harms from each of these classes of information. The explanations also include a separate discussion of international mail products, and their relatively distinct characteristics that arise from the structure of international business, including the involvement of foreign postal administrations and international organizations.

<u>Cost Information</u>

Information relating to the costs of producing products is generally considered to be among the most sensitive commercial information. The CRA and ICRA present data and statistics for products that would provide competitors with valuable information, enabling them to better understand the Postal Service's cost structures, operational capabilities, and its pricing and marketing strategies. This confidential information includes per-piece costs in several analytical categories (attributable costs, volume variable costs, and product-specific costs), as well as cost contribution and cost coverage (margin) by product. Such information would be extremely valuable to competitors in assessing the strengths and weaknesses of various postal products. Armed with detailed product cost information, competitors would be able to better identify and understand areas where they could adapt their own operations to be more competitive with postal products and better assess how to price and market their own products in such a way as to target the Postal Service's weaknesses and compensate for its strengths in producing and marketing various products. Furthermore, information contained in the various sub-reports, workpapers, and other documentation that feed the reports would provide an even more refined knowledge of the Postal Service's costs, cost structures, and capabilities. In this regard, the structure of the Postal Service's analytical tools and reports is well known among the postal community from years of exposure in general rate cases under the former regulatory regime. Postal costs are recorded in elaborate systems of general ledger accounts. These are grouped into various functional and other categories (cost segments and components) for further analysis and ultimate allocation and distribution to individual products. The level of detail contained in the sub-reports and workpapers is highly refined and would enable competitors, and existing and potential customers with whom the Postal Service might negotiate particular contract rates, to gain competitive or negotiating advantages that could lead to suppressing potential financial gains from the sale of postal products or the diversion of business away from the Postal Service to competitors. Either of these results would constitute serious commercial harm.

Volume and Revenue Information

Competitors could use the product-specific revenue, pieces, and weight information to analyze the Postal Service's possible market strengths and weaknesses and to focus sales and marketing efforts on those areas, to the detriment of the Postal Service. Disclosure of this information would also undermine the Postal Service's position in negotiating favorable terms with potential customers, who would be able to ascertain critical information about relevant product trends (*e.g.*, average revenue per piece, average weight per piece). Finally, as explained in greater detail below, disclosure would expose certain foreign postal administrations and other customers to the same competitive harms, to the extent that a category is associated with a single customer or a small group of customers. The Postal Service considers these to be highly probable outcomes that would result from public disclosure of the material filed nonpublicly.

Billing Determinants

Billing determinants present a special category of volume and revenue information that would enable highly refined understanding of individual products aligned specifically to their specific price structures. In this regard, billing determinants present a picture of each product's experience, analyzed according to the different mail characteristics that comprise the elements of the product's price structure. Detailed billing determinants, especially combined with specific product cost information, would enable competitors to better analyze strengths and weaknesses of individual products, including specific elements of the markets for them, such as advantages in certain weight categories and distance zones. This information would provide insights into how competitors might adapt their operations and product offerings, alter their pricing, and target their marketing to take business away from the Postal Service.

Armed with this type of information, competitors would likely focus their marketing and price cutting efforts on the Postal Service's most profitable products. This would lead to erosion of contribution for these products through lost sales and/or the need to lower prices to remain competitive. Postal product cost and contribution information would provide suppliers of postal transportation and other services with information they could use to seek higher rates for services they provide. This would lead to higher postal costs and loss of contribution. Although the extent of the commercial harm is difficult to quantify, even small changes in market share, prices, or costs could lead to millions of dollars in lost revenue, higher costs, and lower margins. It is highly likely that if this information were made public, the Postal Service's competitors and suppliers would take advantage of it almost immediately.

Negotiated Service Agreements

The utility of the sensitive information in billing determinants and other materials would be particularly enhanced with regard to NSA product information relating to particular customers. First, revealing any customer identifying information would enable competitors to focus marketing efforts on current postal customers which have been cultivated through the Postal Service's efforts and resources. The Postal Service considers that it is highly probable that, if this information were made public, the Postal Service's competitors would take immediate advantage of it. Many NSAs include a provision allowing the mailer to terminate the contract without cause by providing at least 30 days' notice. Therefore, there is a substantial likelihood of losing the customers to a competitor that targets them with lower pricing.

