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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Annual Compliance Report, 2009	)))	Docket No. ACR2009

VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.
INITIAL COMMENTS ON THE UNITED STATES POSTAL SERVICE
FY 2009 ANNUAL COMPLIANCE REPORT
(February 1, 2010)

William J. Olson
John S. Miles
Jeremiah L. Morgan
WILLIAM J. OLSON, P.C.
370 Maple Avenue West, Suite 4
Vienna, Virginia 22180-5615
(703) 356-5070

Counsel for:
Valpak Direct Marketing Systems, Inc. and
Valpak Dealers' Association, Inc.

TABLE OF CONTENTS

Page

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INTRODUCTION

On December 29, 2009, the Postal Service filed its "United States Postal Service FY 2009 Annual Compliance Report" as required by 39 U.S.C. section 3652. On January 5, 2010, the Commission issued Order No. 380, Notice of Filing of Annual Reports to the Commission by the Postal Service and Solicitation of Public Comment, seeking initial comments by February 1, 2010, and reply comments by February 16, 2010. Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc. (hereinafter "Valpak") hereby submit these joint initial comments in response to the Commission's Notice.

On October 28, 2009, the Commission appointed a Public Representative ("PR") in anticipation of the Postal Service filing its FY 2009 Annual Compliance Report ("ACR"). On December 17, 2009, the PR filed a "Motion Requesting Commission to Direct United States Postal Service to Provide Estimates of Rate Adjustments Necessary to Maintain Financial Stability." Valpak filed an Answer in Opposition to the PR's motion, and the Commission denied the PR motion on January 7, 2010. Order No. 382. Thereafter, the Commission issued an information request, Commission Information Request ("CIR") No. 1 (Jan. 20, 2010), and scheduled a public forum for February 10, 2010, relating to the Postal Service's plan for financial stability. Notice of Public Forum and Opportunity to Comment (Jan. 20, 2010). Valpak addresses the issue of financial stability in Sections I through IV, *infra*.

Valpak filed a Motion for Issuance of Commission Information Request Concerning Certain Costs Related to Negotiated Service Agreements on January 15, 2010. The Postal Service filed a response to Valpak's motion on January 22, 2010, consisting of an opposition and redacted response to Valpak's proposed questions, along with an Application for Non-public Treatment of its full response. On January 26, 2010, Valpak filed an opposition to the Postal Service's Application for Non-public Treatment. On January 29, 2010, the Commission issued Order No. 401, treating the Valpak opposition as an application requesting early termination of nonpublic status pursuant to 39 C.F.R. section 3007.31. Responses to Order No. 401 are due by February 5, 2010.

Additionally, three Chairman's Information Requests have been filed seeking information on various topics, notably including service performance (a topic discussed in Section VII, *infra*) and, beyond that, inquiring into issues such as retail service wait times.[1]

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[1] Valpak continues to believe that issues such as retail service wait times are beyond the scope of what Congress authorized the Commission to review in the context of service performance and therefore such inquiries are without statutory authorization. *See* Valpak Comments, Docket No. RM2009-11 (a pending docket), pp. 17-18.

I. THE POSTAL SERVICE HAS DONE A COMMENDABLE JOB OF REDUCING COSTS IN THE FACE OF DECLINING MAIL VOLUME, BUT OPERATING INCOME IS NOT SUFFICIENT TO ENDOW THE RETIREE HEALTH BENEFIT FUND AT THE RATE REQUIRED BY PAEA.

A. In FY 2009, the Postal Service Had a Net Operating Loss of $2.4 Billion.

The Postal Service's current financial difficulties have received widespread public attention, but often inadequate analysis. Unfortunately, the lead story too often has been negative — that even after receiving a one-time Congressional reprieve of $4.0 billion[2] in the statutorily-required contribution to the Postal Service Retiree Health Benefit Fund ("PSRHBF"), the Postal Service still recorded a net loss of $3.8 billion in FY 2009. USPS FY 2009 Annual Report, p. 53. However, real understanding of Postal Services finances at the end of FY 2009 requires a careful analysis of Postal Service expenditures. Specifically, a distinction must be drawn between the Postal Service's "normal" operating expenses and "abnormal" (even "artificial") additional financial burdens imposed on the Postal Service.

