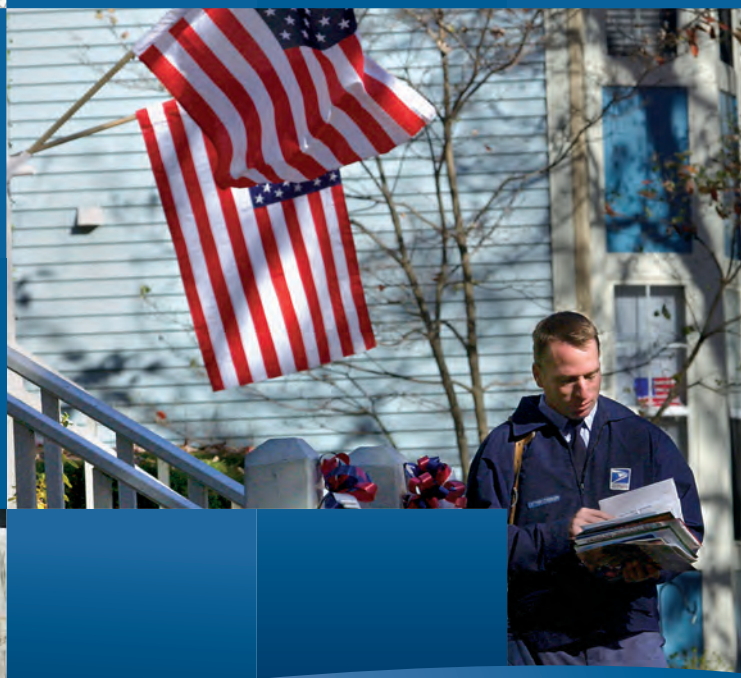
U.S. POSTAL REGULATORY COMMISSION

ANNUAL REPORT TO THE PRESIDENT AND CONGRESS

Fiscal Year 2012



CHAIRMAN'S MESSAGE, DECEMBER 2012

Patterns of human communication are changing at an accelerating pace. The Postal Service is responding by making adjustments to its programs and services, and the Postal Regulatory Commission is active in overseeing the Postal Service during these changing times to assure it maintains the levels of service and accountability envisioned in the controlling statutes. Recent events, however, demonstrate that old-fashioned mail remains an essential communications infrastructure. When Hurricane Sandy devastated whole communities, the Postal Service was among the first responders and connected people to each other and their governments when all other networks were down. In this year's Presidential election, more people used the mail to receive ballots to vote by mail and to get information about the election than ever before. And as the retail/services market–which is seventy percent of our economy–shifts to online buying and package delivery, the Postal Service is there to absorb the growth.

I am pleased, therefore, to introduce the FY 2012 Annual Report of the Postal Regulatory Commission and its part in the postal system of our nation.

The following pages clearly demonstrate the critical role of the Commission in regulating the Postal Service and shaping the future of the mail. The Commission responded to an historic number of requests by the Postal Service. We rendered advisory opinions on three of the Postal Service's most ambitious restructuring proposals since its inception in 1971. The Commission analyzed and set out for public scrutiny, proposals involving reductions to the retail network, to processing plants, to mail delivery standards and to retail hours of operations in rural America. The Commission also considered a record number of post office closing appeals, rulemakings, complaints, classification changes, negotiated service agreements and rate cases.

The Commission strives to ensure that the average citizen's needs, postal stakeholders' interests and legislators' concerns are balanced with the Postal Service's obligations to financial solvency, universal service and transparency. Our decisions offer expert advice to the Postal Service and challenge it to be more efficient and responsive. The merits of our decisions are easily seen in detailed descriptions that comprise the Annual Report and in the adjustments the Postal Service has made as a result.

As evidence of the value the public places on mail services, our Consumer Affairs Office received and responded to over 5,800 inquiries, comments, suggestions and complaints. The growing number of communications we receive from consumers, state and federal governments, business owners and local community leaders demonstrates a growing reliance on the Commission.

As the lead administrator of the Commission, the Chairman can offer certain emphases that express his or her special interests or priorities.

Public voices are critical to our process. Initiatives in this area include:

- Expanding the scope of the Commission's monthly public meetings to provide for a public comment period and reports from other agencies whose responsibilities overlap with the Postal Service.
- Undertaking national outreach to community and civic leaders encouraging them to comment on Postal Service changes under review by the Commission.
- Developing better analytical tools for identifying service-related trends and other areas of concern among the growing number of public commenters to the Commission.
- Supporting a robust Public Representative function that is unique among federal regulatory agencies. An attorney administrator, put in place in FY 2011, proved invaluable in FY 2012 when the Commission reviewed more than 200 post office closing appeals. Consistent representation and needed resources were provided while the special independent role of staff members serving as public representatives was protected.

Employees rely on a modern and supportive infrastructure for the work of the Commission.
Our emphasis in this area includes:

- Maintaining a workplace environment that clearly identifies staff responsibilities, assesses and rewards staff accomplishments and improves employee morale while strictly adhering to administration budget directives. The results of this year's Federal Employees Viewpoint Survey confirm our successful efforts.
- Formulating all office policies in written formats so all reporting requirements are met, activities are carried out consistently and IT infrastructure ensures security and stability of key applications.
- Continuing to operate effectively while staying within approved funding levels that have remained flat for the past five years.
- Exercising more detailed and precise expenditure controls to assure accountability and limit spending.
- Adhering to Administration guidance on compensation to constrain personnel costs while accommodating the increased cost of personnel benefits.

The Postal Service is part of a global system, and we are maximizing the value of our international responsibilities.

- Commission participation in the multi-agency delegations to the Universal Postal Union (UPU) headed by the State Department has resulted in the adoption of terminal dues exchange rates that will add tens of millions of dollars to Postal Service revenues over the next four years.

- Effective Commission participation involves building working relationships with other national posts and postal regulators. I have led this initiative by serving as deputy head of delegations at UPU meetings, speaking at several conferences, maintaining the annual Postal Regulatory Dialogue begun in 2008 and facilitating bilateral meetings with regulators from Portugal, Brazil, China, Russia, and Macedonia.
- The Commission staff gains valuable insights about reform initiatives from these interactions that benefit our analyses of Postal Service transformation plans.

I want to offer a personal note of gratitude to our dedicated staff of economists, lawyers, analysts, and administrators who have successfully handled a fifty percent increase in workload while operating under the tightest of budget constraints. They are among the very best public servants in our federal government.

I would also like to thank Vice Chairman Nanci Langley and Commissioners Mark Acton, Robert Taub, and Tony Hammond for their insightful contributions to our deliberations and for the efforts they regularly make to reach out to the public and stakeholder organizations.

This report reflects the extent of the restructuring which the Postal Service is undergoing and the importance of the role the Commission plays in a positive outcome for that transformation. In particular, I encourage members of Congress to carefully review its contents and to use our agency as a resource as it considers postal matters and possible reforms.

Ruth Y. Goldway
Chairman

UNITED STATES POST OFFICE GARRETT PARK MARYLAND

Table Of Contents

CHAIRMAN'S MESSAGE 1

Chapter I
FY 2012 HIGHLIGHTS 9

Chapter II
ABOUT THE COMMISSION 11

Staff 13

Mission Statement 13

Guiding Principles 13

Commission's Strategic Plan 13

Chapter III
EFFECTIVENESS OF THE COMMISSION'S RULES IN ACHIEVING THE OBJECTIVES OF THE PAEA 15

Objective 1: Effectiveness of Commission Rules in Maximizing Incentives to Reduce Costs and Increase Efficiency . . . 17

- Postal Service Cost Reductions 18
- Commission Advisory Opinions. 18
- Other Commission Activity Related to Cost Reduction. 21

Objective 2: Assuring Stability and Predictability in Pricing 22

- Application of the Price Cap 22
- Docket No. R2012-3 Rate Adjustment Proceeding 22
- Potential Issues with Timing of Rate Adjustments 23
- Docket No. RM2010-13: First-Class Workshared Benchmark 23

Objective 3: Effectiveness of Rules in Maintaining High Quality Service Standards 25

- Special Study on Non-Contiguous Delivery Performance 26
- Consultation with the Postal Service 26

Objective 4: Allow Pricing Flexibility 26

- Application of CPI-U Cap at Class Level 26
- Experimental Products 27
- Promotional Products. 28
- Market Dominant Negotiated Service Agreements 29

Objective 5: Assuring Adequate Revenues 29
Declines in Volume Have Exacerbated the Postal Service's Financial Issues 31
Objective 6: Reducing Administrative Burden and Enhancing Transparency of Ratemaking Process 32
Price Adjustments 32
Negotiated Service Agreements 32
Periodic Reporting Rules 33
Rulemakings 33
Enhancing Transparency through the Annual Compliance Determination 34
Objective 7: Enhance Mail Security and Deter Terrorism 35
Objective 8: Maintaining a Just and Reasonable Rate Schedule 35
Objective 9: Allocating the Total Institutional Costs of the Postal Service Appropriately Between Market Dominant and Competitive Products 35
COMPETITIVE PRODUCTS 35
CP2012-2 General Price Adjustment 36
RM2012-3 Review of Competitive Products' Appropriate Share to Institutional Costs 36
Competitive NSA Dockets 37
Transfers and Additions to the Competitive Product List 38

CHAPTER IV
UNIVERSAL SERVICE OBLIGATION AND MAIL MONOPOLY 39
Estimated Cost of the Universal Service Obligation 39
Estimated Value of the Monopoly 41

CHAPTER V
OTHER LEGAL PROCEEDINGS 43
Post Office Appeals 43
Appeal of 2010 ACD Directive on Standard Mail Flats 44
Commission Rulemakings 45
RM2012-4 Procedural Rules Governing Advisory Opinions in Nature of Service Proceedings 45
Complaints 45
Docket No. C2011-5 Lopez Complaint 45
Docket No. C2012-1 Complaint of the Associated Mail and Parcel Centers, et al. and Post Office Box Enhancements 45
C2012-2 Complaint of the American Postal Workers Union, AFL-CIO 47

Chapter VI
INTERNATIONAL ACTIVITIES 49

Authority 49

UPU Congress 49

Building Global Relationships 51

Chapter VII
PUBLIC AFFAIRS AND OUTREACH EFFORTS 53

Overview 53

Outreach Activity 53

Consumer Relations 53

Chapter VIII
ADMINISTRATION 55

Administration Overview 55

Employee Engagement 55

Equal Employment Opportunity (EEO) 56

Diversity 56

Training 56

Transparency and Open Government 57

Finance 57

Information Technology 57

Dockets and Records Management 58

Appendix A

Technical Description of Price Cap 59

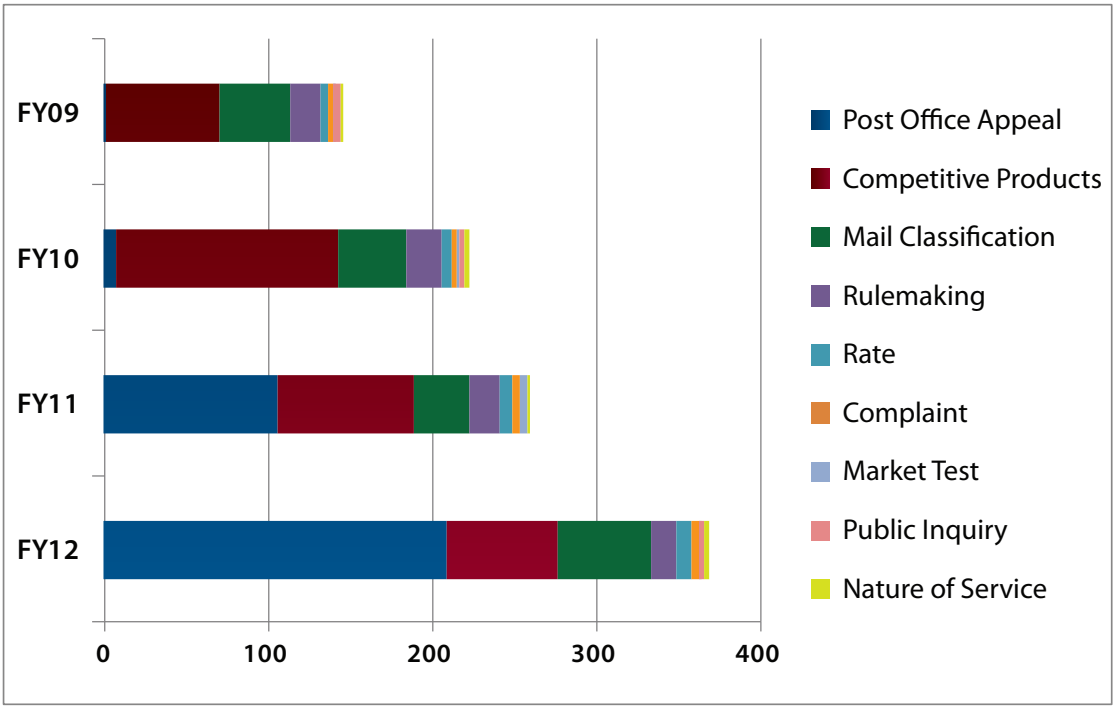
UNITED STATES POST OFFICE GARRETT PARK MARYLAND

Chapter I

FY 2012 Highlights

In FY 2012, the Commission completed 343 dockets and initiated 20 new dockets that remain in progress. The Commission also continued work on six ongoing dockets. Figure I-1 shows how the Commission's workload has grown since FY 2009.

Figure I-1—Commission Dockets
FY 2009 – FY 2012



FY 2012 HIGHLIGHTS INCLUDE:

- Completion of three advisory opinions related to proposed changes in the nature of postal services:
  - In N2011-1 (Retail Access Optimization Initiative) the Commission advised the Postal Service to ensure access to postal services in rural communities, explore more robust modeling techniques, and improve data collection efforts.
  - In N2012-1 (Mail Processing Network Rationalization) the Commission found that the Postal Service could realize substantial cost savings while preserving most overnight mail delivery.
  - In N2012-2 (Post Office Structure Plan) the Commission concluded that if implemented properly, the realignment of retail hours should help balance service and cost savings in a manner consistent with the law.
- Review of 208 post office appeals—the largest number of cases in the Commission's history.
  - Affirmed 162
  - Remanded 16
  - Dismissed 27
  - 3 withdrawn, pending, or another action taken
- Issuance of the FY 2011 Annual Compliance Determination in which the Commission found that:
  - Ten market dominant products and services did not generate sufficient revenue to cover attributable costs;
  - Standard Flats prices were not in compliance;
  - Three competitive products did not comply with 39 U.S.C. 3633(a)(2); and,
  - Only First-Class Mail met the delivery service performance targets.
- Approval of rates for market dominant and competitive products as well as products and services in several experimental or promotional products, and for negotiated service agreements.
- Participation in the U.S. delegation to the UPU Congress, where the Commission:
  - Played an active role in formulating and advocating positions of the United States regarding proposals to amend the Acts of the Union to ensure consistency with U.S. law and policy, and
  - Reviewed over 400 proposals for consideration at both the Congress and subsequent sessions of the Postal Operations Council. The Commission found 12 of these proposals inconsistent with the Postal Accountability and Enhancement of 2006 (PAEA).
- Revision of rules governing appeals of post office closings and consolidations in order to simplify the process and better reflect current practices.
- Issuance of an Advance Notice of Proposed Rulemaking to consider revisions to current procedures for reviewing the Postal Service's proposed changes in nature of services.
- Approval of 56 negotiated service agreements and 144 Non-Published Rate (NPR) contracts.
- Completion of the Commission's five year strategic plan.
- Receipt of the highest rating from the Department of Justice for the Commission's Freedom of Information Act (FOIA) program.
- Response to over 5,800 inquiries, suggestions and comments.

Chapter II

About the Commission

The Postal Regulatory Commission is an independent establishment of the executive branch that has exercised regulatory oversight over the U.S. Postal Service since its creation by the Postal Reorganization Act of 1970 (PRA), with expanded responsibilities under the PAEA. The Commission is composed of five Commissioners, each appointed by the President, with the advice and consent of the Senate, for a term of six years. The Chairman is designated by the President and serves as the head of the agency. A Commissioner may continue to serve after expiration of his or her term for up to one year. No more than three members of the Commission may be from the same political party.

Ruth Y. Goldway, Chairman

First appointed as a Commissioner on April 7, 1998. Designated Chairman by President Barack Obama on August 6, 2009. Term expires November 22, 2014. Former Manager of Public Affairs for the Getty Trust. Former Director of Public Affairs, California State University, Los Angeles. Former Council Member and Mayor, City of Santa Monica. Founder and former Chairperson, Santa Monica Pier Restoration Corporation. Former Assistant Director of California's Department of Consumer Affairs. Co-founder of Women in Logistics and Delivery Services.