Other NSA-related information consists of mailing profiles. This information, if disclosed from any source within the CRA or ICRA, would offer competitors invaluable insight into the types of customers to whom the Postal Service is offering each type of competitive NSA. Even without identifying individual mailers, competitors would be able to direct their sales and marketing efforts at the customer segment that the Postal Service has had the most success at attracting. This would undermine both existing customer relationships and the potential for other new NSA customers.

A similar rationale applies to information showing published price, product revenue, volume according to weight, pricing, and insured value levels, as well as adjustment factor calculations based on product revenues. This information is commercially sensitive, and the Postal Service does not believe that it would be disclosed under good business practices. Competitors could use the information to analyze the Postal Service's possible market strengths and weaknesses and to focus sales and marketing efforts on those areas, to the detriment of the Postal Service. The Postal Service considers these to be highly probable outcomes that would result from public disclosure of the material filed nonpublicly.

Commercially sensitive information related to NSAs is included in the agreements and their annexes, or in related financial work papers. Typically, these materials are filed under seal or redacted when the agreements are established as products. Since the Commission's rules governing confidentiality have taken effect, the Postal Service has filed applications for nonpublic status with each agreement. The reasoning expressed in those applications supports and is consistent with the discussion here.

Information derived from these documents is included in some of the materials filed in the Nonpublic Annex here. This Information may include rates, product cost, contribution, or cost coverage. It also may concern customer mailing profiles, product volume, weight and revenue distribution, and product insured-value distribution. Competitors for the services covered by these agreements would consist of domestic and international transportation and delivery firms, and might include foreign postal operators, who could use the information to their advantage in negotiating the terms of their own agreements with the Postal Service. Also, competitors could use the information to assess offers made by the Postal Service to customers for any possible comparative vulnerabilities, and to focus sales and marketing efforts on those areas, to the detriment of the Postal Service. Customers could also use the information to their advantage in negotiating the terms of their own agreements with the Postal Service. The Postal Service considers these to be highly probable outcomes that would result from public disclosure of the redacted material.

Potential customers (which can include foreign posts) could deduce from the rates provided in individual pricing agreements, from the information in work papers, or in a Governors' Decision, whether additional margin for net profit exists. From this information, each customer or foreign postal operator could attempt to negotiate ever-decreasing prices or incentives, such that the Postal Service's ability to negotiate competitive yet financially sound rates would be compromised.

Information derived from financial work papers supporting NSAs can include costs, assumptions used in pricing formulas and decisions, formulas and negotiated prices, mailer profile information, projections of variables, and cost coverage and contingency rates which have been included to account for market fluctuations and exchange risks. All of this information is highly confidential in the business world. If this information were made public, the Postal Service's competitors would have the advantage of being able to assess the Postal Service's costs and pricing, and determine the absolute floor for Postal Service pricing, in light of statutory, regulatory, or policy constraints. Competitors would be able to take advantage of the information to offer lower pricing to postal customers, while subsidizing any losses with profits from other customers. Such competitors could include foreign posts, which are not required in some instances to use the Postal Service for delivery of parcels destined to the United States. Additionally, foreign postal operators or other potential customers could use costing information to their advantage in negotiating the terms of their own agreements with the Postal Service. Eventually, this could freeze the Postal Service out of the relevant markets.

International Product Information

The Postal Service believes that the same vulnerabilities and harms discussed above that would result from the disclosure of the cost, volume, and billing determinant information generally would also apply to international product information designated as nonpublic. In particular, the harms resulting from disclosure of competitive information in the CRA would also result from disclosure of similar information, workpapers, and supporting documentation related to the ICRA. International mail products and business, however, exhibit operational and pricing distinctions not always shared by the domestic counterparts. In particular, international products may be either inbound or outbound and, in some instances, are affected by bilateral and multilateral agreements among foreign postal administrations. In some cases, particular lines within the ICRA reflect agreements with a single foreign postal administration, and the public disclosure of the information would likely lead to limitations on the negotiating positions of both the Postal Service and the other foreign postal administration in similar agreements they might wish to negotiate with other foreign postal administrations. The same is true where the partner is a private entity rather than a foreign postal administration: for example, disclosure of statistical, billing, and cost information about GXG could limit the ability of FedEx Express, a supplier to the Postal Service, to negotiate effectively and could allow competitors to analyze the traffic for competitive advantage against FedEx Express. Further, the outbound letter monopoly has been largely suspended by virtue of 39 CFR 320.8, thereby contributing to the intensity of competition in this market. The more disaggregated nature of the product information in the international context and the relatively smaller numbers associated with them makes the international data particularly vulnerable to analysis and use by competitors.