Table I-1, *infra*, shows the Postal Service's revenues and operating expenses over the three-year period during which Postal Service finances have been reported on by the Postal Service in Annual Compliance Reports[3] ("ACR") — *i.e.,* FY 2007 – FY 2009. In that table, "**operating expenses**" **include** all costs of retiree health benefits for current retirees, but **exclude** money set aside to pay health benefits for future retirees — *i.e.*, payments into the

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[2] Under Pub. L. 111-68, the Postal Service's September 30, 2009 (FY 2009) payment into the PSRHBF was reduced from $5.4 billion to $1.4 billion.

[3] ACRs are required to be filed under the Postal Accountability and Enhancement Act ("PAEA"), Pub. L. 109-435, 39 U.S.C. section 3652.

PSRHBF are shown separately. Thus, the $3.8 billion loss reported for FY 2009 includes two components:

- a $1.4 billion contribution to the PSRHBF, and
- a $2.4 billion loss from operations, referred to in these comments as the "**operating loss**."[4]

Of course, during FY 2009, the Postal Service fell victim to the recession.[5] That, in large part, was responsible for the sharp decline in mail volume, accompanied by an unprecedented decline in total revenues of $6.9 billion — over 9 percent. Expenses were cut by $1.7 billion (as can be seen from Table I-1), but no matter how effectively the Postal Service managed its costs, it was unable to reduce operating expenses as fast as mail volume and revenue declined. Consequently, the Postal Service swung from an operating **profit of $2.8 billion** in FY 2008 to an operating **loss of $2.4 billion** in FY 2009.

As shown in Table 1-1, during the last three years, the Postal Service actually had a cumulative **operating income** of $3.6 billion. Moreover, during those same three years, a **collection of loss-generating products** failed to cover their attributable costs by almost this

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[4] Prior to PAEA, the Postal Service funded retiree health care costs on a **current** basis, but did not set aside any funds for such **future** costs. The Postal Service's Annual Report and SEC Form 10-K now include contributions to PSRHBF as operating expenses because they are statutorily-mandated outlays under PAEA.

[5] On November 28, 2008, the Business Cycle Dating Committee of the National Bureau of Economic Research identified December 2007 as being the peak prior month in economic activity in the U.S. economy — thereby constituting both the end of the last expansion and the beginning of the current recession. http://www.nber.org/cycles/dec2008.html.

same amount — over **$3.4 billion**.[6] Although Operations at the Postal Service scored heavily with their cost cutting, Pricing was giving away points to these loss-generating products (including two entire classes of mail), which harmed the overall effort. Particularly in view of the Postal Service's distinctly unbusiness-like pricing policies, generating a cumulative three-year operating income of $3.6 billion must be considered an outstanding accomplishment. However, even this amount is far from sufficient to fund a $15.4 billion contribution to PSRHBF demanded by Congress under PAEA for the same three-year period.

Table I-1
U.S. Postal Service Operating Revenue and Expenses
FY 2007 – FY 2009
($, millions)

	FY 2007	**FY 2008**	**FY 2009**
Operating Revenue (incl. net investment/interest income)	74,963	74,932	68,036
Less: Operating Expenses	71,757	72,138	70,430
Operating Income (Loss)	**3,206**	**2,794**	**(2,394)**
Funding of PSRHBF	8,358	5,600	1,400

	FY 2007 - FY 2009
Three-year cost of PSRHBF	**15,358**
Three-year Operating Income	**3,606**

Sources: USPS FY 2009 Annual Report, p. 55; FY 2008 ACD, p. 22, Table III-5.

[6] Annual losses from loss-generating products during this period were: FY 2007, $0.57 billion; FY 2008, $1.08 billion; and FY 2009, $1.75 billion. *See* Section II, *infra*.