Nanci E. Langley, Vice Chairman

Appointed as a Commissioner on June 6, 2008. Served as Vice Chairman from January 2012 to present, and October 2008 - 2009. Term expires November 22, 2012. Former Director of Public Affairs and Government Relations, Postal Regulatory Commission. Former Deputy Staff Director to Senator Daniel K. Akaka (D-HI), U.S. Senate Committee on Homeland Security and Governmental Affairs' Subcommittee on Oversight of Government Management, the Federal Workforce and the District of Columbia. Communications Director to former U.S. Senator Spark M. Matsunaga (D-HI). Elected as a Fellow of the National Academy of Public Administration in 2009.

Mark Acton

Appointed as a Commissioner on August 3, 2006. Term expires October 14, 2016. Served as Vice Chairman from November 22, 2007 to October 15, 2008. Served as Special Assistant to former Postal Rate Commission Chairman George Omas. Former Staff Director, Republican National Committee (RNC) Counsel's Office. Former Deputy to the Chairman of the 2004 Republican National Convention. Served as Special Assistant to the RNC Chief Counsel as well as RNC Counsel's Office Government Relations Officer and Redistricting Coordinator. Formerly served as both Executive Director, Republican National Convention, Committee on Permanent Organization and Deputy Executive Director, Committee on Rules. Former Executive Director of the RNC Redistricting Task Force.

Robert G. Taub

Appointed as a Commissioner in October 2011. Term expires October 14, 2016. Former Special Assistant to Secretary of the Army, John McHugh. Former Chief of Staff to U.S. Representative John McHugh. Served for 12 years on the House of Representative's Oversight & Government Reform Committee in a series of senior positions, including service as Staff Director of its former Postal Service Subcommittee. Former Senior Policy Analyst with the U.S. Government Accountability Office (GAO). Staff member for three different Members of Congress, a Member of the British Parliament, and state and county officials in upstate New York.

Tony Hammond

Appointed as a Commissioner on August 15, 2002. Served as Vice Chairman from 2003 to 2005 and then again from 2009 to 2010. Sworn in on May 1, 2012, for a third term as a Commissioner. Term expires October 14, 2012. Former owner and managing member, T. Hammond Company, LLC. Former Senior Consultant to Forbes 2000, Incorporated. Former Senior Vice President of the direct marketing firm, FL&S. Served as Director of Campaign Operations for the Republican National Committee for the 1998 election cycle. Former Executive Director and Finance Director, Missouri Republican Party. Staff to former U.S. Representative Gene Taylor (R-MO).

STAFF

Assisting the Commission is a staff with expertise in law, economics, finance, statistics, and cost accounting. The Commission is organized into four operational offices:

- Accountability and Compliance;
- General Counsel;
- Public Affairs and Government Relations; and
- Secretary and Administration.

The Commission maintains an independent office for its Inspector General.

MISSION STATEMENT

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

GUIDING PRINCIPLES

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

- Openness;
- Stakeholder (public) participation;
- Collegiality and multi-disciplinary approaches;
- Timely and rigorous analysis;
- Fairness and impartiality;
- Integrity;
- Commitment to excellence; and
- Merit.

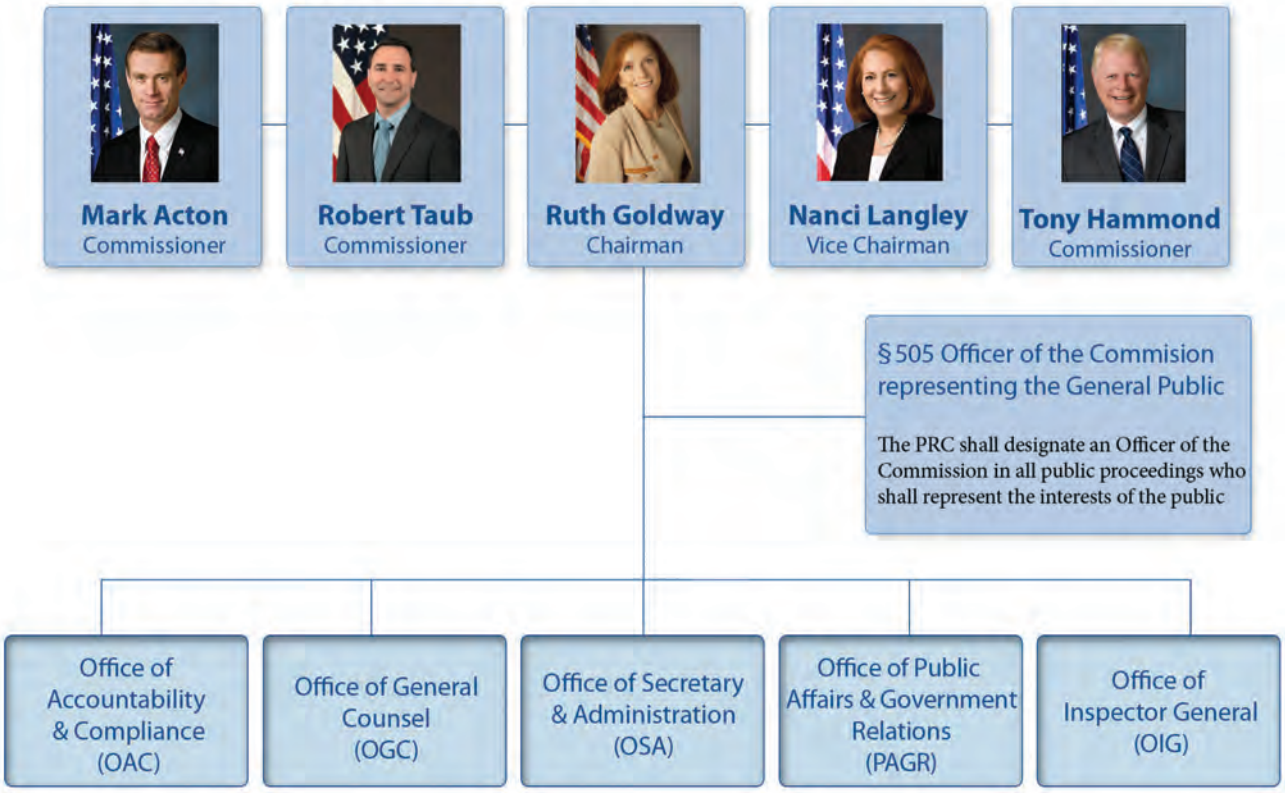
COMMISSION'S STRATEGIC PLAN

The Commission's Strategic Plan for 2012 – 2016 is based upon the Commission's realistic and forward looking assessment of the challenges ahead. As the primary regulator of the Postal Service, the Commission provides a window on the quality of service and the general operations of the Postal Service to the Congress, stakeholders and the general public. The Strategic Plan begins with the Commission's Mission and Guiding Principles, which direct all Commission actions, and it outlines Strategic Goals and Implementation Strategies to help the Commission fulfill its mission.

The Commission's mission, as outlined in its Strategic Plan, is to: ensure the Postal Service complies with title 39; provide transparency and accountability into Postal Service operations and finances; and issue advisory opinions on changes in the mail that are at least substantially nationwide in scope. Additionally, the Commissioners meet informally with Office Heads, on a quarterly basis, to receive and discuss updates related to the strategic goals of the Plan.

The Strategic Plan can be viewed in its entirety on the Commission's website at www.prc.gov

Postal Regulatory Commission Organization



Chapter III

EFFECTIVENESS OF THE COMMISSION'S RULES IN ACHIEVING THE OBJECTIVES OF PAEA

39 U.S.C 3651 requires the Commission to submit an annual report to the President and the Congress that includes an analysis of "the extent to which regulations are achieving the objectives under sections 3622 and 3633" of Title 39. The objectives of section 3622, which pertain to market dominant products, are to:

1. Maximize incentives to reduce costs and increase efficiency;
2. Create predictability and stability in rates;
3. Maintain high quality service standards;
4. Allow the Postal Service pricing flexibility;
5. Assure adequate revenues, including retained earnings, to maintain financial stability;
6. Reduce administrative burden and enhance transparency of the ratemaking process;
7. Enhance mail security and deter terrorism;
8. Establish and maintain a just and reasonable schedule for rates and classifications, without restricting the Postal Service's ability to make changes of unequal magnitude within, between or among classes of mail; and
9. Allocate the total institutional costs of the Postal Service appropriately between market dominant and competitive products.

For competitive products, the objectives of section 3633 are to:

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

Rule 3010.14(7) requires the Postal Service to include a discussion in each rate adjustment that demonstrates how the planned adjustments help achieve these objectives, as well as a discussion of how the planned adjustments properly take into account the 14 factors listed in section 3622(c). The Commission rules are designed to strike a reasonable balance among these objectives and embody the PAEA principles of flexibility, accountability, and transparency.

The rules are designed to allow the Postal Service pricing flexibility by applying the Consumer Price Index-Urban (CPI-U) cap at the class level rather than at the rate category level.[1] Under the law, this flexibility is moderated by the separate worksharing requirements of section 3622(e)(3) and consideration of competing objectives.

Section 3622(e)(2) directs the Commission to ensure that workshare discounts do not exceed the costs avoided by the Postal Service as a result of the workshare activity, unless certain exceptions are met. This provision effectively limits the Postal Service's ability to set workshare discounts that exceed 100 percent of avoided costs. Accordingly, Commission rules require the Postal Service to justify any proposed workshare discounts that exceed 100 percent of avoided costs by explaining how they meet one of four exceptions under the PAEA.[2]

To date, the Commission rules have been effective in balancing the Postal Service's pricing flexibility with the statutory requirements related to workshare discounts. This has been accomplished through adjusting discounts, reviewing Postal Service justification of exceptions, or in some cases, initiating rulemakings intended to clarify workshare relationships. The Commission notes that current practice by the Postal Service regarding filing notices of rate adjustments prior to completion of annual compliance determinations may be problematic because the discounts will not reflect the data filed in the latest compliance determination.

The Commission rules also allow for expeditiously reviewing negotiated service agreements (NSA) between the Postal Service and individual mailers.[3] The Postal Service has further flexibility in offering experimental products. If a product is deemed to be experimental it is excluded from certain requirements of the ratemaking rules.[4] Specific limitations on experimental products are outlined in the PAEA.

The Commission rules allow even greater flexibility to price competitive products.[5] The rules allow the Commission up to 30 days to determine whether the Postal Service's proposed rates for competitive products are meeting the objectives of section 3633.[6] The Commission uses an incremental cost test to validate compliance with the cross subsidy requirement that revenue generated from competitive products equals or exceeds the incremental costs of such products.[7] In FY 2012, through a rulemaking process, the Commission reaffirmed that the appropriate share of institutional costs to be borne by competitive products is 5.5 percent, subject to revision in a future rulemaking proceeding if necessary.[8]

The statute establishes a tension between the restrictions of an inflation-based cap on market dominant rate increases and the objective that the

1 39 CFR 3010.12
2 39 CFR 3010.14
3 39 CFR 3010.40
4 *Id.*
5 39 CFR part 3015
6 39 CFR 3015.2
7 39 CFR 3015.7
8 Order No. 1449

Postal Service must be self sufficient and maintain financial stability. Further, while the PAEA provided incentives in the form of the price cap to reduce costs and increase efficiency, it also imposed new personnel-related expenses requiring the pre-funding of future healthcare costs for retirees. The schedule of payments into the Retiree Health Benefits Fund (RHBF) ranges from $5 billion to $5.6 billion annually. Payments were to begin in FY 2007 and end in FY 2016 when the schedule would be replaced with an actuarial-based system of payments. The Postal Service has made three full payments and one partial payment into the fund.

The Postal Service is compelled to reduce costs and increase efficiency in order to stay within the price cap. Roughly 60 percent of Postal Service costs vary directly with volume while the other 40 percent are fixed, at least in the short term. When mail volume is increasing, as it was when the PAEA was passed in 2006, there are more pieces to share the burden of the fixed costs. Conversely, when mail volumes decline, as they have in recent years, there are fewer pieces to share the burden of fixed costs. Because fixed costs are difficult to reduce regardless of increased efficiency, total unit costs increase as volume declines. The Postal Service's total operating expenses have been declining at a faster pace than the rate of inflation.[9] However, much of this decline is due to volume loss. On a unit basis, the Postal Service has not been able to keep operating costs in line with the CPI-U.

Although much of the Commission's work implicates a number of these nine objectives, the remainder of this chapter discusses the impact of the Commission's work on each objective separately.

[9] Operating expenses do not include payments into the RHBF.

OBJECTIVE 1: EFFECTIVENESS OF COMMISSION RULES IN MAXIMIZING INCENTIVES TO REDUCE COSTS AND INCREASE EFFICIENCY

A primary goal of the CPI-U cap is to provide incentive for the Postal Service to increase efficiency and reduce costs. As discussed further in section H, the Postal Service has not been able to generate sufficient revenue through its CPI-U-based price increases to cover its overall costs. However, the Postal Service has been able to reduce operating costs, which do not include payments into the RHBF, over the past few years.

The Postal Service has made several adjustments to its service in order to reduce costs. When the Postal Service determines to make a change in the nature of its services that will affect mail users on a nationwide or substantially nationwide basis, it must, prior to implementation, submit a proposal to the Commission requesting an advisory opinion related to the proposed changes. After the request is submitted, parties are provided an opportunity for a hearing on the record in accordance with the provisions of 5 U.S.C. 556 and 5 U.S.C. 557. 39 U.S.C. 3661(c). The Commission rules regarding advisory opinions encompass these requirements.[10]

The rules ensure transparency of Postal Service programs that impact nationwide service. This transparency allows the public an opportunity to provide suggestions on how the Postal Service's proposed changes can maximize cost savings and improve efficiency. In FY 2012 the Commission completed three nature of service advisory opinions. These opinions reviewed Postal Service initiatives

[10] 39 CFR 3001.18

intended to reduce costs and increase efficiency. Each advisory opinion included Commission suggestions and recommendations. The Commission also completed a study on peak load costs.

Postal Service Cost Reductions

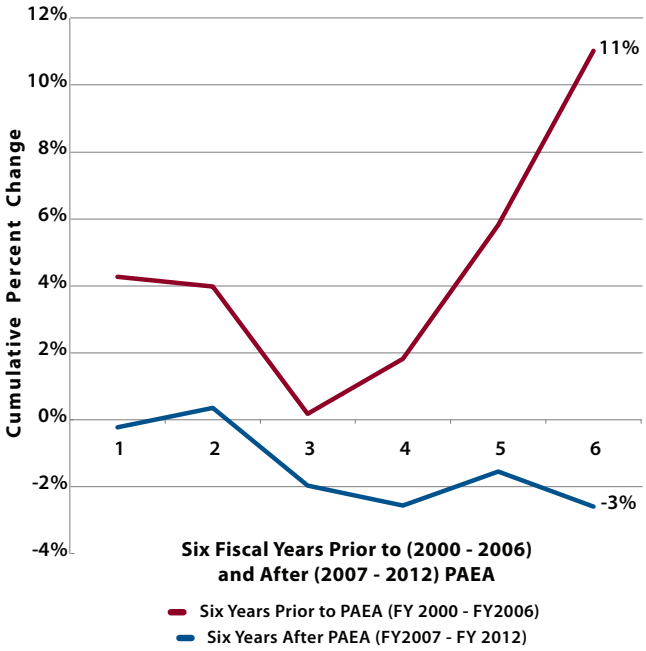
Various factors outside of the Postal Service's direct control, such as increased fuel prices and higher Federal Employee Retirement System (FERS) premiums, make it challenging to assess how well the PAEA is working to maximize incentives to reduce costs and increase efficiency. The required payments into the RHBF impose an approximately $5.5 billion annual payment. In addition, declining volumes have impacted both the total costs and the unit costs of the Postal Service.

As seen in Figure III-1, the Postal Service has been able to reduce total operating costs since implementation of the price cap regime. It has accomplished this primarily through workhour reductions.

Total operating costs in FY 2012 declined 1.1 percent, or $744 million. Reductions in workhour usage enabled the Postal Service to reduce compensation and benefits costs by approximately $342 million over the past year. Non-personnel expenses also declined by $394 million. The Postal Service absorbed increases in the cost of fuel in both purchased transportation and its own delivery fleet. In FY 2011 the RHBF payment was deferred until FY 2012. Total expenses increased 14.6 percent in FY 2012 because this RHBF expense was carried forward and added to that year's expenses.