(5) At least one specific hypothetical, illustrative example of each alleged harm;

The following restates the harms discussed above and presents at least one hypothetical situation illustrating the consequences of disclosure.

Harm: Competitors, mailers, and suppliers could use cost, revenue, and volume summary data and statistics in the CRA and the ICRA, disaggregated by individual product and by NSA category, to gain knowledge and insights regarding the relative strengths and weaknesses of the Postal Service's competitive product lines. Such refined understanding would give competitors advantages in seeking to divert business from the Postal Service and to gain new business for which the Postal Service might compete. Mailers and suppliers would be able to negotiate favorable deals with the Postal Service more effectively. As a result, the Postal Service would experience losses of existing and new business, or erosion of contributions and margins.

Hypothetical: The CRA and ICRA provide data by product indicating total revenues, attributable costs, volume variable costs, product specific costs, and per-piece attributable costs, contribution, and cost coverage (margin), broken out by individual product, and separated between products purchased through public schedules and those purchased through contract rates (NSAs). Hypothetically, this information would be made public. Competitors would use it to gain a refined understanding of the relative strengths and weaknesses of the Postal Service's product lines (domestic and international), the individual strengths and weaknesses of particular products, and the degree to which products are sold through public schedules, compared to contract pricing arrangements. This information would provide a better foundation to enable competing firms to make decisions regarding investments and product design in their own product lines. For example, firms that have individual products for domestic express service (overnight) or international express service, as well as products comparable to Priority Mail, could assess their own prospects for competing with these product lines, respectively, and decide to allocate investments in improved operations, supplier arrangements, and technologies to improve their competitive positions against the weakest Postal Service products. To the extent that these decisions made firms more competitive, the Postal Service could lose existing or new business.

Hypothetical: Cost, contribution, and/or cost coverage information is released to the public and available to a competitor. The competitor, including foreign postal administrations operating in the United States, could assess the profitability of certain services based on the data released. The competitor then would target its advertising and sales efforts at actual or potential customers in market segments where the Postal Service has substantial contribution, thereby hindering the Postal Service's ability to keep these customers' business.

Hypothetical: Cost, contribution, and/or cost coverage information is released to the public and available to a supplier of materials, transportation, or other services. Suppliers would be made aware of expected contribution margins by product and would be better able to assess the relative strengths and weaknesses of the Postal Service's product lines. With this information, suppliers, including foreign postal administrations in the case of international products, would decide to increase the rates they charge the Postal Service to provide transportation and/or other services, or would be able to negotiate better prices for their goods and services.

Hypothetical: Cost information is disclosed to the public. Mailers who seek to negotiate individual contract rates with the Postal Service would gain a better understanding of the average or unit costs of particular products, as well as the relative and absolute strengths and weaknesses of particular product lines. This information would enable the mailers to negotiate contract rates with the Postal Service more effectively than in the absence of such information. Similar disclosures would result in advantages for foreign postal administrations or other competitive entities in international mail.

Harm: The various companion reports, sub-reports, workpapers, special cost and other studies, and documentation contained in the Nonpublic Annex would provide detailed and refined knowledge and understanding of the individual costs, cost structures, contributions, and cost coverages (margins) of individual postal products and contract pricing agreements. These materials, which produce and support the summary data and statistics contained in the CRA and ICRA, would provide highly detailed information regarding operational procedures used to produce the products, the costs and relative efficiencies of operations and sub-operations, and the amount and character of overhead, including the relative proportions of volume variable and overhead costs. Companion reports and sub-reports provide detailed functional analyses of Postal Service costs within a framework that is well-understood, or easily learned, from information in the Public Annex, or from familiarity with or research into past postal rate cases. Public disclosure would therefore be tantamount to publishing virtually every detail regarding the relative costs and efficiencies of providing postal competitive products. This information would provide blueprints for competitors, suppliers, and mailers who might seek to negotiate favorable contract rates. The information would better enable them to make favorable operational, investment, pricing, and marketing decisions in relationships with the Postal Service. The results would be loss of existing or future business for the Postal Service, or the erosion of total revenues, contributions, margins, and overall financial stability.