B. Postal Service Indebtedness Increased to $10.2 Billion, and Net Worth Has Sunk to a Negative $5.4 Billion.

In order to pay Congressionally-required contributions to the PSRHBF that could not be funded with cash flow from operations, the Postal Service had to resort to extensive borrowing. As a result, **indebtedness** has increased from **$2.1 billion** at the end of FY 2006, shortly before the PAEA was enacted, to **$10.2 billion** at the end of FY 2009.[7] Concurrent with the buildup of indebtedness and reported losses since PAEA was enacted, the Postal Service's **net worth** has gone from a **positive $6.3 billion** at the end of FY 2006 to a **negative $5.4 billion** at the end of FY 2009.[8]

C. The Postal Service Expects Another Loss in FY 2010.

In the current year, FY 2010, the Postal Service expects to reduce operating expenses by over $4 billion, but still projects a **net operating loss of $2.3 billion** before a further payment of $5.5 billion to the PSRHBF.[9] The FY 2010 Integrated Financial Plan ("IFP") explains:

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[7] Postal Service borrowing authority is restricted, under both the Postal Reorganization Act of 1970 ("PRA") and PAEA, to no more than $3 billion per year, and an aggregate amount of no more than $15 billion. *See* 39 U.S.C. § 2005(a) and the 2009 Comprehensive Statement on Postal Operations, p. 62. To the extent that the Postal Service borrows money to fund payments to the PSRHBF, it is shifting onto its balance sheet liabilities that always were known to exist, but previously were neither funded nor accrued in the financial statements. The current balance sheet neither includes the amount of money currently held in the PSRHBF as an asset, nor reflects the estimated actuarial liability, although such information on both is available in footnotes to the financial statements.

[8] USPS FY 2009 Annual Report, p. 58

[9] *See* FY 2010 Integrated Financial Plan, p. 2. The $2.3 billion operating loss includes $2.2 billion for current retiree health benefits.

> This IFP is based upon current laws and regulations. While the FY2009 financial results reflect the $4.0 billion PSRHBF payment reduction approved by Congress in September 2009, no further reductions are assumed herein for FY2010. [*Id.,* p. 2.]
>
> The FY2010 Financing Plan includes borrowing up to the statutory limit of $3.0 billion to fund the net loss. This will bring total debt at year end to $13.2 billion, but will leave a cash balance of only $200 million.... Assuming actual results for FY2010 approximate the Plan, the Postal Service **would have insufficient cash to meet its obligations in October 2010, and throughout FY2011**. Accordingly, while this Plan reflects payment of all obligations, we may not be able to make all payments due in FY2010, including but not limited to, the $5.5 billion prefunding of RHB due September 30, 2010. [*Id.*, pp. 1-2 (emphasis added).]

As the FY 2010 IFP notes, in FY 2009, the Postal Service was able to comply with PAEA's financial burden only by virtue of a last-minute change in the law. Furthermore, its ability to comply with PAEA, both in FY 2010 and in subsequent years, is in serious jeopardy.

The Postal Service's current financial bind arises from a combination of factors. The driving force, obviously, is the fact that the PAEA requires the Postal Service over 10 years to deposit in the PSRHBF sufficient funds to pay **all estimated** future retiree health care benefits which have accumulated over many years. **The statutory funding schedule mandates that over the next** seven years the Postal Service contribute between $5.5 and $5.8 billion per year — *i.e.*, **more than $37 billion** — while also operating under a variety of other constraints:

(1) statutory debt limit provisions;

(2) a mandate under annual appropriation riders to deliver mail six days a week;

(3) a statutory proscription against closing small post offices solely for economic reasons;

(4) by-now-predictable Congressional resistence to closing and consolidation of plants;

(5) a statutory CPI cap that limits the ability to increase prices; and

(6) political pressure to underprice certain postal products.

It would be presumptuous to assume that Congress will again act, and the Postal Service properly assumes no changes in current law for the planning process and the IFP. At the same time, in the face of the existing Congressionally-imposed constraints described above, it is unreasonable to expect the Postal Service over the next seven years to generate free cash flow that exceeds operating requirements by more than $37 billion. The CPI price cap alone guarantees that the Postal Service could not generate such excess cash flow, but even if the price cap ceased to exist, new electronic forms of communication have eroded the monopoly and would limit severely the Postal Service's ability to general such excess cash flow through price increases. Obviously, the cooperation of Congress is required for the Postal Service to solve its fiscal problems. Most importantly, Congress will need to decide either to extend the schedule for funding the PSRHBF or alter some of the above-described constraints.[10] Until Congress resolves at least the PSRHBF funding issue, it can be said that postal management is faced with a "Mission Impossible."