Although the Postal Service has been able to reduce total operating costs, the combined effects of RHBF payments that exceed $5 billion a year and sustained volume declines have resulted in an increase in

Figure III-1—Comparison of Cumulative Change in Total Operating Costs Before and After PAEA



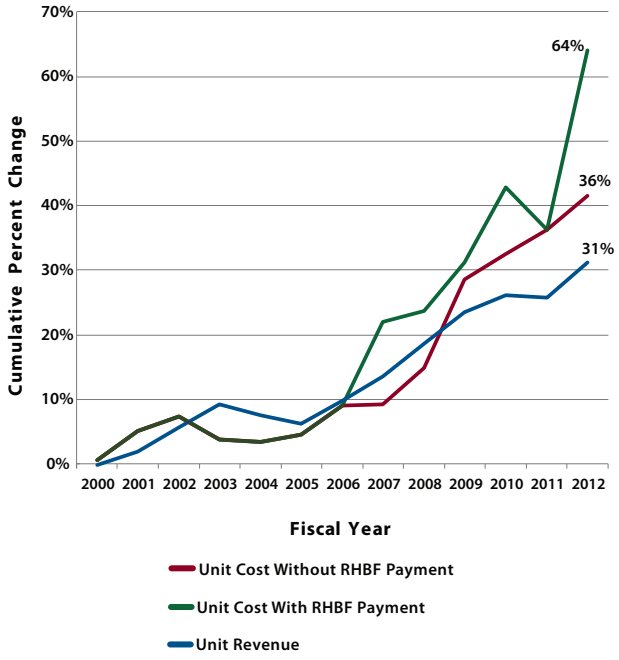
the average total unit cost. The average unit cost is significant because the Postal Service generates revenue almost exclusively from the sale of postage. To remain profitable, the average unit revenue must increase as average unit cost increases.

As seen in Figure III-2, the cumulative increase in average unit cost, both with and without the RHBF payment, has been greater than the cumulative increase in average unit revenue since passage of the PAEA in FY 2007.

Commission Advisory Opinions

In FY 2012, the Commission reviewed three Postal Service requests for advisory opinions under 39 U.S.C. 3661. The Commission completed its review of the Retail Access Optimization Initiative (RAOI) and the related Post Office Structure Plan (POStPlan).

Figure III-2—Cumulative Change in Total Average Unit Cost and Revenue FY 1999—FY 2012



The Commission also completed its advisory opinion on the Mail Processing Network Rationalization (MPNR). In both the RAOI and the MPNR Opinions, the Commission found that the Postal Service did not take full advantage of available modeling tools to determine the optimum alignment of facilities. The Commission was also unable to verify the Postal Service's cost savings estimates. In each of its advisory opinions the Commission recommended improvements to the Postal Service's planned initiatives.

N2011-1: Retail Access Optimization Initiative

The Commission issued its advisory opinion on the Postal Service's RAOI on December 23, 2011. The RAOI was a centrally-directed plan examining whether to discontinue approximately 3,650 of the more than 32,000 post offices, stations and branches in the Postal Service's retail network.

The advisory opinion included several critiques of the RAOI and advised the Postal Service to use the most relevant and robust data available when utilizing screening procedures. The Commission also expressed concern that for the majority (approximately 77 percent) of the RAOI facilities, the availability of alternate retail access was not considered as part of the screening process. In instances where alternate access was identified by the Postal Service, a significant portion of the alternate facilities did not offer a complete range of postal services. The Commission advised the Postal Service to add a constraint to the screening criteria to ensure availability of at least one alternate facility that provides full service.

The Commission was concerned that the RAOI screening criteria, if separated from the discontinuance procedures, may have a disparate impact on vulnerable populations. The Commission found that in order to provide adequate access, the Postal Service should develop alternatives that are better tailored for customers in rural or remote areas.

Data quality issues prevented the Commission from constructing a reasonably reliable estimate of the potential financial effects of the RAOI. The Commission recommended several ways for the Postal Service to improve the quality of its data for use in future operational and strategic decision-making.

The Commission concluded the RAOI was not an optimization initiative in the traditional economic sense. A better practice for the Postal Service would be to utilize modern optimization techniques that consider both consumer access and supplier revenue concepts. The Commission suggested that the Postal Service use available modeling techniques,

Geographic Information Systems software and spatial modeling tools in the process of selecting facilities for discontinuance review, mapping facilities, and optimizing the network. The Commission also advised the Postal Service to utilize driving distances rather than straight line distances in the screening process.

N2012-2: Post Office Structure Plan

The Commission issued its advisory opinion on the POStPlan on August 23, 2012. The POStPlan initiative was filed in response to the Commission's advisory opinion on the RAOI and requests from Congress. Unlike the RAOI, this initiative reflected a determination by the Postal Service to explore options to adjust its retail window hours without closing post offices. Under the POStPlan, retail window hours of operation at more than 13,000 post offices nationwide will be reduced to six, four, or two hours per weekday. In approximately 73 locations, hours of operation will increase.

The Commission found that the POStPlan was a significant improvement over the previous RAOI. The Commission also found that the POStPlan's objective of achieving cost savings with limited reductions in access and service was consistent with public policy. It recognized that the POStPlan may reduce retail service and customer convenience at post offices by reducing weekday hours of operation. The Commission concluded that if implemented properly, the POStPlan should help balance service and cost savings in a manner consistent with the law.

To further enhance the implementation of the POStPlan, the Commission provided recommendations on: the Postal Service's customer preference survey: implementing the POStPlan at facilities that will require modifications to buildings and/or operations; the Postal Service's instructional memorandum to area vice presidents and district managers; data collection and review of whether the POStPlan is meeting its objectives and goals; and, monitoring and measuring changes in revenue at POStPlan post offices.

N2012-1: Mail Processing Network Rationalization

The Commission issued its advisory opinion on the Postal Service's MPNR initiative on September 28, 2012. Under the Postal Service's plan, 80 percent of all First-Class Mail would be delayed by at least one day and service standards would be modified for Periodicals, Standard Mail and Package Services.[11] The plan included cost savings from the consolidation of 229 of its 461 processing plants. The Commission concluded that it was possible for the Postal Service to undertake significant network rationalization and realize substantial cost savings while preserving most current service levels. It advised the Postal Service to consider alternatives that would preserve service levels before proceeding with full implementation.

As in the RAOI case, the Commission found that the Postal Service did not take full advantage of its network modeling tools. The Postal Service's modeling effort could be improved by starting with a baseline model that is validated against known conditions, including actual plant productivities. The Commission found that the Postal Service should review its underlying assumption that larger plants process mail less expensively than smaller plants. The Commission also found that a network rationalization solution that shifts mail processing to plants that currently exhibit higher productivities than other plants should be considered.

[11] In July 2012, the Postal Service proceeded with a phased implementation plan that includes interim service standards until January 31, 2014, preserving overnight First-Class Mail service (with the exception of First-Class Mail that is handled by more than one processing facility) and consolidating 140 plants.

The Commission concluded that in order to capture the anticipated $1.6 billion net cost savings upon full implementation of the MPNR, the Postal Service would have to improve average system-wide productivity by over 20 percent. The Commission cautioned that improvements of this magnitude are ambitious and involve some risk.

The Commission estimated that the MPNR cost savings may be as low as $46 million annually assuming mail processing productivities remain at current levels, or as high as $2 billion annually if all proposed assumptions prove correct, and that these cost savings may be offset by reduced contribution to the bottom line from volume loss by mailers who no longer believe the level of service provided meets their postal needs.

The Commission encouraged the Postal Service to study the effects of the service standard changes during the initial implementation phase to inform its decisions before going forward with full implementation. While these evaluations may not be cost free, given the magnitude of service changes contemplated, it is important for the Postal Service to proceed with accurate information. The Postal Service has said it will consider these recommendations during Phase I when it finalizes plans for Phase II.

Other Commission Activity Related to Cost Reduction

The Commission's advisory opinion on the Postal Service's proposal for the Elimination of Saturday Delivery (N2010-1) highlighted the need to consider peak load costs if Saturday volume is shifted, as the Postal Service suggested, to Monday or Friday. The Commission concluded that without a clear understanding of how staffing and equipment utilization will adapt, the result of the change could be capacity issues that impede operations and delay service. In August 2011, the Commission issued a Request for Proposals (RFP) to help create a model to estimate the effect on mail processing labor costs of workload fluctuations. George Mason University School of Public Policy (GMU) was awarded the contract, and in October 2011, submitted their "Report on Peak Load Cost Modeling." It compared a linear optimization model with an econometric analysis and determined that a linear model with a representative sample would be the best method for analyzing peak load cost issues.

Peak load costs occur when volume peaks and additional processing, delivery, and transportation costs are incurred because additional labor, machine, and space capacity are needed. The Postal Service's optimal choice is to use peak levels of these resources only when they are needed, avoiding excess supply of labor and facilities and their associated costs during non-peak times. The GMU report uses a linear optimization model with constraints to analyze the trade-offs between resource use during peak and non-peak times.[12] The GMU model identifies an optimal level that minimizes staffing and equipment costs while abiding by the constraints of labor contracts, facility capacity, and service standards. The results of the model can then be compared to actual results to obtain a measure of the efficiency of the model, as well as the effectiveness of the Postal Service's current resource allocation. The model can also be used to estimate the cost of changes in labor contracts, facility

[12] The GMU model is a modified version of the one described by Crew, Kleindorfer and Smith in their paper "Peak-Load Pricing in the Postal Services," published in the Economic Journal, Vol. 100, (September 1990) pp. 793-807.

capacity and mail service standards by running the model with and without each individual constraint.

OBJECTIVE 2: ASSURING STABILITY AND PREDICTABILITY IN PRICING

The Commission rules related to application of the price cap in rate adjustments are intended to assure stability and predictability in pricing while promoting efficiency.[13] The Commission's rules on worksharing, which embody the statutory requirements of section 3622(e)(2), also foster stability and predictability in rates.[14]

Application of the Price Cap

The PAEA limits market dominant price adjustments by the percentage change in CPI-U, unadjusted for seasonal variation, over the previous 12 months. In order to promote pricing stability and predictability the Commission's rules adopted a moving average, rather than a point-to-point calculation, to determine the annual limitation on market dominant price adjustments (i.e. the price cap).[15] A point-to-point approach only compares the percentage change in CPI-U on two distinct points in time. The moving average approach compares two 12-month averages to determine the price cap. Figure III-3 shows the stability of using a moving average, opposed to a point-to-point approach.

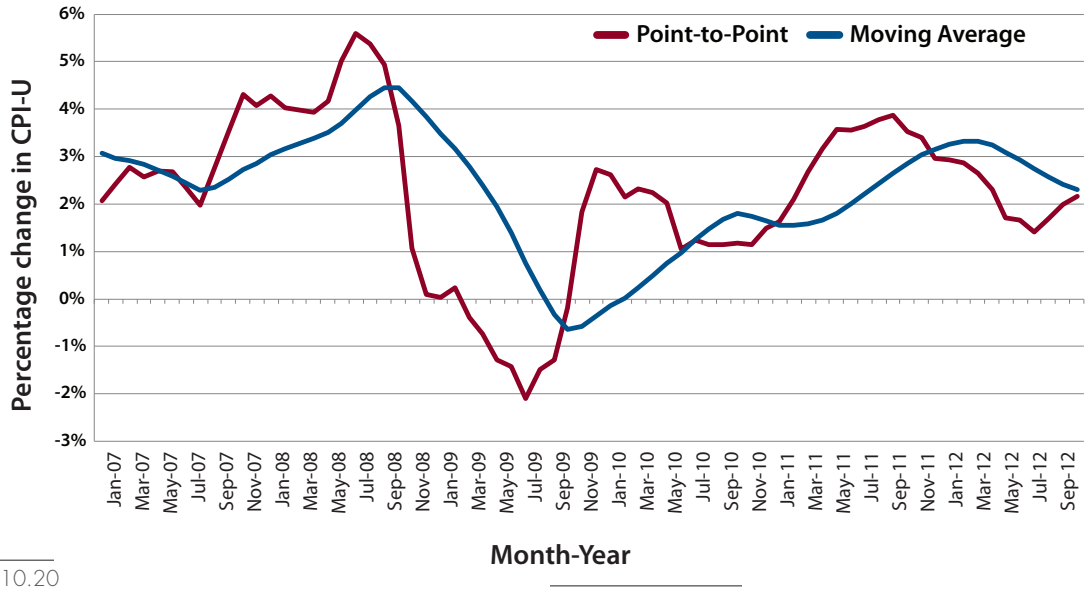
Figure III-3 shows that the moving average method moderates swings in inflation. The moving average method also responds more slowly to swings in monthly inflation rates, which provides more predictability and stability in the calculation of the price cap.

A technical description of the application of the CPI-U price cap is found in Appendix A.

Docket No. R2012-3 Rate Adjustment Proceeding

In order to ensure stability and predictability in rates, Commission rule 3010.7 requires the Postal Service to maintain a Schedule for Regular and Predictable

Figure III-3—Comparison of Percentage Change in CPI-U with Moving Average and Point-to-Point Method



[13] 39 CFR 3010.20
[14] 39 CFR 3010.14
[15] 39 CFR 3010.21

Price Changes (Schedule) with the Commission. Commission rule 3010.7(e) requires updates to this Schedule, as appropriate. The Commission rules allow the Postal Service to file notices of price adjustment at its discretion.[16] The Postal Service filed its initial schedule on February 11, 2008. On October 18, 2011, the Postal Service filed an update with the Commission stating that the Postal Service is expected to implement price changes for all market dominant classes on January 22, 2012.[17] Additionally, the Postal Service notified the Commission that it expected to implement price changes for all market dominant classes annually in January with price increases for each market dominant class equal, on average, to the applicable price cap limitation in that year.

Section 3622(e)(2) directs the Commission to ensure that workshare discounts do not exceed the costs avoided by the Postal Service, unless certain conditions are met. The Commission rules[18] require the Postal Service to justify any proposed workshare discounts that exceed 100 percent of avoided costs by explaining how they qualify for one of four exceptions permitted under the PAEA.

The Commission evaluated the consistency of the proposed discounts that would be in effect in FY 2012 with Section 3622(e) based on FY 2010 avoided cost estimates because FY 2011 data were not yet available. The Commission found that the proposed discounts met the Section 3622(e) requirements based on FY 2010 cost avoidance data.

[16] 39 CFR 3010.10

[17] For details on the amount of these price changes, refer to the Notice of Market Dominant Price Adjustment in Docket No. R2012-3.

[18] CFR 3010.14

Potential Issues with Timing of Rate Adjustments

Although having a schedule of price adjustments helps create stability and predictability in rates, the timing of the FY 2012 adjustment presented challenges in calculating workshare discount passthroughs due to cost data being 10 months out of date at the time of the proceeding. As the Commission noted in its Section 701 Report, rate adjustment filings in October, November and December mean that available cost data are more than one year old.[19]

Docket No. RM2010-13: First-Class Workshared Benchmark

Workshare benchmarks are used to determine the cost avoided between levels of worksharing. The costs avoided provide a standard for determining the maximum size of workshare discounts for that mail. Consistent benchmarks foster predictability and stability in rates. In Docket No. R2009-2, the Postal Service proposed workshare discounts for First-Class Mail and Standard Mail that were not based on established workshare cost avoidance methodologies. In First-Class, the Postal Service did not use the existing benchmark, bulk metered mail, for calculating workshare discounts and instead based the discounts on presort First-Class Mail delinked from single-piece First-Class Mail. In Standard Mail, the Postal Service did not use the existing methodology based on costs

[19] For example, when the Postal Service filed its ACR in late December, 2011, the Commission evaluated FY 2011 workshare discounts, which were already obsolete, based on FY 2011 cost data. The Commission found that numerous workshare discounts had a passthrough above 100 percent and did not qualify for any of the exceptions. Because the rate adjustments for FY 2012 had already been approved, the workshare discounts could not be adjusted in the FY 2012 rates. The Postal Service had adjusted some discounts in the FY 2012 notice of rate adjustments to bring them into alignment with the costs but other discounts remained out of alignment.

avoided by shape between Basic and High Density, and High Density and Saturation.

The Postal Service's proposals reflected its legal view that the cap on the size of workshare discounts imposed by section 3622(e) does not apply if the services in question are separate products. In response, the Commission established Docket No. RM2009-3 to determine whether this was a proper interpretation of the statute. In Order No. 536, the Commission concluded that section 3622(e) properly applies to separate products. Specifically, it concluded that Presorted First-Class Mail is properly viewed as a workshared variant of a portion of Single-Piece First-Class Mail.