Hypothetical: The Cost Segments and Components reports of the CRA and ICRA are disclosed to the public. These reports group costs recorded in postal accounts according to various functional categories. The costs are distributed by postal product. Disclosure would provide competitors with a detailed understanding of the cost structures of each competitive postal product, the relative strengths and weaknesses of each product from cost perspectives, and the flexibilities available to the Postal Service within the legal framework applicable to postal prices. The refined understanding resulting from disclosure would better enable competitors to make decisions that would compensate for Postal Service strengths and capitalize on its weaknesses. These decisions might involve design of competing firms' own products, alternative price structures, operational procedures, and marketing strategies. They could also involve formulation of negotiating approaches and strategies by existing and potential suppliers of goods and services used in producing postal products, and the formulation of more informed negotiating positions by mailers seeking to enter into favorable contract rate arrangements with the Postal Service. Such competitive advantages could lead to diversion of business away from the Postal Service or reduction of potential contribution from individual contracts.

Hypothetical: Cost distribution models, cost estimation models, and several sub-reports feeding into the CRA and ICRA are disclosed to the public. These materials provide highly refined information that would improve understanding of product cost structures and the behavior of postal costs. Certain cost reports, such as those outlining in detail the application of specific cost pools by mail processing operation in estimating product costs, would provide detailed knowledge of operational procedures employed by the Postal Service in offering products and services. This information would enhance competitors' abilities to make informed decisions about investment in capital and technologies used to produce their own competing products. For example, knowledge of inflexibilities in processing Priority Mail, or in transportation used to convey Parcel Return Service, might lead competitors to explore more efficient processing of competing products, or to negotiate more competitive transportation contracts used for competing products. Over time, annual disclosures of such information would enable competitors (or suppliers and mailers) to identify and understand trends in cost behavior that would better inform their decision-making. Such developments would lead to an erosion of the Postal Service's competitive position and a loss of business or contribution.

Hypothetical: Information in certain reports and documentation of special cost and other studies (*e.g.*, Parcel Return Service cost models) is disclosed publicly. Such information would provide a better understanding of the Postal Service's customer base for particular products. For instance, data from mail characteristics studies would enable competitors to formulate a profile of the Postal Service's customer base for certain products. This information would better enable competitors to devise marketing and sales strategies that would target the most vulnerable markets for particular postal products. More effective marketing by competitors would lead to reduced sales by the Postal Service and an erosion of contributions and margins.

Hypothetical: Cost models and sub-reports feeding the CRA and ICRA reports are disclosed to the public. Detailed knowledge of the Postal Service's cost estimation, cost distribution, and special study models and procedures would provide competitors, as well as mailers who seek favorable contract rates, with tools that would enhance their abilities to analyze postal costs and operations. While large, sophisticated firms who have competed with the Postal Service for long periods of time might not benefit as much from these models, since they have been exposed to them before and likely have developed their own sophisticated analytical tools, the availability of this information might benefit new firms and, in effect, decrease barriers to entry in certain competitive markets.

Harm: Competitors could use disaggregated product volume, weight, and revenue distribution information to assess vulnerabilities and focus sales and marketing efforts to the Postal Service's detriment.

Hypothetical: Disaggregated revenue, volume, and weights contained in the Nonpublic Annex are disclosed to the public. Another delivery service's employee could monitor the filing of this information and pass it along to the firm's sales and marketing functions. The competitor could assess the profitability of certain services on a per-piece or per-pound basis, or the Postal Service's relative concentration in certain service offerings. The competitor could then target its advertising and sales efforts at actual or potential customers in market segments where the Postal Service appears to have made headway, hindering the Postal Service's ability to reach out effectively to these customers.

This example applies even more strongly for information split between Negotiated Service Agreement (NSA) mail and other mail in the same category, because the competitor would assess the profitability and market strengths of the Postal Service's offerings to a small subset of NSA customers, thereby gaining somewhat more particularized insight into the characteristics of customers that the Postal Service specifically targets with its own contractual sales efforts.

A more pointed variant on this hypothetical pertains to Inbound International Letter-Post NSA Mail and Inbound Surface Parcel Post (at Non-UPU Rates). Because these are associated with a single foreign postal administration (*e.g.*, Canada Post

Corporation (CPC)), a competing delivery service provider with access to this information could use it to determine the average per-item and per-pound price offered by the Postal Service to CPC, as well as the average weight of Inbound Letter-Post and Surface Parcel Post items from Canada. The competitor could use that information as a baseline to negotiate with freight companies to develop lower-cost alternatives and entice CPC's volume away from the Postal Service's domestic. delivery network.

Harm: Customers, including foreign postal administrations, and suppliers could use disaggregated product volume, weight, and revenue distribution information to undermine the Postal Service's leverage in negotiations.