In developing this year's compliance determination, Valpak would urge the Commission to add two topics to its analysis.

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[10] The Postal Service FY 2009 SEC Form 10-K notes that "[a]lthough P.L. 109-435 dictates the funding requirements through 2016, the amounts to be funded and the timing of funding can be changed at any time with passage of a new law or upon an amendment of existing law as passed by Congress and signed into law by the President." P. 20.

- First, rather than limiting its report to "current law" (which the analysis above demonstrates cannot be reasonably assumed to remain unchanged), the Commission also should present a review based on at least one alternative scenario assuming a lower annual payment for PSRHBF.

- Second, when discussing the Postal Service's continuing inability to comply with conflicting statutory requirements, the Commission could help Congress by framing the issues and options in terms that would encourage an urgent and early resolution from Congress.[11]

Toward that end, Section III, *infra*, discusses various ways by which the PSRHBF realistically could be revised so that it could be funded by Postal Service operations.

II. IN FY 2009, THE POSTAL SERVICE CONTINUED TO OFFER NUMEROUS POSTAL PRODUCTS THAT, COLLECTIVELY, HEMORRHAGED MONEY FOR THE POSTAL SERVICE, AND NOW ARE JEOPARDIZING ITS FINANCIAL STABILITY.

A. PAEA Requires Prices that Cover Attributable Costs

Already in this docket, the Commission has indicated that it will address the Postal Service's ability "[t]o assure adequate revenues, including retained earnings, to maintain financial stability." 39 U.S.C. §§ 3622(a) and (b)(5). *See* Commission Information Request No. 1 (Jan. 20, 2010), pp. 1-2, and Commission Notice of Public Forum (Jan. 20, 2010).

One large threat to Postal Service financial stability in FY 2009 was only partially external — arising from the Postal Service's own below-cost pricing of numerous postal products. Neither the Postal Reorganization Act of 1970 nor PAEA anticipated that the Postal

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[11] PAEA envisions that the Commission will monitor and report to the President and the Congress on the financial condition of the Postal Service, specifically including "the extent to which regulations are achieving the objectives under sections 3622 and 3633…." *See, e.g.*, 39 U.S.C. § 3651(a) ("Annual Reports by the Commission"). *See also* PAEA § 701 (uncodified, set out as notes under 39 U.S.C. § 501) (five year "assessments of ratemaking, classification, and other provisions").

Service intentionally would offer money-losing products year after year. Indeed, the continued losses discussed here constitute a failure to comply with two different requirements of law.

(a) the requirement in PAEA prohibiting mail classes that do not cover their costs:

> the **requirement** that each **class of mail** or type of mail service bear the direct and indirect **postal costs attributable** to each class or type of mail service through reliably identified causal relationships **plus that portion of all other costs** of the Postal Service reasonably assignable to such class or type. [39 U.S.C. § 3622(c)(2) (emphasis added).]

(b) the requirement in PRA (continued under PAEA) that all postal rates include a share of the Postal Service's institutional costs:

> **[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. [39 U.S.C. § 101(d) (emphasis added).]

When viewed together, these provisions require not only that each **class** of mail generate sufficient revenue to cover its attributable costs, but they also require that **all postal rates** (for all postal products) cover some "fair and equitable" share of unattributed costs, however small that portion might be. Therefore, the requirement that rates include some positive portion of the Postal Service's institutional costs is not irrelevant below the class level. Rather, under these two statutory tests, the Commission needs to subject to special examination prices for all postal products failing to cover their attributable costs, even if those products happen to exist within classes which make a positive contribution to institutional costs due to intra-class subsidies. Every piece that fails to cover attributable costs makes it that much more difficult for the Postal Service to generate the retained earnings that are necessary for financial stability.

B. The Commission's FY 2008 Annual Compliance Determination Revealed Problems.

In Docket No. ACR2008, the Commission determined the Postal Service to be in compliance with PAEA despite the fact that 10 market-dominant products lost a combined $1.1 billion.[12] *See* FY 2008 Annual Compliance Determination ("ACD"), pp. 4-5. The Commission focused on the problem of these loss-making products and provided some direction to the Postal Service with respect to pricing them in a way whereby they might cover their costs, at least eventually, but ultimately it took a "wait-and-see" approach in light of the then-pending price adjustment (Docket No. R2009-2). The Postal Service represented that its pricing changes would send better signals to Periodicals mailers, and encourage lower-cost mail. Docket No. ACR2008, Postal Service FY 2008 ACR, p. 33. With the benefit of hindsight, it seems that the Postal Service pricing strategy, instead of moving toward its objective, moved further away.