To determine what portion of Single-Piece First-Class Mail best represents mail that is likely to be presorted given a sufficient price incentive (i.e., what single-piece mail should be viewed as the benchmark for measuring the costs avoided by presorting First-Class letter mail), the Commission initiated Docket No. RM2010-13. The Commission also sought comments on these specific activities for which costs should be considered avoided when that base group is workshared.

In Order No. 1320, the Commission concluded that the broad metered mail category that includes metered, Information-Based Indicia (IBI), and Permit Validation Imprint (PVI) letters, best represents single-piece First-Class Mail that is likely to convert to presort First-Class Mail.[20] The Commission also determined that the metered mail base group should include three categories of costs that worksharing avoids: (1) mail processing; (2) delivery; and (3) collection.[21] The Commission further concluded that the costs avoided by ancillary mailer activities integral to a worksharing activity, such as cleansing pre-barcoded addresses, should be reflected in workshare discounts.

In Order No. 1320, the Commission also evaluated five technical proposals to modify the First-Class Mail presort cost models and two proposals for new workshare discounts. The Commission concluded that each technical proposal was reasonable, but that each needed to be further developed to demonstrate that it would be more accurate than using the current methodology. The Commission also concluded that for the proposed new workshare discounts, the Postal Service should work with the petitioners to investigate the potential benefits to the Postal Service, as well as the mailers, of offering those discounts.[22]

While Docket No. RM2010-13 was pending before the Commission, the Postal Service filed an appeal in the District of Columbia Circuit Court of Appeals on the Commission's conclusion in Order No. 536 that the cap on workshare discounts applies to separate products, and from that order's tentative conclusion that avoided costs should include the cost that ancillary but integral workshare characteristics avoid. The Court dismissed the Postal Service's appeal on the premise that it was not ripe for review. The Court observed that the Commission had not yet indentified a benchmark for Presorted First-Class Mail in Docket No. RM2010-13. *See* U.S. Postal Service v. Postal Regulatory Commission, 443 Fed. Appx. 560 (D. C. Cir. Oct 21, 2011) (No. 10-1324). On April 20, 2012, the Commission issued Order No. 1320, concluding Docket No. RM2010-13. On May 11, 2012, the Postal Service filed a petition for review of that order in the Circuit Court of Appeals for the District of Columbia. *See* USCA No. 12-1221.

[20] Commission Order No. 1320 at 10-11.
[21] *Id.* at 19-31.
[22] *Id.* at 32-59

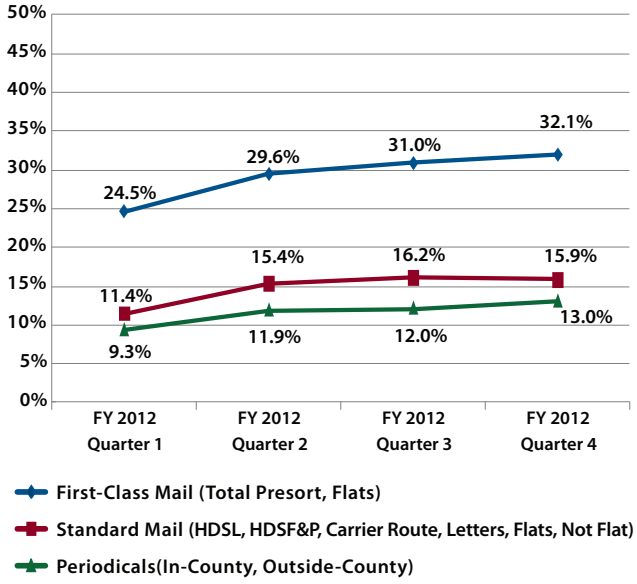
OBJECTIVE 3: EFFECTIVENESS OF RULES IN MAINTAINING HIGH QUALITY SERVICE STANDARDS

Reviewing quality of service allows the Commission to assess whether the Postal Service is meeting the objective of maintaining the "high quality service standards established under section 3691," and furthers the objective of increasing transparency. This review is also important in relation to the rate cap requirements of 39 U.S.C. 3622(d)(1)(A) when analyzing whether quality of service is impacted in order to comply with rate cap requirements. The Commission's service performance reporting rules require quarterly reporting of service performance at the product level.[23] Commission rules regarding advisory opinions on changes in nature of service add transparency to service standards.

The Annual Compliance Determination (ACD) provides reliable insight into the Postal Service's quality of service obligation. In the FY 2011 ACD, the Commission concluded that although the Postal Service was demonstrating success in meeting its service standard goals in the areas of single-piece First-Class Mail and Special Services, it experienced difficulty meeting its service standard goals for most other market dominant products. FY 2012 was the first complete year that the Postal Service has reported service performance results for the majority of its market dominant products. The Commission will review the FY 2012 service performance results in the upcoming FY 2012 ACD.

The level of Full Service Intelligent Mail participation continued to impact the reliability of many service performance results. The level of Full Service Intelligent Mail participation is an essential determinant of the effectiveness of the hybrid system used for service performance measurement. The Commission's monitoring of the internal measurement system throughout FY 2012 found that for many products the volume in measurement was still low. The Postal Service has expanded its efforts to increase measurements in FY 2012 and has announced plans for full implementation in FY 2013.

Figure III-4—Percent of Pieces in Measurement FY 2012



Commission rules add an additional element of transparency to service performance review when changes in the nature of postal services have a nationwide affect. Rule 3001.74 stipulates that all information submitted as part of a request for an advisory opinion must include information "necessary and appropriate to fully inform the Commission and the parties of the nature, scope, significance and

[23] 39 CFR 3055.31

impact of the proposed change in the nature of postal services and to show that such change in the nature of postal service is in accordance with and conforms to the policies established under the Act." In the MPNR case, the Commission reviewed and analyzed the Postal Service's request to change service standards. The Commission's review and analysis led it to conclude that the Postal Service could preserve most of its current levels of service and still realize substantial cost savings from network rationalization.

Special Study on Non-Contiguous Delivery Performance

39 CFR 3055.7 requires the Postal Service to submit, as part of the Annual Compliance Report, a biennial special study on delivery performance, by class of mail, to non-contiguous areas of the United States. This rule is intended to ensure that noncontiguous areas receive adequate service. The first report, issued as part of the FY 2011 Annual Compliance Report, evaluated final delivery service performance to the remote locations of Alaska, Honolulu and Caribbean Districts as compared to service performance at the gateway cities of Anchorage, Honolulu, and San Juan. The Commission found no compelling evidence that service performance in the rural/remote areas of noncontiguous locations is distinctively lower than the gateway cities. However, in most cases the noncontiguous locations have among the lowest performance in the nation. The Commission recommended the Postal Service review processing operations and service standards in these areas.

Consultation with the Postal Service

39 U.S.C. 3652(a)(2)(B) requires that the Postal Service, in consultation with the Commission, establish modern service standards for market dominant products. The Commission has monitored the Postal Service's progress toward compliance with PAEA provisions through regular monthly consultations. In particular, the Commission has monitored service performance measurements. The Commission has continued the monthly consultations to monitor the Postal Service's progress in implementing systems for measuring Postal Service performance in meeting the agreed upon service standards.

Objective 4: Allow Pricing Flexibility

The Commission rules related to application of the CPI-U price cap, introduction of new products, and implementation of promotional offerings, are designed to encourage the pricing flexibility envisioned in the PAEA.[24] The CPI-U price cap, which is applied at the class level, rather than at the product or rate category level, allows the Postal Service flexibility in pricing within a particular class. This flexibility is balanced by other statutory mandates. The Commission rules embody the statutory language allowing experimental products as a means for evaluating potential new product offerings.[25] Promotional products and negotiated service agreements allow the Postal Service to offer limited time products and services and negotiated rates.

Application of CPI-U Cap at Class Level

In FY 2012 the Postal Service exercised its pricing flexibility under the price cap by applying non-uniform price increases to products, including above average price increases for many products that did not cover

[24] CFR 3010.20 – 3010.29 and 39 CFR 3020.32
[25] 39 CFR 3020.13

their costs in FY 2010. For example, Standard Mail Flats, which had an 81.8 percent cost coverage in FY 2010, received a 2.209 percent price increase. This was consistent with the Commission's FY 2010 ACD directives. FY 2010 ACD at 106-07.

Figure III-5 compares the average rate increases by product with the percentage increase allowed under the CPI-U cap.

Experimental Products

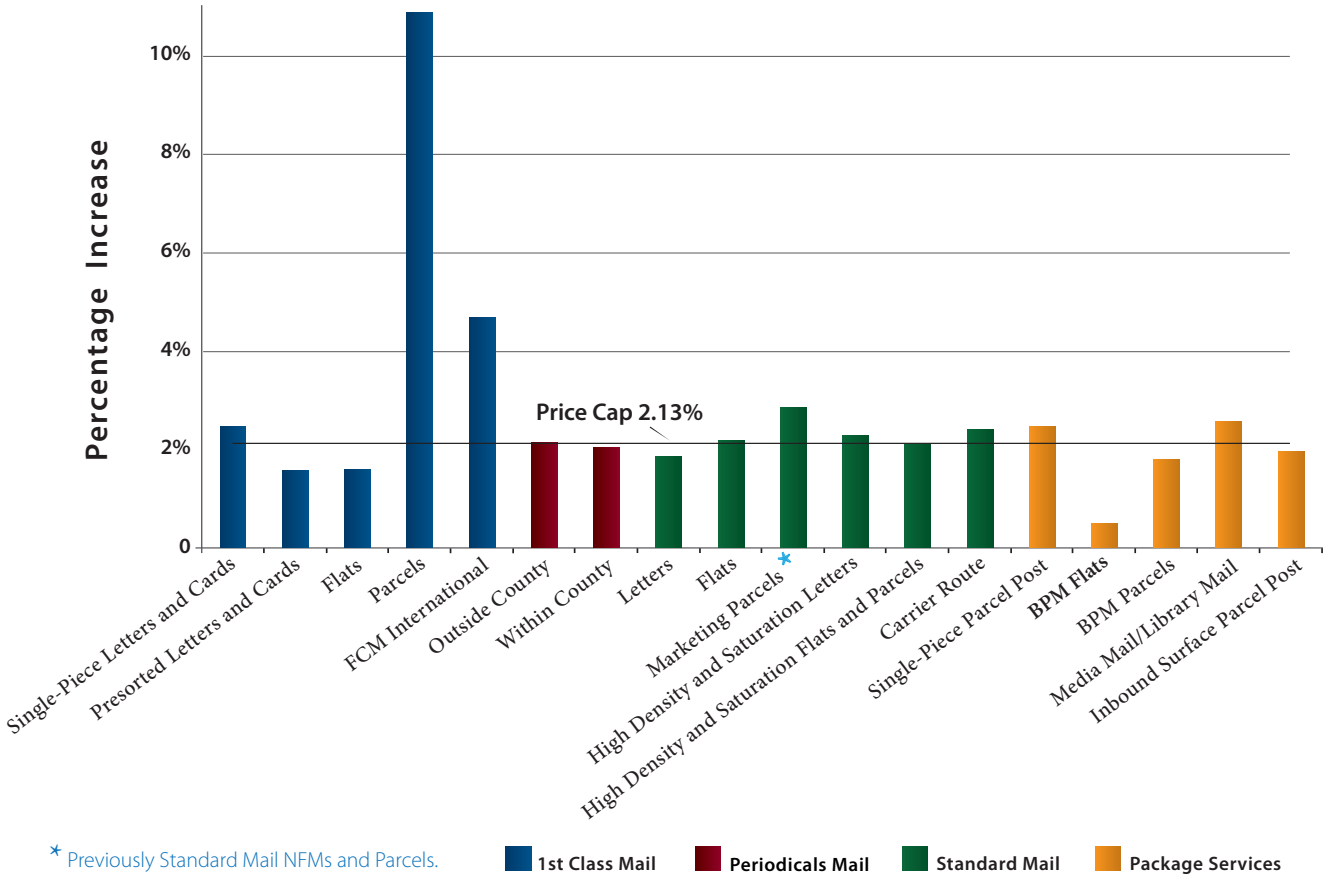
To qualify as an experimental product under 39 U.S.C. 3641 the offering must (1) be significantly different from all products offered by the Postal Service within a two year period; (2) not result in undue market disruption, especially for small businesses; and (3) be correctly categorized as market dominant or competitive. In FY 2012, the Commission reviewed and approved one new experimental product and the addition of two permanent products, one of which had been a market test.

Every Door Direct Mail-Retail

The Postal Service first began offering Every Door Direct Mail—Retail (EDDM—R) as an experimental product pursuant to Commission authorization of a market test in Docket No. MT2011-3. In January 2012, the Commission granted the Postal Service's request for an exemption from the $10 million annual revenue limitation for EDDM-R.[26] The

[26] Commission Order No. 1164.

Figure III-5—Docket No. R2012-3 Price Adjustments by Product



* Previously Standard Mail NFMs and Parcels.

effect of the exemption was to increase the annual revenue limitation to $50 million pursuant to 39 U.S.C. 3641(e)(2). Subsequently, the Postal Service requested a modification to the Mail Classification Schedule (MCS) by adding Every Door Direct Mail–Retail (EDDM-R) to the market dominant product list.[27] The Commission found that the Postal Service's request met the statutory requirements and issued Order No. 1460 on September 7, 2012 approving the Postal Service's request.

Picture Permit Imprint Indicia

In Order No. 1324, the Commission approved the Postal Service's request to add picture permit imprint indicia as a new price category for First-Class Mail Presorted Letters and Postcards and Standard Mail High-Density and Saturation Letters, Carrier Route, and Letters. Picture permit indicia allow certain images to be placed in the permit indicia area of those First-Class and Standard Mail products. The price for the new category is one-cent per piece for First-Class Mail and two-cents per piece for Standard Mail.

First-Class Tracer

The Commission approved the proposed experimental product identified as First-Class Tracer (Tracer) on December 9, 2011. Tracer is a barcode that the mailer affixes to a mailpiece. The mailer keeps a portion of the label that includes a tracking number and a QR code, which enables the mailer to go to the USPS.com website and check the status of the respective mailpiece by either entering the tracking number or by scanning the QR code with a mobile device. The approval included a data collection plan as a requirement of the Postal Service's implementation of the Tracer product market test. To date, the Postal Service has not filed data collection results with the Commission.

Promotional Products

In FY 2012, the Commission approved two mobile barcode promotions. The first was approved in Order No. 1296.[28] This program requires First-Class and Standard mailers to place a two-dimensional barcode on or inside a mailpiece to qualify for a two percent discount. A qualifying barcode must lead the recipient to a mobile-optimized webpage that either (1) allows the recipient to purchase a product or service; or (2) includes content unique to the individual recipient. The promotion was in effect from July 1, 2012, through August 31, 2012.

In FY 2012, the Postal Service requested an additional mobile barcode promotion that would be in effect from November 7, 2012, through November 21, 2012. This promotion, known as the Mobile Shopping Promotion, provides a two percent discount on First-Class and Standard mailpieces displaying a mobile barcode linking to a mobile optimized shopping website that allows the recipient to purchase a product. The Mobile Shopping Promotion also includes a one percent rebate on First-Class and Standard Mail if a portion of the mailer's orders are fulfilled via Priority Mail between November 9, 2012, and December 31, 2012.

The Commission was concerned that the Mobile Shopping Promotion may potentially violate the 39 U.S.C. 3633 prohibitions against cross-subsidization

[27] Request of the United States Postal Service to Add Every Door Direct Mail–Retail to the Mail Classification Schedule, July 10, 2012 (Request). On July 18, 2012, the Postal Service filed a correction to its Request. United States Postal Service Notice of Errata to Request of the United States Postal Service to Add Every Door Direct Mail – Retail to the Mail Classification Schedule, July 18, 2012.

[28] This promotion was similar to the mobile barcode promotion offered in FY 2011. *See* Docket No. R2011-5.

of competitive products if a mailer is eligible for rebates on First-Class Mail and Standard Mail based on its use of Priority Mail. To ensure no cross-subsidization occurred, the Commission required the Postal Service to treat the rebate as an advertising cost to Priority Mail when determining competitive products' incremental costs in its Annual Compliance Report.