Hypothetical: Disaggregated revenue, volume, and weight information in the Nonpublic Annex would be released to the public. A foreign postal administration's employee would monitor the filing of this information and pass the information along to its international postal relations functions. The foreign postal administration would assess the Postal Service's average per-item or per-pound revenue for categories about which it is negotiating with the Postal Service, with particular focus on categories known to be included in NSAs with other foreign postal administrations (*e.g.*, Inbound International Letter-Post NSA Mail, Inbound International Priority Mail Negotiated Service Agreements, Inbound Surface Parcel Post (at Non-UPU Rates), Inbound Air Parcels, and Inbound EMS). Accurately or not, the foreign postal administration would use the average revenue information as a justification for pricing demands in negotiations, refusing to accept a higher price without steeper concessions than the Postal Service might otherwise have been able to foreclose. The Postal Service's ability to negotiate the best value from the bargain would suffer as a result. This hypothetical applies with equal force for customers other than foreign postal administrations, for NSA mail and non-NSA mail that can be made subject to an NSA (*e.g.*, International Priority Airmail, which can be included in Global Plus 1 NSAs), and for partnerships with suppliers such as FedEx Express with respect to GXG.

Harm: Public disclosure of information in the report would be used by competitors of the NSA customers to their detriment.

Hypothetical: A competitor of a Postal Service NSA customer could obtain unredacted versions of the billing determinants for domestic and international products, including NSAs and ICMs. It would analyze the work papers to assess the customer's underlying costs, and use that information to identify lower cost alternatives to compete against the Postal Service customer. Likewise, suppliers of goods and services to the NSA customer could use the detailed information to their advantage in negotiations with the NSA customer.

Harm: Public disclosure of information contained in the Nonpublic Annex associated with international delivery services provided in partnership with specific third parties would be used by those parties' competitors to their detriment.

Hypothetical: A competitor of Canada Post, such as a competing international delivery service, would obtain information contained in the Nonpublic Annex. The competitor would analyze the information to assess the average per-piece and per-pound revenue for Inbound International Letter-Post NSA Mail, Inbound Xpresspost, and/or Inbound Surface Parcels (at Non-UPU Rates), which correspond to Canada Post's average per-piece and per-pound cost for U.S. delivery of its pertinent products. The competitor would use that information to assess the market potential and, as a baseline, to negotiate with U.S. customs brokers and freight companies to develop lower-cost alternatives and undermine Canada Post's market offerings. The same scenario could apply with respect to comparable information, such as settlement charges due or payable, for other foreign postal operators or for FedEx Express concerning GXG.

Harm: Competitors could use customer mailing profiles, product volume, weight, and revenue distributions, and product insured-value distribution information to assess vulnerabilities and focus sales and marketing efforts to the Postal Service's detriment.

Hypothetical: Customer mailing profile information in the Nonpublic Annex is released to the public. Another delivery service's employee would monitor the filing of this information and pass the information along to its sales and marketing functions. The competitor would assess the typical size, mailing volume, and content characteristics of Postal Service NSA customers. The competitor would then target its advertising and sales efforts at actual or potential customers with similar profiles, hindering the Postal Service's ability to reach out effectively to these customers.

This hypothetical would apply even for more generic product-level data, from which one could calculate the distribution of the Postal Service's overall customer base in terms of item weight, revenue, or value (in the case of international insurance). For these reasons, release of any of the nonpublic information would pose actual commercial harm to the Postal Service, regardless of the information's present favorability.

Harm: Revealing customer identifying information associated with competitive domestic and international NSAs would enable competitors to target the customers for sales and marketing purposes.

Hypothetical: The identities of customers in which rates are established in NSAs would be revealed to the public. Another expedited delivery service would pass along the information to its sales function. The competitor's sales representatives would quickly contact the Postal Service's customers and offer them lower rates or other incentives to terminate its contract with the USPS in favor of using the competitor's services. Lost sales would undermine the Postal Service's revenues.

Harm: In billing determinants and supporting documentation pertaining to domestic and international competitive NSAs, disclosure of information that would reveal prices associated with particular pricing agreements would provide competing domestic and foreign postal operators, or other potential customers, extraordinary negotiating power to extract lower rates from the Postal Service.