C. FY 2009 Annual Compliance Report.

In FY 2009, the list of underwater[13] products has seen some changes:

- one additional product was added to the list of loss-making products (*i.e.,* Bound Printed Matter Parcels);

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[12] Seven money-losing products were mail products: (I) Inbound Single-Piece First-Class Mail, (ii) Standard Mail Flats, (iii) Standard Mail NFMs and Parcels, (iv) Periodicals In-County, (v) Periodicals Outside County, (vi) Single-piece Parcel Post, and (vii) Media and Library Mail; and three were ancillary services: (I) Registered Mail, (ii) Stamped Cards, and (iii) Total International Ancillary Services

[13] Products or classes which do not at least cover their attributable costs are sometimes described to as being "underwater" and this convenient shorthand terminology is used herein.

- three products (*i.e.,* Single-Piece Parcel Post, Registered Mail, and Total International Ancillary Services) on the list improved from FY 2008 to FY 2009, but remain underwater;

- one product (*i.e.,* Inbound Single Piece First-Class Mail) stayed the same; and

- the financial condition of the rest of the underwater products worsened, some dramatically.

In the aggregate, the Postal Service went from having:

- **10 products** with a combined cost coverage of **88.1 percent,** to

- **11 products** with a combined cost coverage of **80.5 percent**.

Collectively, as shown in Table II-1, the **$1,081.77 million loss** from these products in FY 2008 skyrocketed almost **62 percent**, to a **$1,751.3 million loss** in FY 2009.

Table II-1
Loss-Generating Market-Dominant Products, FY 2009

Product	FY 2008 Deficit ($, million)	FY 2008 Cost Coverage	FY 2009 Deficit ($, million)	FY 2009 Cost Coverage
Inbound Single-Piece First-Class Mail	$101.81	60.5%	$105.2	60.5%
Standard Mail Flats	$217.83	94.4%	$622.3	82.2%
Standard Mail NFMs and Parcels	$165.33	79.7%	$208.1	75.2%
Periodicals Within County	$3.73	96.0%	$14.5	86.2%
Periodicals Outside County	$433.72	83.6%	$642.8	75.0%
Single-piece Parcel Post	$64.02	91.8%	$62.0	91.9%
Bound Printed Matter Parcels	N/A	N/A	$8.5	97.7%
Media and Library Mail	$58.02	87.9%	$75.0	84.1%
Registered Mail	$0.86	98.5%	$0.7	98.6%
Stamped Cards	$0.38	72.4%	$0.4	63.6%
Total International Ancillary Services	$36.07	42.5%	$11.8	68.4%
Total	**$1,081.77**	**88.1%**	**$1,751.3**	**80.5%**

Sources: Table I-2, FY 2008 ACD, p. 5 and FY 2009 ACR.

In FY 2009, aggregate losses from these products constituted

- **73 percent** of the Postal Service's $2.4 billion "**operating loss**"(*i.e.*, exclusive of payments to the PSRHBF, as defined in Section I), and
- **46 percent** of its entire $3.8 billion **total loss.**

1. Periodicals

As shown in Table II-2, the Periodicals class has now completed its thirteenth year of being subsidized heavily by other mail classes. And, in FY 2009, the subsidy to the Periodicals class reached an all-time high of $642.0 million. *See* Table II-2, *infra*.

The coverage for both Periodicals products is below 100 percent:

- Within County Periodicals — 86.3 percent; and
- Outside County Periodicals — 75.0 percent.

Of course, the volume of Within County Periodicals is small, with over 97 percent of Periodicals' total losses coming from the Outside County product.