Market Dominant Negotiated Service Agreements

Since the passage of the PAEA, the Postal Service has requested approval of two market dominant negotiated service agreements (NSAs) with commercial mailers. The first was in FY 2011, with Discover Financial Services (Discover), and the second was in FY 2012 with Valassis, Inc. (Valassis). The Commission approved both.

In Order No. 1428, the Commission approved the Postal Service's request for its NSA with Valassis. The Commission found that the NSA complied with all relevant statutory authority because, among other things: the prices offered by the Postal Service to Valassis are compensatory, and therefore the agreement is not anti-competitive; the NSA would benefit consumers and the Postal Service, and not unreasonably harm the marketplace; and similar agreements would be available to other mailers on reasonable terms.

The Newspaper Association of America (NAA) has filed an appeal of the Commission's decision with the U.S. Court of Appeals for the District of Columbia Circuit (NAA v. PRC) (No. 12-1367) which is pending.[29]

[29] On August 24, 2012, NAA petitioned the court for an Emergency Motion for a stay of the Valassis NSA pending the outcome of the appeal. The court denied NAA's motion on September 25, 2012.

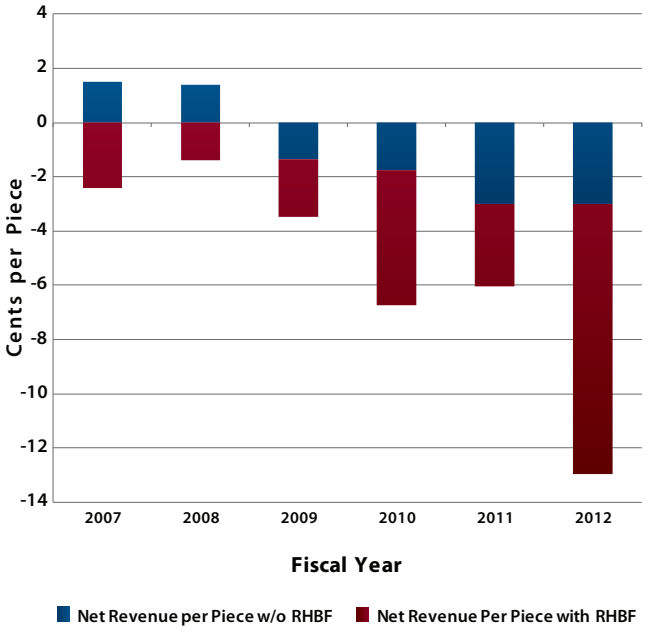
Objective 5: Assuring Adequate Revenues

The Postal Service's current financial challenges demonstrate that it is at risk of failing to meet the objectives of section 3622(b)(5), which include assuring adequate revenues, including retained earnings, to ensure financial stability. Ten years after enactment of the PAEA, 39 U.S.C. 3622(d)(3) requires the Commission to review the system for regulating rates and classes for market dominant products to determine if the system is achieving the objectives of 3622(b). The tenth anniversary will occur in December 2016.

Since FY 2006, the Postal Service has reported financial losses totaling over $41 billion. In that same period, the funding schedule for the RHBF has required total payments of $33 billion. The price cap regulations prohibit the Postal Service from increasing rates higher than an inflation-based index. Annual average increases under this index have ranged from 0 percent to 3.8 percent. Despite the Postal Service's efforts to significantly reduce costs, the revenue generated from these increases has not been enough to cover the funding requirements and operating expenses.[30] For example, in FY 2012 the Postal Service lost $15.9 billion, or 10 cents per mail piece, including $11.2 billion in RHBF expenses. In FY 2012 the average revenue per piece was 40.8 cents. For the Postal Service to break even, the average revenue per piece would have to increase to 50.8 cents. This equates to a 24 percent average increase in revenue per piece. To cover only operating costs, without the RHBF payment, a

[30] The Commission has advocated adjustments to the funding of retiree health benefits in the report to Congress in response to a Postal Service Inspector General report on retiree health benefit funding and also in the Commission's Section 701 report to the Congress.

Figure III-6—Net Revenue Per Piece

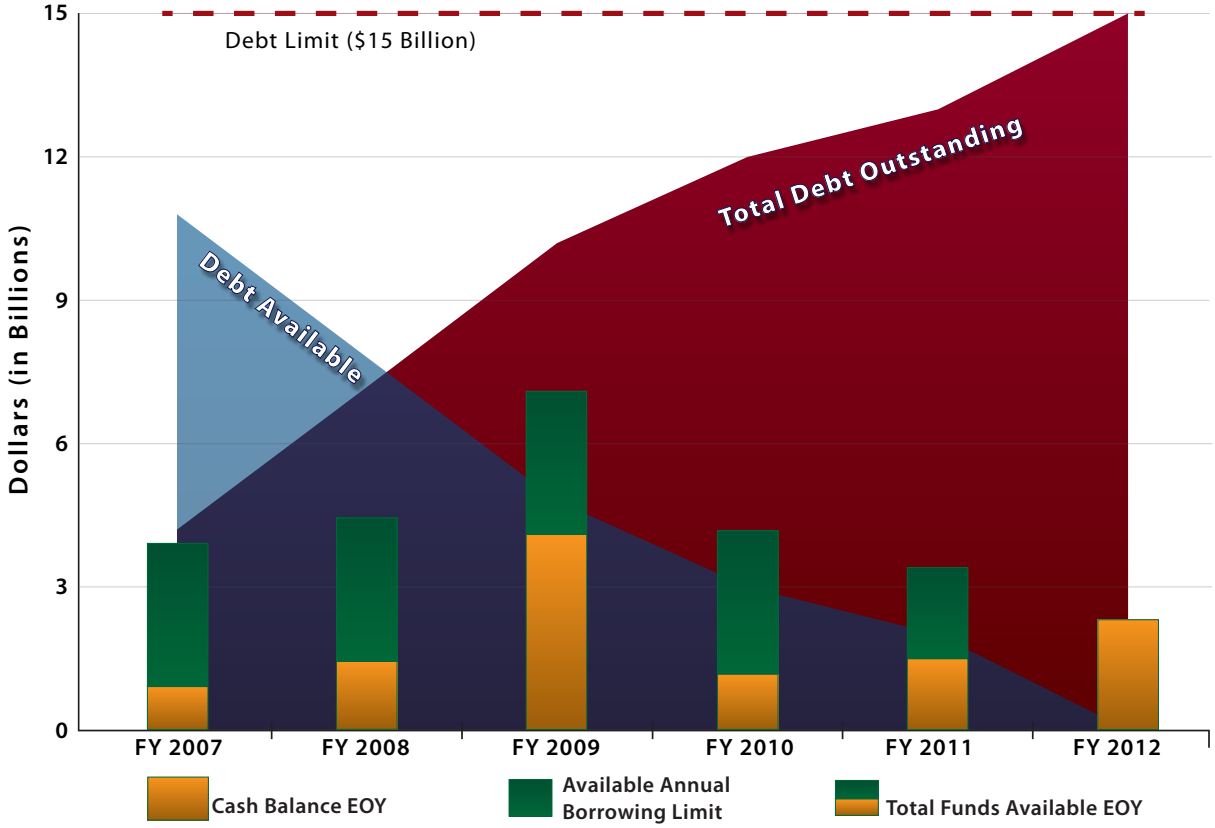


seven percent increase in revenue would have been necessary to break even. The actual CPI-U capped average rate increase was 2.133 percent.

The revenue losses over the last four years have strained the Postal Service's ability to maintain cash balances sufficient to fund operations. The level of outstanding debt has increased significantly since FY 2007 and has reached the $15 billion statutory limit. Although the Postal Service is allowed by law to borrow $3 billion a year, it cannot exceed the overall debt limit. Consequently, the funds available to the Postal Service on an annual basis, including cash on hand and short-term debt, have dwindled.

In FY 2012, the Postal Service, for the first time, defaulted on payments due to the U. S. Treasury for

Figure III-7—Postal Service Financial Situation Jeopardizes Operations



the Retiree Health Benefit Fund because of insufficient cash and liquidity.[31] The continued losses in revenue may seriously hamper the Postal Service's ability to pay for basic operations in the very near future. Allowing the Postal Service to reduce the retiree health benefits funding schedule would provide the most immediate beneficial effects in financial condition. Table 1 shows the Postal Service's cash flows over the last six years, since the enactment of the PAEA.

Declines in Volume Have Exacerbated the Postal Service's Financial Issues

Sustained declines in mail volumes have exacerbated the Postal Service's financial losses. Since FY 2006, when volume peaked, total volume has declined by over 53 billion pieces. The bulk of the volume losses were in market dominant products, specifically First-Class Mail, which has declined by almost 29 billion pieces, and Standard Mail, which has lost almost 23 billion pieces. The loss of 29 billion pieces of First-Class Mail, the most profitable product, resulted in institutional cost contribution declines of almost $6 billion since FY 2006, and the Standard Mail volume losses resulted in losses of institutional cost contribution of almost $1.5 billion. If volume had remained at 2006 levels the combined $7.5 billion in contribution to institutional cost would have been enough to pay the $5.6 billion due to the RHBF at the end of FY 2012 and would have offset most of the $3.5 billion operating loss incurred in FY 2012.

Competitive products, which are not constrained by the price cap, have received average price increases that were approximately five percent per year. Despite higher prices, volumes have increased over the past three years. These products are not yet a significant part of total Postal Service volumes, and constitute only about one percent of total volumes, however, they have provided an increasing revenue stream and have the potential to offset the losses in market dominant products to some degree in the future.

[31] The Postal Service was responsible for making two payments into the Retiree Health Benefits Fund. The first payment of $5.5 billion was the FY 2011 payment deferred by the Congress to August 1, 2012. The second payment of $5.6 billion was due on September 30, 2012.

Table III-1—Cash Flow FY 2007—FY 2012

	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Net Income/(Loss)	(5,142)	(2,806)	(3,794)	(8,505)	(5,067)	(15,906)
Non-Cash Items and Other Cash Flows	2,539	2,367	5,367	5,213	5,561	15,474
Cash Flows from Investing Activities	500	(1,938)	(1,806)	(1,323)	(1,053)	(557)
Cash Flows from Financing Activities	2,005	2,910	2,890	1,687	886	1,820
Net Increase/(Decrease) in Cash	(98)	553	2,657	(2,928)	327	831
Cash Balance BOY	997	899	1,432	4,089	1,161	1,488
Cash Balance EOY	899	1,432	4,089	1,161	1,488	2,319
Debt Outstanding	4,200	7,200	10,200	12,000	13,000	15,000

OBJECTIVE 6: REDUCING ADMINISTRATIVE BURDEN AND ENHANCING TRANSPARENCY OF RATEMAKING PROCESS

The Commission rules are designed to balance reducing administrative burden with enhancing transparency.[32] The Commission rules accomplish this balance by facilitating 45-day generally applicable rate adjustments, but requiring detailed financial data in the Postal Service's Annual Compliance Report.[33] The Commission rules pertaining to NSAs and periodic reporting have also balanced the need for decreased administrative burden and increased transparency.[34] In FY 2012, the Commission also initiated new rulemakings designed to reduce the administrative burden related to the post office closing appeals process.

Price adjustments

The Commission's review of price adjustment focuses on three areas: (1) ensuring prices do not violate the price cap; (2) ensuring workshare discounts are consistent with, or justified by an exception to, the workshare discount limitation in 39 U.S.C. 3622(e); and (3) ensuring preferential prices satisfy 39 U.S.C. 3626. In addition, the Postal Service typically requests, and the Commission reviews, modifications to the mail classification schedule in conjunction with proposed price adjustments.

While the PAEA limited the Commission's review of market dominant price adjustments to 45 days, the Commission further reduced the review period to 34 days, including 20 days for interested parties to comment on the Postal Service's request.[35] Since the passage of the PAEA the Commission has expeditiously reviewed the Postal Service's four market dominant price adjustments. The Commission has completed its review of each of these requests well under the 45-day statutory deadline.

Negotiated Service Agreements

While there is no defined review period mandated for the Commission's evaluation of a new market dominant NSA, the Commission endeavors to review the proposed NSAs as expeditiously as possible. The review process is intended to minimize the administrative and economic burden of implementing agreements while still requiring submission of relevant data supporting statutory compliance of the NSA. The Commission's regulations are intended to streamline the review of market dominant NSAs, especially functionally equivalent market dominant NSAs. However, the Postal Service has not requested a functionally equivalent NSA with a similarly situated mailer since the passage of the PAEA in 2006.

For competitive NSAs the statute and the Commission rules contemplate a 15-day review.[36] Such agreements are evaluated for compliance with the statutory requirements applicable to competitive products. 39 U.S.C. 3633(a). While many NSAs require prior Commission approval, certain NSAs need not be evaluated prior to implementation. The Commission has structured these agreements, known as Non-Published Rates (NPR) contracts, to reduce administrative burden and provide the Postal Service with more flexibility so long as these contracts meet the Commission's pre-approved price and cost

[32] 39 CFR 3031.10 – 3031.12
[33] 39 CFR 3031.11
[34] 39 CFR 3010.43 and 39 CFR 3050.2
[35] 39 CFR 3010.13
[36] 39 CFR 3015.5

coverage requirements. The need for the Commission to review the individual contracts pre-implementation is effectively eliminated.

Periodic Reporting Rules

Under 39 U.S.C. 3652(a)(1) of the PAEA, the Commission has responsibility for selecting appropriate input data and analytical methods to be used by the Postal Service to demonstrate compliance with the requirements of the PAEA.[37] The Commission rules for changing methods for collecting and analyzing these data are based on informal rulemakings under section 553 of the Administrative Procedure Act (APA).

The Commission's rules approach analytical issues through a process that is intended to be highly flexible, and vary according to the complexity of the proposed change and the level of documentation supporting it.[38] The rules identify separate procedures for strategic rulemakings, discrete issue rulemakings, and expedited rulemakings.[39]

Twenty of the 21 proposals [40] initiated by the Postal Service in FY 2012 to make changes to its costing models were approved by the Commission.[41] The one remaining and recently initiated Postal Service proposal is still pending before the Commission.[42]

39 CFR 3050.11 describes the procedures by which the Commission may, on its own behalf or in response to a petition by the Postal Service, a public representative, or any other interested person, change an accepted analytical principle. In the last quarter of FY 2012, Pitney Bowes Inc. (Pitney Bowes) filed a petition to initiate an informal rulemaking to change the analytical principle that establishes the set of worksharing relationships that are presumed to exist between the various presort rate categories of presorted First-Class letter mail.[43] The Commission granted Pitney Bowes' petition[44] and established Docket No. RM2012-6. In doing so, the Commission rejected the Postal Service's general argument that selecting an appropriate benchmark for determining the costs avoided by a particular form of worksharing does not constitute an analytical principle that the Postal Service must follow in preparing its periodic reports to the Commission.

Rulemakings

Strategic Rulemaking

In FY 2012, work continued in Docket No. RM2011-3, the longer-term strategic rulemaking initiated by the Commission the year before. The Commission initiated this docket to systematically evaluate the Postal Service's need to update and improve upon the data and analytical methods that it uses to report on the costs, volumes, revenues, and service quality of its products under 39 U.S.C. 3652(a) of the PAEA. This docket is designed to reduce administrative burden

[37] 39 U.S.C. 3652(a) states:
(a) COSTS, REVENUES, RATES, AND SERVICE.—Except as provided in subsection (c), the Postal Service shall, no later than 90 days after the end of each year, prepare and submit to the Postal Regulatory Commission a report (together with such nonpublic annex to the report as the Commission may require under subsection (e))—
(1) which shall analyze costs, revenues, rates, and quality of service, using such methodologies as the Commission shall by regulation prescribe, and in sufficient detail to demonstrate that all products during such year complied with all applicable requirements of this title.

[38] 39 CFR part 3050

[39] *See* Order No, 589

[40] At the time the Annual Report for FY 2011 was issued (November 2011), in anticipation of the 2011 ACR, the Postal Service had submitted 15 proposed changes to its costing methodologies. Eight of these submitted in FY 2011 were approved prior to the Postal Service's 2011 ACR filing with the Commission. The remaining seven proposals submitted in November 2011, were approved in January 2012, after the 2011 ACR was filed. Consequently, they are included in the 21 FY 2012 proposals to change costing methods.

[41] As approved, one of these proposals incorporated a modification proposed by Time, Inc.

[42] *See* Docket No. RM2012-8.

[43] Petition of Pitney Bowes Inc. for the Initiation of a Proceeding to Consider Proposed Changes in Analytic Principle, July 12, 2012.