Hypothetical: Customer A's negotiated rates are disclosed publicly. Customer B sees the rates and determines that there may be some additional profit margin between the rates provided to Customer A and the statutory cost coverage that the Postal Service must produce in order for the agreement to be added to the competitive products list. Customer B, which was offered rates identical to those published in Customer A's agreement, then uses the publicly available rate information to insist that it must receive lower rates than those the Postal Service has offered it, or it will not use the Postal Service for its expedited package service delivery needs.

Alternatively, Customer B attempts to extract lower rates only for those destinations for which it believes the Postal Service is the low-cost provider among all service providers. The Postal Service may agree to this demand in order to keep the customer's business overall, which it believes will still satisfy total cost coverage for the agreement. Then, the Customer would use other providers for destinations other than those for which it extracted lower rates. This would affect the Postal Service's overall projected cost coverage for the agreement, so that it no longer would meet its cost coverage requirement. Although the Postal Service could terminate the contract when it first recognized that the mailer's practice and projected profile were at variance, the costs associated with establishing the contract, including filing it with the Postal Regulatory Commission, would be sunk costs that would have a negative impact on the product overall.

Harm: In billing determinants and supporting documentation pertaining to domestic and international competitive NSAs, public disclosure of information contained in underlying financial analyses would be used by competitors and customers to the detriment of the Postal Service.

Hypothetical: A competing package delivery service would obtain a copy of information contained in unredacted versions of financial work papers associated with particular agreements. It would analyze information contained in the work papers to determine what the Postal Service would have to charge its customers in order to comply with business or legal considerations, including meeting its minimum statutory obligations regarding cost coverage and contribution to institutional costs. It then would set its own rates for products similar to those that the Postal Service offers its customers below that threshold, and would market its purported ability to beat the Postal Service on price for domestic or international delivery services. By sustaining this below-market strategy for a relatively short period of time, the competitor, or all of the Postal Service's competitors acting in a similar fashion, would freeze the Postal Service out of one or more relevant delivery markets. Even if the competing providers could not manage wholly to freeze out the Postal Service, they could significantly cut into the revenue streams upon which the Postal Service relies to finance provision of universal service.

Harm: In billing determinants and supporting documentation pertaining to domestic and international competitive NSAs, public disclosure of product volume, weight, revenue distribution, and product insured-value distribution would enable competitors to assess vulnerabilities and focus sales and marketing efforts to the Postal Service's detriment.

Hypothetical: For Inbound Air Parcel Post ("Inbound Inward Land Rates"), a competing package delivery service would be able to determine what the Postal Service would need to charge its customers (which may include foreign posts) and meet its minimum statutory obligations for cost coverage and contribution to institutional costs. The competing package delivery service would then set its own rates for products similar to those the Postal Service offers other posts under that threshold, and would market its ability to better the Postal Service's on price for inbound air parcels. By sustaining this below-market strategy for a relatively short period of time, the competitor, or all of the Postal Service's competitors acting in a likewise fashion, would freeze the Postal Service out of the inbound air parcel delivery market.

Hypothetical: For Inbound Surface Parcel Post (at Non-UPU rates), such as the Competitive Product Prices Bilateral Negotiated Services Contract with Canada (Docket Nos. MC2010-14 and CP2010-13), another postal operator would see the price and conclude that there may be some additional profit margin between the rates provided to Canada Post and the statutory cost coverage that the Postal Service must produce in order for the agreement to be added to the competitive products list. That postal operator would then negotiate lower prices with the Postal Service on its own behalf, or use its knowledge to offer postal customers lower prices than they currently receive. Either or both ways, the Postal Service would lose market share and contribution.

(6) The extent of protection from public disclosure deemed to be necessary;

The Postal Service maintains that the portions of the materials filed nonpublicly and relating to competitive products should be withheld from persons involved in competitive decision-making in the relevant markets for competitive delivery products (including private sector integrators and foreign postal administrations), as well as their consultants and attorneys. Additionally, the Postal Service believes that actual or potential customers of the Postal Service for these or similar products should not be provided access to the nonpublic materials.

(7) The length of time deemed necessary for the nonpublic materials to be protected from public disclosure with justification thereof; and

The Commission's regulations provide that nonpublic materials shall lose nonpublic status ten years after the date of filing with the Commission, unless the Commission or its authorized representative enters an order extending the duration of that status. 39 C.F.R. § 3007.30.

(8) Any other factors or reasons relevant to support the application.

None.

Conclusion

For the reasons discussed, the Postal Service asks that the Commission grant its application for nonpublic treatment of the Nonpublic Annex of the FY 2009 ACR.

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with Section 12 of the Rules of Practice and Procedure.

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