[44] PRC Order No. 1510, October 23, 2012.

and enhance transparency by involving the Postal Service, its stakeholders, and the public in the early stages of the evaluation process. The objective is to agree on priorities assigned to various areas of future research and the nature of the data and analytical methods that future research should employ.

The Commission held a technical conference open to the public on January 12, 2012. It focused primarily on the possibility of the Postal Service performing a street time pilot study, the data that such a study would require, and the form the pilot study should take. The Postal Service filed a Scoping Study in May that further explored those issues. A public technical conference was held on August 15, 2012, addressing that study. This docket is pending.

Rules Applicable to Appeals of Post Office Closings

The Commission has revised its rules governing appeals of post office closings and consolidations in order to simplify them and better reflect current practices.[45] The Commission's previous rules had been adopted more than 30 years ago and were complex. The new rules provide more streamlined procedures and simplify the appeals process, particularly for the majority of petitioners who are not represented by legal counsel. The new rules identify options for filers without access to the Internet, eliminate delays in the filing of the administrative record, comport with Postal Service rule changes, and accelerate the procedural schedule for appeals.[46] They also allow interested persons to file comments without first formally intervening.[47]

The Commission deferred action on several more controversial proposals to a later date, allowing for additional research and analysis.

[45] 39 CFR part 3025
[46] 39 CFR 3025.11; 39 CFR 3025.21; 39 CFR 3025.43
[47] 39 CFR 3025.14

Enhancing Transparency Through the Annual Compliance Determination

A key tool for achieving transparency in Postal Service operations is the annual review of information provided by the Postal Service to the Commission, in accordance with regulations adopted by the Commission. The Postal Service has 90 days after the close of the fiscal year to collect, audit, and submit data that the Commission determines necessary. The Commission has an additional 90 days to solicit comments from the public, evaluate the data, and provide a written determination of Postal Service compliance with applicable statutory policies.

On March 28, 2012, the Commission issued its 2011 ACD report. This report, the fifth since enactment of the PAEA, assessed the financial and service performance of the Postal Service during FY 2011.

The Commission concluded that the Postal Service's financial condition continued to deteriorate. Moreover, the Commission found that the Postal Service faces significant challenges, placing the Postal Service's ability to fulfill its universal service obligation at risk.

The Commission identified 10 market dominant products and services that did not generate sufficient revenues to cover attributable costs in FY 2011. Of those products, the Commission again found the rates for the Standard Mail Flats product not in compliance with the PAEA, as it did in the 2010 ACD. On April 27, 2011, the Postal Service petitioned for judicial review of the 2010 ACD. The United States Court of Appeals for the District of Columbia Circuit upheld the Commission's finding of noncompliance but asked the Commission for clarification as to the standard used to determine noncompliance. The Commission

provided clarification in Order No. 1427. *See* Chapter V for further discussion.

The Commission also determined that three competitive products—Global Plus 2A Contracts, International Expedited Services, and International Money Transfer Services-Inbound—did not comply with 39 U.S.C. 3633 (a)(2). Accordingly, the Commission ordered the Postal Service to take corrective action.

The Commission also concluded that reported service performance met the delivery service standards for the Single-Piece First-Class Mail and Special Services products. The Postal Service is demonstrating success in meeting its service standard goals in the areas of single-piece First-Class Mail and Special Services. However, the Postal Service did not meet its delivery service standard target for the majority of market dominant products in FY 2011.

OBJECTIVE 7: ENHANCE MAIL SECURITY AND DETER TERRORISM

The Commission rules do not impact this objective.

OBJECTIVE 8: MAINTAINING A JUST AND REASONABLE RATE SCHEDULE

The Commission's rules related to providing predictability and stability in rates, allowing pricing flexibility, and enhancing transparency facilitate a just and reasonable rate schedule.[48] In addition, the Commission's complaint rules are designed, in part, to maintain a just and reasonable rate schedule and adequate service.[49] The complaint rules enable the Commission to hear and resolve complaints in a streamlined and efficient manner, while providing due process for all participants. There were no new rate related complaints filed in FY 2012.

OBJECTIVE 9: ALLOCATING THE TOTAL INSTITUTIONAL COSTS OF THE POSTAL SERVICE APPROPRIATELY BETWEEN MARKET DOMINANT AND COMPETITIVE PRODUCTS

Objective 9 is closely related to the three statutory requirements found in 39 U.S.C. 3633(a).

Competitive Products

The Commission's review of rate adjustments and mail classifications for competitive products is governed by 39 U.S.C. 3633(a), which establishes three statutory requirements, incorporated into the Commission's rules, applicable to competitive products.

First, competitive products may not be cross-subsidized by market dominant products. The Commission uses an incremental cost test to validate compliance with the cross-subsidy requirement that revenue generated from competitive products equals or exceeds the incremental costs of such products.

Second, each competitive product must cover its attributable cost. The Commission reviews each product in its ACD and when the Postal Service files notices of competitive price changes to ensure this requirement is being met.

Finally, competitive products must collectively cover an appropriate share of the Postal Service's institutional costs. The Commission has determined that the minimum contribution must be 5.5 percent of the Postal Service's total institutional cost. As seen in

[48] 39 CFR part 3010 and 39 CFR part 3015
[49] 39 CFR part 3030

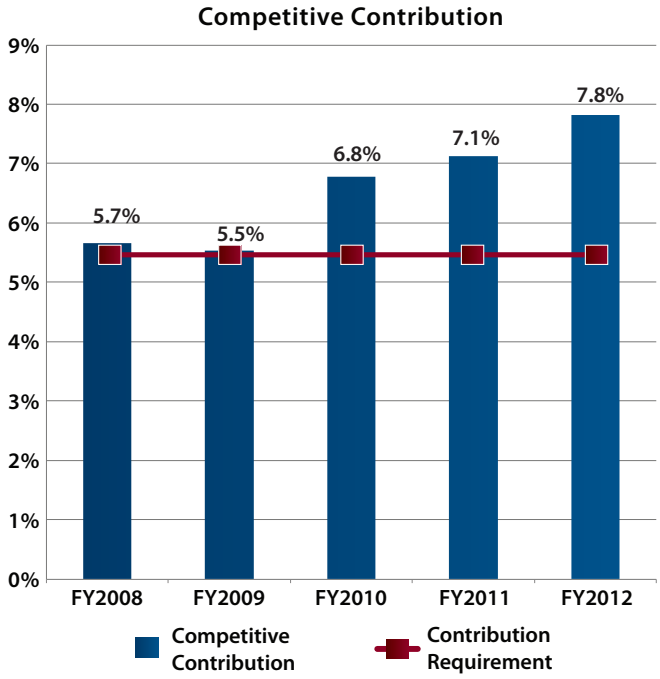
Figure III-8, since the first ACD in FY 2007, the Postal Service has met the contribution minimum.

Within the constraints of these statutory requirements, the Commission's rules provide the Postal Service with the flexibility to develop prices for its competitive products.[50] The Commission has 30 days to determine whether the Postal Service's proposed rates for competitive products satisfy the requirements of section 3633 and the Commission's implementing regulations.

CP2012-2 General Price Adjustment

On November 22, 2011, the Postal Service filed notice with the Commission concerning changes in rates of general applicability for competitive products. In Order No. 1062, the Commission determined that the rate adjustments met the requirements of 39 U.S.C. 3633(a). The approved rates went into effect on January 22, 2012.

Figure III-8—Competitive Products Contribution FY 2007 – FY 2011



The Commission also found that the Postal Service met the conditions outlined in Order No. 689 concerning the transfer of commercial Standard Mail parcels from the market dominant product list to the Parcel Select product on the competitive product list under the name Lightweight Parcel Select. Since commercial Standard Mail parcels previously did not cover their attributable costs, as a condition of approving the request, Order No. 689 required the Postal Service to demonstrate that planned prices for Parcel Select (including Lightweight Parcel Select) covers attributable costs.

RM2012-3 Review of Competitive Products' Appropriate Share to Institutional Costs

The PAEA directs the Commission to promulgate a regulation to ensure that competitive products, collectively, bear an "appropriate share" of the Postal Service's institutional costs. *See* 39 U.S.C. 3633(a)(3); 39 CFR 3015.7(c). The Commission is required to review its appropriate share regulation at least every five years to determine if the contribution requirement should be "retained in its current form, modified, or eliminated." 39 U.S.C. 3633(b). In making such a determination, the Commission is required to consider "all relevant circumstances, including the prevailing competitive conditions in the market, and the degree to which any costs are uniquely or disproportionately associated with any competitive products." *Id.*
The Commission conducted its first review of the competitive products' appropriate share of the Postal Service's institutional costs and considered whether the appropriate share rule should be modified.

[50] 39 CFR 3015.2

In Order No. 1449, the Commission left the appropriate share rule unchanged. The Commission's review included consideration of the following relevant circumstances: the lack of evidence of a Postal Service competitive advantage; a market share analysis; changes to the market and competitors; historical competitive contribution levels; changes to competitive product offerings and the mail mix; and uncertainties.

The Commission noted that the statute allows it to initiate a proceeding to change the competitive contribution's appropriate share at any time. Parties may also petition the Commission to initiate such a proceeding when circumstances warrant. Thus, if any significant uncertainties materialize and result in meaningful changes to the Postal Service finances as it pertains to section 3633(b), the Commission will be in a position to evaluate the effects of such changes on the appropriate share contribution level.

Competitive NSA Dockets

In FY 2012, the Commission reviewed competitive NSAs in 55 docketed proceedings. These NSAs consist of negotiated prices for both competitive domestic and international mail services. Examples of competitive NSAs include the following: Domestic—Express Mail, Priority Mail, and Parcel Select, and Priority Mail–Non-Published Rates (Priority Mail–NPR); International—Global Direct Contracts, Global Plus Contracts, and Global Expedited Package Services–Non-Published Rates (GEPS–NPR). Table III-2 shows the number of competitive domestic and international NSAs, and total NSAs, approved during the past five fiscal years (FY 2008 – FY 2012).

Table III-2—Negotiated Service Agreements Dockets Approved by the Commission

Competitive NSAs	FY 2012	FY 2011	FY 2010	FY 2009	FY 2008
Total Competitive Domestic	32	14	13	31	2
Total Competitive International	23	50	111	32	19
Total Competitive NSAs	**55**	**64**	**124**	**63**	**21**

Since FY 2010, there has been a reduction in the total number of agreements approved by the Commission. This decrease largely reflects implementation of the NPR procedures.

Table III-3 shows the number of GEPS–NPR and Priority Mail–NPR contracts filed by the Postal Service with the Commission since the NPR contracts were introduced in FY 2011. During FY 2012, there were 141 GEPS–NPR contracts and three Priority Mail–NPR contracts filed with the Commission

Table III-3—Non-Published Rates Contracts Filed With the Commission

Non-Published Rates (NPR) Contracts	FY 2012	FY 2011
GEPS-NPR[1]	141	168
Priority Mail-NPR	3	3
Total NPR Contracts	**144**	**172**

[1] The GEPS–NPR figures reflect the number of contracts filed under both the GEPS–NPR 2 and GEPS–NPR 3 products. No contracts were filed under the GEPS–NPR 1 product.

Transfers and Additions to The Competitive Product List

39 U.S.C. 3642 permits a product to be transferred from the market dominant product list to the competitive product list and vice versa. In determining whether to allow a product transfer, the Commission must consider the Postal Service's market power with respect to the product, as well as whether the product is covered by the postal monopoly. The Commission must also give due regard to the availability and nature of private sector enterprises engaged in delivering the product, the views of those using the product, and the likely impact on small business concerns. In addition, the Commission must ensure that the product covers its attributable cost. 39 U.S.C. 3633(a)(2).

MC2012-13 Transfer of Parcel Post

The Postal Service proposed to (1) remove Single-Piece Parcel Post from the market dominant product list; (2) add "Parcel Post," a nearly identical product, to the competitive product list; and (3) leave Alaska Bypass Service [51] on the market dominant product list.

In Order No. 1411, the Commission conditionally granted the Postal Service's requested transfer. The Commission determined that the proposed transfer satisfied 39 U.S.C. 3642. However, the Commission's financial analysis indicated that the rates for the proposed Parcel Post competitive product would not cover its attributable costs, and would violate 39 U.S.C. 3633(a)(2). The Commission authorized the transfer subject to the following conditions: (1) the Postal Service must file a notice of competitive price adjustment for Parcel Post rates that demonstrates such rates satisfy 39 U.S.C. 3633(a) and 39 CFR part 3015; (2) the Commission must make a finding that the competitive Parcel Post rates satisfy 39 U.S.C. 3633(a) and 39 CFR part 3015; and (3) the Parcel Post transfer does not become effective until the effective date of prices found by the Commission to satisfy 39 U.S.C. 3633(a) and 39 CFR part 3015. By the end of FY 2012, the Postal Service had not yet met the conditions necessary for the transfer to occur.

MC2012-44 Transfer of First-Class Mail International

The Postal Service filed a request to transfer a subset of Outbound Single-Piece First-Class Mail International from the market dominant product list to the competitive product list. At the time of the filing, Outbound Single-Piece First-Class Mail International encompassed five categories of mail: (1) letters; (2) postcards; (3) large envelopes (flats); (4) packages (small packets); and (5) rolls. The Postal Service proposed to transfer two of these categories, packages and rolls, to the competitive product list under the name First-Class Package International Service (FCPIS). In Order No. 1461, the Commission approved the Postal Service's proposed transfer. The Commission found that the proposal satisfied 39 U.S.C. 3642 and 39 U.S.C. 3633. The Commission also noted that the remaining Outbound Single-Piece First-Class Mail International product, which only contained letters, postcards, and large envelopes, should continue to cover its attributable costs.

[51] Alaska Bypass Service allows shippers to send shrink-wrapped pallets of goods within Alaska at Parcel Post rates from designated "hub points" to designated "bush points."

Chapter IV

UNIVERSAL SERVICE OBLIGATION AND MAIL MONOPOLY

ESTIMATED COST OF THE UNIVERSAL SERVICE OBLIGATION

The PAEA requires the Commission to provide annual updates on the estimated cost to the Postal Service for providing universal service. The law requires estimates for three separate elements: (1) the cost of providing service to areas of the Nation that would not receive service but for the universal service obligation (USO); (2) the revenue foregone by providing free or reduced rates for postal services as required by 39 U.S.C. 2401(c); and (3) other public services or activities related to the universal service obligation.

The Commission estimate of the first element includes the cost of maintaining small post offices, which are generally located in rural or remote areas, the Alaska air subsidy, and Group E post office boxes. Small post offices are those classified under Cost Ascertainment Groups (CAG) K and L.[1] The Alaska air subsidy is the difference in cost of flying mail to remote areas and the average cost of highway transportation. Group E post office boxes are offered free of charge to postal patrons who do not receive delivery.[2]

The second element is calculated as the difference in revenue between mail that receives a statutorily defined discount and the revenue that would have been received if these pieces were not discounted. It also includes the losses on market dominant products that are offered at CPI-U-capped prices that do not cover the costs of providing the products.[3]

---

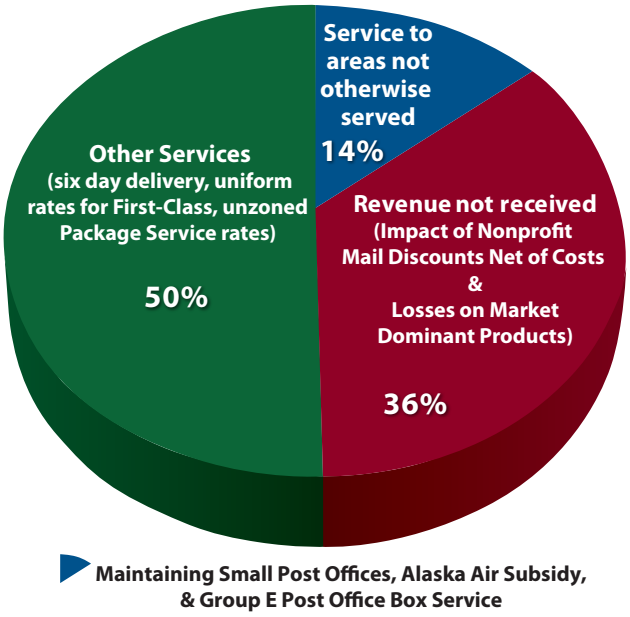
1 The Postal Service uses CAG classifications (A – L) to categorize post offices by the amount of revenue generated. CAG K and L represent the smallest revenue generating post offices.

2 The Postal Service offers Group E Post Office Box Service for free to address potential discrimination issues (Docket No. RM2011-9).

3 The USO cost of losses on market dominant products includes only losses on Periodicals. Because of constraints imposed by the PAEA, the Postal Service cannot effectively use price cap flexibility to fully recover Periodicals costs.

The final element includes the estimated cost of delivering mail six days a week rather than five days a week, and the estimated lost revenue from un-zoned rates in Package Services and First-Class. Figure 1 shows the proportion of the total cost of the USO due to each element.

Figure IV—1 FY 2012 Proportion of Total Cost of Universal Service by Element



As seen in Table IV-1 the estimated cost of providing universal service has increased since FY 2008.[4] For fiscal years 2008 and 2009, the USO cost of six-day delivery is based on the George Mason University method used in previous annual reports. For fiscal years 2010 and 2011, it has been updated to reflect the Commission's findings in N2010-1, Advisory Opinion on the Elimination of Saturday Delivery. These updates consist of additional components, including mail processing and transportation related USO costs of six-day delivery and other refinements, such as improvements in calculating average wage rates and overhead costs.

Table IV-1—Estimated Cost of Universal Service Obligation ($ in Billions)

Mandate	FY 2011	FY 2010	FY 2009	FY 2008
Six-Day Delivery Instead of Five-Day Delivery	2.480	2.427	2.08	2.16
Nonprofit Mail Discounts	1.329	1.284	1.322	1.223
Unzoned Media/ Library Rates	0.115	0.098	0.096	0.094
Losses on Market Dominant Products	0.609	0.611	0.642	0.437
Maintaining Small Post Offices	0.583	0.566	0.536	0.549
Alaska Air Subsidy	0.123	0.118	0.121	0.124
Uniform Rates for First-Class Mail	0.122	0.078	0.081	0.212
Group E Post Office Box Service	0.036	0.038	0.037	N/A
Total Cost of Universal Service Obligation	5.397	5.220	4.915	4.799

The changes account for the majority of the increase over FY 2009. Without these refinements the cost of six-day delivery would have been $2.1 billion in FY 2010 and $2.2 billion in FY 2011.[5] In addition, the George Mason University method has been further

[4] The data necessary to compute the costs of the USO for a given year is not available until after the Commission's Annual Report for that year is published. Therefore, the cost estimates use data from the previous fiscal year.

[5] These cost estimates do not include the loss in revenue that may result from lower demand for post services. In the N2010-1 advisory opinion, the Commission estimated this amount to be $587 million.

updated to include the cost of providing Group E post office box service as a cost component of the USO.[6]

The Postal Service provides statutorily discounted rates for the nonprofit rate categories in Periodicals and Standard Mail. Additionally, statutory discounts are given to Periodicals, Classroom and Science of Agriculture and to Library Rate. The Postal Service also provides free postage for blind and disabled persons, and balloting materials under the Uniform and Overseas Citizens Absentee Voting Act. Table IV-2 presents the Commission's estimates of revenue foregone by the Postal Service in providing discounted rates to preferred categories of mail for fiscal years 2008-2011.

ESTIMATED VALUE OF THE MONOPOLY

The Commission updated its combined and mailbox monopoly values for the present year using the base assumptions and methodology outlined in its 2008 Report on Universal Postal Service and the Postal Monopoly. The value of the monopoly estimates the profit lost by the Postal Service if potential competitors were allowed to enter and compete in the Postal Service's letter monopoly (stemming from the Private Express Statutes) and the mailbox monopoly. In other words, if the Postal Service's combined monopolies (letter monopoly and mailbox monopoly) and, separately, the mailbox monopoly were eliminated, the value of the monopoly would be the reduction in the Postal Service's profit for each case.

The base case assumptions applying to competitors in the present analysis include: (1) full diversion of local contestable mail when discounting existing Postal Service rates by at least 10 percent; (2) competitors incur only delivery costs and deliver three times a week under the combined monopoly, and once a week under the mailbox monopoly; and (3) competitors are 10 percent more cost efficient than the Postal Service. Other than differences in delivery frequency, mail subject to diversion under the mailbox monopoly is much more restricted in scope compared to the combined monopoly, as explained in the Commission's USO report.

Table IV-2—Estimated Revenue Not Received ($ in Billions)

Mail Class	FY 2011	FY 2010	FY 2009	FY 2008
Standard Mail				
Nonprofit	0.893	0.989	1.001	0.969
Nonprofit – ECR	0.073	0.085	0.097	0.072
Total Standard Mail	0.966	1.074	1.098	1.041
Periodicals				
Nonprofit	0.106	0.012	0.013	0.011
Classroom	0.006	0.001	0.001	0.001
Total Periodicals	0.112	0.013	0.014	0.012
Library Rate	0.0002	0.001	0.001	-0.001
Free-for-the-Blind Mail	0.051	0.066	0.054	0.052
Total	1.129	1.154	1.167	1.104

[6] The Commission approved a change in analytical principles to treat the costs associated with Group E Post Office Box Service (mainly facility-related costs) as institutional rather than as part of the attributable costs of Post Office Box Service in Docket No. RM2011-9, Order No. 744. In this order, the Commission concluded that treating Group E attributable costs as institutional represents a more equitable distribution of the costs of universal service. *Id* at 4. The Commission also concluded that this treatment is analogous to and consistent with the treatment of intra-Alaska air transportation. *Id* at 4. To be consistent, the costs of providing Group E post office box service has been added to the cost of the USO. The Order accepting this change in analytical principle was issued on June 9, 2011; estimates for prior years are included for comparison purposes.

The method employed to estimate each monopoly value is much the same as last year's approach. The Commission's model estimates competitor profits for all routes based on contestable volumes, discounted rates and delivery costs. Entry occurs only on routes where the entrant would earn positive profits. The monopoly value is estimated as the sum of the contribution lost to the Postal Service from routes that competitors find profitable and from which they capture volume. The updated and previous year values are shown in Table IV-3. The monopoly valuation model continues to incorporate separate unit variable and non-delivery costs for city and rural routes.[7]

Table IV-3: Estimated Value of the Monopoly ($ in Billions)

Mandate	FY2011	FY2010	FY2009	FY2008
Mailbox Monopoly	0.91	0.69	0.79	1.07
Combined Monopolies	1.66	1.55	2.11	2.96

The updated "base case" monopoly values reported below are slightly higher than last year's values. The FY 2010 estimate of the Combined Monopolies fell approximately $600 million, primarily due to the reduction in mail volume. The values of the Combined and Mailbox Monopoly for FY 2011 are respectively $1.66 billion and $0.91 billion, slightly higher than last year's values.

The Commission's estimates are incomplete in several respects. As described in the 2008 USO report, it is possible that entry would only occur on profitable co-located routes that benefit from economies of density. The Commission's model evaluates entry for each route regardless of the extent of route clustering. The Commission's model also does not capture the cost of any carrier route sorting required by potential entrants for five-digit sorted letter mail entering the system at the plant or delivery unit level. Including these costs would lower the extent of entry. In addition, the model does not include switching costs or brand loyalty, both of which could also reduce the extent of entry.

[7] There are six contestable products for the Combined Monopoly: First-Class Presort Letters; First-Class Presort Cards; Periodicals; Enhanced Carrier Route; Standard Letters, Flats, Parcels; and Parcel Post. The first two and the fourth products are not considered contestable in the Mailbox Monopoly case because they are delivered to mailboxes.

Chapter V

OTHER LEGAL PROCEEDINGS

The Office of the General Counsel supports the Commission in the timely and efficient adjudication of matters filed under the provisions of the PAEA. Increasing transparency of the Postal Service's pricing, classification, and service policies is a primary objective for the initiation of rulemakings to support relevant statutory objectives as well as the legal review of the Postal Service's products and services for compliance with statutory requirements. These dockets are available for public review and comment.

POST OFFICE APPEALS

The Commission's authority to review post office closings is provided by 39 U.S.C. 404(d)(5). That section requires the Commission to review the Postal Service's determination to close or consolidate a post office on the basis of the record that was before the Postal Service. The Commission is empowered by section 404(d)(5) to set aside any determination, findings, and conclusions that it finds to be (a) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law; (b) without observance of procedure required by law; or (c) unsupported by substantial evidence on the record. Should the Commission set aside any such determination, findings, or conclusions, it may remand the entire matter to the Postal Service for further consideration. Section 404(d)(5) does not, however, authorize the Commission to modify the Postal Service's determination by substituting its judgment for that of the Postal Service.

In FY 2012 there were an unprecedented number of post office closings and subsequent appeals to the Commission and adjudicating this large volume of appeals was a major undertaking. It required collaboration between the Commission's technical staff from the Office of Accountabilty and Compliance and attorneys from the Office of the General Counsel, the participation of a large number of Public Representatives, supervised by the Attorney Administrator, and the contribution of resources from all the Commission's departments.

On December 15, 2011, the Postal Service advised the Commission that it would "delay the closing or consolidation of any Post Office until May 15, 2012."[1] The Postal Service further indicated that it would "proceed with the discontinuance process for any Post Office in which a final determination was already posted as of December 12, 2011, including all pending appeals" *Id.* It stated that the only "Post Offices" subject to closing prior to May 16, 2012, are those that were not in operation on, and for which a Final Determination was posted as of, December 12, 2011. *Id.* It affirmed that it would "not close or consolidate any other Post Office prior to May 16, 2012." *Id.* at 2. Lastly, the Postal Service requested the Commission "to continue adjudicating appeals as provided in the 120-day decisional schedule for each proceeding." *Id.*

The Commission considered 208 post office closing appeals in FY 2012.[2] 207 of those cases have concluded.[3] In approximately 78 percent (162) of those concluded cases the Commission affirmed the Postal Service.[4] The Commission dismissed approximately 13 percent (27) and remanded approximately 8 percent (16).[5]

APPEAL OF 2010 ACD DIRECTIVE ON STANDARD MAIL FLATS

On April 17, 2012, the United States Court of Appeals for the District of Columbia Circuit left intact the Commission's Fiscal Year 2010 Annual Compliance Determination (FY2010 ACD). *United States Postal Service v. Postal Regulatory Commission*, 676 F.3d 1105 (D.C. Cir. 2012). At issue were the Commission's finding that the rates for Standard Mail Flats were in violation of 39 U.S.C. 101(d) and the remedy requiring the Postal Service to "increase the cost coverage of the Standard Mail Flats product through a combination of above-average price adjustments and cost reductions until such time that the revenues for this product exceed attributable costs." FY2010 ACD at 106.

The Court upheld the Commission's finding that 39 U.S.C. 3622(c)(14) authorizes the Commission to consider the policies of the PAEA, at least in extreme circumstances, when conducting its annual compliance review of market dominant products, specifically section 101(d) which requires that "[p]ostal rates shall be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis." 676 F.3d at 1108. However, the Court questioned whether the Commission's determination was consistent with its treatment of other market dominant products having comparable, or lower, cost coverages and whether it would continue to be appropriate if the attributable cost coverage of Standard Mail Flats were to improve. *Id.* The Court therefore remanded the case to the Commission for a further explanation of the circumstances triggering section 101(d) and the appropriateness of the prescribed remedy for Standard Mail Flats.

On August 9, 2012, the Commission issued its Order on Remand. Docket No. ACR2010-R, Order on Remand, August 9, 2012. In that Order, the Commission reviewed the factors which, together,

1 United States Postal Service Notice of Status of the Moratorium on Post Office Discontinuance Actions, December 15, 2011, at 1 (Notice).
2 81 of those cases were filed in FY 2011 and the Commission disposed of the cases in FY 2012.
3 One case filed in FY 2012 remains open.
4 133 of those cases were decided by a tie vote. In the absence of a majority vote the status quo is maintained and for purposes of post office closing appeals, Postal Service determinations are affirmed.
5 One case was closed as it was duplicative of an earlier appeal.

constituted "extreme circumstances" authorizing Commission action. *Id.* at 8-10. The Commission also explained why the remedy it imposed in the 2010 ACD was appropriate for Standard Mail Flats and consistent with its treatment of other market dominant products. *Id.* at 10-20.

COMMISSION RULEMAKINGS

RM2012-4 Procedural Rules Governing Advisory Opinions in Nature of Service Proceedings

On April 10, 2012, the Commission issued an Advance Notice of Proposed Rulemaking in Docket No. RM2012-4 to consider potential revisions to its current procedures under 39 U.S.C. Section 3661 for reviewing Postal Service proposals for a "change in the nature of postal services which will generally affect service on a nationwide, or substantially nationwide basis…." 39 U.S.C. 3661(b). This docket was initiated in response to the Postal Service's expressed need for more expeditious hearing processes in light of its present financial situation. *See, e.g.*, Docket No. N2012-1, Request of the United States Postal Service for an Advisory Opinion on Changes in the Nature of Postal Services, December 5, 2011 at 13. Procedural revisions must be consistent with 39 U.S.C. 3661(c) requiring an opportunity for hearing on the record under section 556 and 557 of title 5. The Commission solicited comments on the issues of: (1) whether changes to the current procedures and regulations are warranted and (2) if so, what procedural changes should be implemented. Eight initial comments and four reply comments were filed by interested parties. If the Commission advances this rulemaking, it will issue a Notice of Proposed Rulemaking with an opportunity for further comments.

National Association of Letter Carriers witness Professor Michael Crew.

COMPLAINTS

Docket No. C2011-5 Lopez Complaint

On July 12, 2011, Ramon Lopez filed a complaint alleging that the Postal Service refused to deliver mail to his residence, and the Postal Service responded that it had been suspended because his home was found to be vacant. The Commission dismissed the case based on that explanation, and reopened it on voluntary remand after Mr. Lopez appealed. After considering subsequent filings from Mr. Lopez and the Postal Service, the Commission again dismissed the complaint because it failed to present a claim upon which relief could be granted. Mr. Lopez has appealed, and the case is pending.

Docket No. C2012-1 Complaint of the Associated Mail and Parcel Centers, et al. and Post Office Box Enhancements

On March 15, 2012, organizations representing Commercial Mail Receiving Agencies (CMRAs),

businesses which operate private mail box stores, filed a complaint with the Commission. The Complainants claimed that the Postal Service, by offering customers certain enhanced services at competitive Post Office Box service locations without first obtaining Commission approval, ran afoul of sections 3633, 3642, and 3661 of title 39. The enhanced services are: (1) the option to receive electronic notification when mail is delivered to the post office box; (2) the option to use the post office street address and a "#" designation rather than a "P.O. Box" address designation; and (3) for customers who elect to use the post office street address, the option to receive packages from private carriers.

The Postal Service moved to dismiss the complaint. In its Motion to Dismiss, the Postal Service did not challenge the allegation that it is offering the enhanced services. Rather it moved to dismiss the complaint on the ground that the enhanced services had already been resolved by the Commission in prior proceedings to transfer Post Office Box service to the competitive product list (Docket No. MC2011-25) and to adjust rates and classifications (Docket No. CP2012-2).

On June 13, 2012, the Commission issued an order granting the Motion to Dismiss as to the Complainants' claim under 39 U.S.C. 3661 and denying the Motion to Dismiss as to the Complainants' claims under 39 U.S.C. 3633 and 3642. The Commission found that although the introduction of the enhanced services does not implicate section 3661, the enhanced services were not at issue in the prior proceedings and therefore the Complainants could not be faulted for failing to object to the enhanced services in those proceedings. The Commission found that it was unclear whether the Complaint raises material issues of law or fact. Because the Postal Service had not submitted a filing describing the nature and implementing rules for the enhanced services, the Commission determined that it could not accurately evaluate their impact. In the interests of efficiency and to afford the Complainants and the Postal Service a venue to air their views, the Commission established Docket No. MC2012-26. The Commission gave the Postal Service the option to make an elective filing in that docket under 39 CFR 3020.30 to inform the Commission and the public of

Commission Public Hearing.

the nature, scope, and significance of the enhanced services to the competitive Post Office Box service.

In response to the Commission's order, the Postal Service made an elective filing to provide the Commission with additional information to complete its review of the enhanced services at competitive Post Office Box service locations.

A decision in Docket No. MC2012-26 is pending.

C2012-2 Complaint of the American Postal Workers Union, AFL-CIO

On June 13, 2012, the American Postal Workers Union, AFL-CIO filed a complaint alleging that Postal Service actions in a pending Advisory Opinion request (Docket No. N2012-1, Mail Processing Network Rationalization Service Changes) violated 39 U.S.C. 3661 and 3691.

The alleged section 3661 violations consisted of the Postal Service's implementation of changes before receipt of the Commission's advisory opinion; failure to file a separate request for the changes announced after the advisory opinion request was filed; and, given the absence of such filing, failure to file a request a reasonable time prior to their implementation. The alleged section 3691 violation stemmed from the Postal Service's purported failure to address the impact of the proposal in terms of statutory factors and objectives.

The Commission dismissed the Complaint. It found that the plain language of section 3661 does not require the Postal Service to "receive" a Commission decision before implementing proposed service changes. It found that the Postal Service had filed its advisory opinion request a reasonable time prior to implementation of proposed changes, and therefore satisfied section 3661 requirements with respect to timing. The Commission further found that the Phase I changes were lesser-included changes within the context of the Docket No. N2012-1 filing, and did not have to be the subject of a separate section 3661 advisory opinion request. With respect to section 3691, the Commission found that the appropriate forum for the alleged deficiencies was in the pending advisory opinion docket, not the Complaint.

UNITED STATES POST OFFICE GARRETT PARK MARYLAND

Chapter VI

International Activities

AUTHORITY

39 U.S.C. 407 establishes an ongoing role for the Commission in international postal matters. Section 407(b)(2)(A) addresses one aspect of this authority by generally requiring the Secretary of State, in exercising foreign policy authority with respect to international postal-related matters, to coordinate with other agencies as appropriate and, in particular, to give full consideration to authority vested by law in several named agencies, including the Postal Regulatory Commission.

More specifically, sections 407(c)(1) and 407(c)(2) address a more specific issue: namely, the Commission's role and the Secretary of State's obligations with respect to aspects of international treaties, conventions, or amendments that concern market dominant rates or classifications. Section 407(c)(1) requires the Secretary, before concluding any treaty, convention, or amendment that establishes a rate or classification for a product subject to subchapter I of chapter 36 [a market dominant product] to request the Commission to submit its view on the consistency of such rate or classification with standards and criteria the Commission has established under section 3622. Section 407(c)(2) further provides that the Secretary shall ensure that each treaty, convention or amendment is consistent with the views of the Commission, except pursuant to the Secretary's written determination that it is not in the foreign policy or national security interest of the United States to ensure consistency with the Commission's views.

UPU CONGRESS

In FY 2012, the Commission devoted considerable effort to preparing for the Universal Postal Union, 25th Congress in Doha, Qatar which was held from September 24 to October 15, 2012. The Universal Postal

Allison Levy, Senior International Policy Advisor to the Postal Regulatory Commission.

Union (UPU) is a United Nations technical agency that facilitates the exchange of mail through a global universal postal network made up of its 192 member countries, including the United States. The Congress is the UPU's supreme authority that meets every four years to adopt a new global postal strategy and amend the Union's international treaty, which governs such issues related to the exchange of mail as remuneration, technical standards, and product features. Over 2,200 postal operators, regulators, government representatives, private sector members and other stakeholders attended the 25th UPU Congress.

The Department of State, by law, has lead responsibility for international postal policy and therefore led the U.S. delegation to the UPU Congress. The Commission played an active role in formulating and advocating positions for over 250 proposals to amend the Acts of the Union to ensure consistency with U.S. law and policy, working in close coordination with the Department of State, other U.S. government agencies and the private sector. Many of these proposals were the culmination of four years of work by various UPU working groups and committees in which the Commission participated.

The Commission contributed its analytical and policy expertise to the UPU Terminal Dues Working Group, as part of the U.S. delegation, to develop proposals that were ultimately adopted at the 25th Congress. These newly adopted proposals will provide the U.S. Postal Service with an annual increase of 13 percent in inbound terminal dues revenue from 2014 to 2017 while minimizing terminal dues increases on outbound mail that could impact U.S. mailers. The increases in inbound terminal dues should allow the Postal Service to cover costs for handling and delivery of inbound international mail by 2017 and add tens of millions of dollars in needed revenue to the Postal Service over that time.

39 U.S.C. 407(c)(1) requires the Secretary of State to seek the Commission's views on whether any amendment to an international treaty or convention that will impact a rate or classification for a market dominant product is consistent with 39 U.S.C 3622, which addresses development of a modern system of ratemaking for market dominant products. On August 28, 2012, the Secretary of State sought the Commission's views on whether any proposals to amend the Acts of the UPU and establish a rate or classification for a market dominant product at the 25th UPU Congress would be inconsistent with 39 U.S.C. 3622. The Commission reviewed over 400 proposals for consideration at both the Congress and subsequent session of the Postal Operations Council in early 2013. On September 10, it provided a written response to Nerissa Cook, Deputy Assistant Secretary for Global and Economic Affairs, Bureau of International Organization Affairs, U.S. Department of

State, outlining its views on those proposals that were inconsistent with 39 U.S.C. 3622.

In advance of providing its views to the Department of State, on July 30, 2012, the Commission established Docket No. PI2012-1 to solicit input from the public on principles that should guide the Commission in providing its views to the Department of State. The Commission received eight initial comments and four reply comments. The Commission reviewed and considered these comments in providing its views to the Department of State. On September 14, 2012, the Commission notified the public through its website that the Department of State had requested the Commission's views in accordance with 39 USC 407(c)(1) and that the Commission had fulfilled its statutory responsibility by providing its views to the Commission in writing on September 12, 2012.

BUILDING GLOBAL RELATIONSHIPS

In addition to its active involvement in the UPU, in FY 2012 the Commission continued to strengthen relationships with other postal regulators and build information on regulatory best practices. In May 2012, Chairman Goldway participated in the 4th annual Global Regulatory Dialogue in Brazil. The Dialogue, which the Commission initiated in 2009, is a forum for international postal regulators to share information and best practices in postal regulation to enable each country to better adjust to the changing postal market and better facilitate global mail delivery. Participants included postal regulators from Brazil, China, Ecuador, the European Commission, Germany, the Postal Union of the Americas, Spain and Portugal. Chairman Goldway, along with her counterparts, gave presentations on the modernization of the postal network, postal reform in the United States, the competitive environment for postal services in the United States and priority issues for the UPU Congress, which were followed by in-depth debate and discussion. In FY 2012, the Commission also hosted bilateral meetings with senior postal regulators from Brazil and the former Yugoslav Republic of Macedonia to discuss at a more technical level with Commissioners and Commission staff such issues as quality of service, cost accounting, rate setting, and complaint handling.

U.S. Delegation to the 25th Congress of the Universal Postal Union in Doha, Qatar.

Lastly, the Commission continued to support broader U.S. government initiatives to promote free trade and commercial ties with other countries, particularly in the area of postal and express delivery services. At the request of the U.S. Department of Commerce, Chairman Goldway participated in the Fifth Annual U.S.–China Symposium on Postal Reform and Express Delivery in Nanning, China, where she gave a presentation on developments in postal reform in the United States.

© 2012 Lois Elvey

(L to R): Patricia Lacina, Director, Office of Global Systems, U.S. Department of State; Dennis M. Delehanty, Director of Postal Affairs, Office of Global Systems, U.S. Department of State; Ruth Y. Goldway, Chairman, Postal Regulatory Commission; Susan L. Ziadeh, U.S. Ambassador to the State of Qatar, U.S. Department of State; and Patrick R. Donahoe, Postmaster General and Chief Executive Officer, U.S. Postal Service, at 25th Congress of the Universal Postal Union.

Chapter VII

Public Affairs and Outreach Efforts

OVERVIEW

The Commission's Office of Public Affairs and Government Relations (PAGR) is a significant resource both in support of public outreach and education, media relations and liaison with the U. S. Congress, the Administration, the Postal Service and other government agencies. This office informs and advises Commissioners and Commission staff on legislative issues and policies related to the Commission and the Postal Service in addition to coordinating the preparation of both congressional testimony and responses to congressional inquiries concerning Commission policies and activities. PAGR coordinates media requests and provides assistance to the general public.

OUTREACH ACTIVITY

In its normal course of activities, the Commission routinely hears from members of the public involved in or representing the mailing industry as well as members of Congress. The Commission performed public outreach activities to engage citizens and other stakeholders as a key part of its statutory responsibilities.

The Commission affords public comment on rulemakings, complaints, mail classification cases, public inquiries, rate cases and other matters. There is an opportunity for both formal and informal comment and both initial and reply comments.

CONSUMER RELATIONS

During FY 2012, the Commission received over 5,800 inquiries, suggestions and comments. This decrease in inquiries relative to the 10,093 received last year was due in part to over 5,000 inquiries received for Docket

N2010-1, the Postal Service's proposal for a change from six-day to five-day delivery. Consumer inquiries were received largely by mail, and through the Commission's website link, "Contact PRC."

Table VII-1—Consumer Inquiries

Method of Contact	FY 2012	FY 2011	FY 2010	FY 2009
Email	151	204	123	225
FAX	35	48	15	244
Mail	2702	1848	374	199
Website	2387	2777	5021	421
Phone	601	771	339	253

Of the inquiries received in FY 2012, 5,227 comments were from consumers, 14 from business owners, 256 from postal employees and organizations, 214 from Federal, State and local governments, 94 from the media, and 18 from mailers. Approximately half of the comments were for Docket N2011-1, nature of service inquiry on the Postal Service's Retail Access Optimization Initiative to consider closing approximately 3,700 post offices.

In addition to this outpouring of opinions, other top consumer issues included 596 comments and suggestions on the Postal Service's financial situation, concerns about Missing Mail (211), Undelivered Mail (137), Delayed Mail (94), and 1,053 comments about the Postal Service's Area Mail Processing reviews, representing a substantial increase from the 80 comments received in FY 2011.

Commission Order No. 195 established that rate and service inquiries forwarded to the Postal Service's Office of the Consumer Advocate require a response by the Postal Service within 45 days, a goal consistently met by the USPS. In FY 2012, the Commission forwarded 938 rate and service inquiries to the Postal Service. The Order also requires the Postal Service to file a monthly report summarizing the general nature of these inquiries. The reports are filed on the Commission's website under "What's New" and with Postal Service Periodic Reports.

Representatives affected by the closing of mail processing plants voicing their concerns at a PRC Monthly Public Meeting.

Chapter VIII

Administration

ADMINISTRATION OVERVIEW

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

The Commission completed its 5-year Strategic and Human Capital Plans and is committed to implementing the strategies. As part of the Commission's commitment to its workforce as outlined in the Strategic Plan, the Commission continues to provide a safe work environment for its employees. The Commission ended FY 2012 accident-free with no on-the-job injuries or lost workdays. In line with the President's guidance, the Commission continued to support its Flexible Work Program to include alternate work schedules and telework opportunities. During FY 2012, 66 percent of employees participated in the Flexible Work Program. All Commission employees are allowed to participate in the ad hoc telework program.

EMPLOYEE ENGAGEMENT

In FY 2012 the Commission again participated in the Federal Employee Viewpoint Survey (FEVS). The Commission's response rate was the third highest of all government small agencies at 89.1 percent, and compares favorably to our FY 2011 response rate of 80 percent and the FY 2012 government-wide response rate of 46 percent. The Commission is committed to developing actionable plans based on the feedback

received in the FEVS. In response to employee feedback in the FY 2011 survey, the Commission implemented key initiatives for employees. As a result of these initiatives, the FY 2012 Employee Viewpoint Survey revealed:

- Employee Engagement Index positive responses were 73 percent compared to 66 percent for all small agencies
- Supervisor Index positive responses were 77 percent compared to 73 percent for all small agencies
- Intrinsic Work Experience Index positive responses were 81 percent compared to 71 percent for all small agencies
- Leadership and Knowledge Management Index positive responses were 65 percent compared to 60 percent for all small agencies
- Results Oriented Performance Culture Index positive responses were 65 percent compared to 57 percent for all small agencies

The FY 2012 Federal Employee Viewpoint Survey also highlighted opportunities and challenges for the Commission. We experienced a decrease in the positive responses to questions regarding pay and workload. Over the last several years, the Commission has experienced a rapidly increasing workload while adhering to the federal pay freeze. In response to these challenges the Commission has developed programs for training and professional development directed at employee engagement and retention.

Commission staff participating in the Feds Feed Families Campaign.

EQUAL EMPLOYMENT OPPORTUNITY (EEO)

During FY 2012, the Commission had no formal EEO complaint filings and provided the required EEO and Notification and Federal Employee Anti-discrimination and Retaliation Act of 2002 (No FEAR) training to our employees.

DIVERSITY

In FY 2012, the Commission made measurable progress in our commitment to support initiatives to recruit, develop and retain a skilled, high-achieving, and diverse workforce. Fifty percent of our executive positions are filled by women and minorities. Women and minorities also represent 65 percent of the Commission's overall workforce. The Commission provided internship opportunities to aid in the recruitment and development of professionals with diverse backgrounds, and will continue to monitor and to capture opportunities for diverse new hires, including the use of formal recruitment channels such as organizations that target under-represented groups.

TRAINING

The Commission has an existing training program available to all employees that allows for skills training, professional development and student loan reimbursement. As part of our 2012—2016 Human Capital Plan and training goals, the Commission is

developing an enhanced leadership development program that includes mentoring, coaching and competency development.

TRANSPARENCY AND OPEN GOVERNMENT

The Commission continued its commitment to transparency, accountability and openness through our Freedom of Information Act (FOIA) program. In FY 2012 we received the highest rating on the Assessment of Agency Progress from the Department of Justice.

As part of its mission of ensuring transparency, accountability and openness, the Commission continued to provide live audio-casts of hearings, technical conferences and public meetings. In FY 2012, we increased the capability of the system to allow more people to access live audio-casts. These audio-casts are available at www.prc.gov.

FINANCE

In response to the 2009 Presidential Memoranda regarding government contracting, and in line with the President's subsequent Executive Order 13576 – Delivering an Efficient, Effective, and Accountable Government, the Commission continued to improve its contracting policy, process and procedures, resulting in increased accountability and cost savings to the Commission.

The Commission has successfully partnered with women and minority-owned businesses. In FY 2012, 40 percent of Commission contracts were awarded to women and minority owned businesses. The Commission continues to work within budget,

Commission staff's children participating in Bring Your Child to Work Day.

and improvements in accounting and contracting processes to be cost effective and efficient.

INFORMATION TECHNOLOGY

The Commission made improvements to its Dockets infrastructure to facilitate public access and ease of use and to maintain the integrity of Commission records. The Commission also updated its physical network (servers, cabling) and its essential network systems applications and software to ensure security and stability of the Information Technology infrastructure as well as employee productivity. The Commission revised its website to include expanded information on the Public Representative program, thus continuing its commitment to openness and transparency. As part of its mission of ensuring transparency, accountability and openness, the Commission provides live broadcasts of hearings, technical conferences and public meetings and archives these broadcasts to its public website.

DOCKETS AND RECORDS MANAGEMENT

The Commission transitioned Records Management to the Office of the Secretary and Administration (OSA). It submitted an updated record schedule to National Archives and Records Administration (NARA) and completed a Records Management evaluation to ensure compliance with Administration guidance. The Commission received a score of 87 out of 100 points on the FY 2012 NARA Annual Assessment, moving it from high to moderate risk.

The Commission's Health and Safety Team.

Appendix A

TECHNICAL DESCRIPTION OF PRICE CAP

Pursuant to 39 U.S.C. 3622(d) and 39 CFR 3010.20 et seq. the annual limitation (price cap) is equal to the percentage change in the CPI-U between the most recent average 12-month and the preceding 12-month period when notices of price adjustments are 12 months apart or more.

The Commission publishes the 12-month average change in CPI-U on its website at http://www.prc.gov/PRC-DOCS/home/CPI.pdf.

In FY 2012, the Postal Service filed Docket No. R2012-3 only 9 months after Docket No. R2011-2. Therefore, the Commission applied rule 3010.22, which was designed for notices of price adjustments less than 12 months apart.

When notices of price adjustments are less than 12 months apart the price cap is calculated in two steps. First, the average of the preceding 12 months of CPI-U is calculated, which is called the "recent average".

Second, the recent average is divided by the recent average of the most recent previous notice of price adjustment ("previous recent average") and one is subtracted from the quotient. The result is expressed as a percentage. Table A-1 Illustrates the calculation of the price cap in Docket No. R2012-3.

Table A-1—Illustration of Docket No. R2012-3 Partial Year Price Cap

Description	Rule	Result
Recent Average: simple average of the 12 most recent CPI-U values (September 2010 through August 2011)	3010.22(b)	222.4
Previous Recent Average: the recent average from the most recent previous notice of rate adjustment	3010.22(b)	217.8
The Price Cap: Recent Average divided by the Previous Recent Average minus one (expressed as a percentage)	3010.22(b)	2.133%

901 New York Avenue NW, Suite 200
Washington, DC 20268 - 0001