When the Postal Service adjusted prices for market-dominant products in May 2009, it increased prices for Periodicals the maximum amount under the Consumer Price Index cap authority (CPI-U plus previously banked), but apparently did little to change incentives within the Periodicals pricing structure or achieve cost efficiencies through operational changes. In approving the price adjustments, the Commission anticipated that these adjustments would not permit Periodicals to cover its costs in FY 2009, but deferred the matter:

> The [FY 2008] ACR case appears to be a better forum for considering those issues. [Docket No. R2009-2, Order No. 191, pp. 41-42.]

In that then-pending ACR case, the Commission took no action with respect to Periodicals, but made the following observations, invoking the requirements of both PAEA provisions discussed, *supra*:

> The need to bring Periodicals revenues into closer alignment with attributable costs is **not simply** a matter of achieving **technical compliance with PAEA requirements** for this class, but also of

> fostering broader assurances of **systemwide financial stability and fairness to other mailers**.
>
> Both of these considerations highlight the **imperative need to** reduce the extent to which Periodicals are exposed to manual sorting operations, to control other costs, to improve cost modeling, to **align the pricing structure more closely with cost incurrence, and** to employ pricing objectives that also **send clear signals** to mailers. Toward these ends, *the Commission anticipates exploring the feasibility and impact of including allied piece costs in worksharing cost. It supports and encourages the* ***Joint Task Force*** *effort to improve the data used in the Periodicals cost model, to search for practices that will improve operational efficiency handling and transporting Periodicals, and to consider whether the discount or rate structure can help the Postal Service and its customers to become more efficient users of the mail. It also strongly encourages the Postal Service and Periodicals mailers to consider* ***administrative solutions to processing decisions*** *that currently elevate service decisions over cost considerations*. [Docket No. ACR2008, FY 2008 ACD, pp. 58-59 (emphasis added, italics original).]

Moreover, it appears that the Postal Service earns a profit on many periodicals, while losing substantial amounts on others. If so, use of pricing flexibility granted by PAEA to make price adjustments allowed within the rate cap could reduce losses greatly within the Periodicals class. In last year's ACD, the Commission itself noted that the pricing structure for Periodicals (I) has **price-cost ratios for** bundle, sack, and pallet **passthroughs that are significantly below 100 percent,** and (ii) otherwise **does not reflect cost incurrence** or **send the right signals** to mailers. FY 2008 ACD, pp. 54, 57, 58. The Commission admonished the Postal Service to align the pricing structure for Periodicals more closely with cost incurrence. Sending the right price signals could accomplish much to discourage extremely costly periodicals.

The Postal Service discusses the $642.0 million problem of Periodicals in its FY 2009 ACR, in less than three pages. FY 2009 ACR, pp. 39-41. Notably, though, the Postal Service itself concludes that "the Periodicals class **does not satisfy section 3622(c)(3) of title 39**…." *Id.*, p. 39. Yet the Postal Service decision to hold all market-dominant products — even underwater products — unchanged in calendar year 2010 means that there will be no pricing solution to Periodicals in the near future. In fact, the Postal Service's proposal to bring Periodicals into compliance with the requirement of 39 U.S.C. section 3622(c)(3) was set out in one simple sentence:

> The Postal Service continues to pursue operational efficiencies, as well as opportunities to fine-tune prices that signal the appropriate level of cost-reducing behavior…. [FY 2009 ACR, p. 40 (footnote omitted).]

Translated, it appears that the Postal Service does not hold much hope that the situation will be improved, much less corrected, anytime soon.

There no longer should be any question as to whether the Commission can reasonably rely on efforts of the Joint Task Force or "administrative solutions to processing decisions" to solve the seemingly never-ending problem of the Periodicals class failing to cover its costs. After 13 years, it should be abundantly clear that those and similar efforts have failed. With Periodicals' losses growing exponentially from $437.2 million in FY 2008 to $642.0 million in FY 2009, the Postal Service itself now faces in serious financial trouble in no small part as a result of the cumulative losses from Periodicals.

Losses from Periodicals Should Not Be Part of the Universal Service Obligation. The Commission's Report on Universal Postal Service and the Postal Monopoly (Dec. 19,

2008) included the FY 2007 loss ($448 million) from the Periodicals class in the calculation of the Universal Service Obligation ("USO") costs, stating:

> Under the PAEA price cap, the losses in FY 2007 from the two subclasses that make up the Periodical class could not have been eliminated. Therefore, the FY 2007 loss of $448 million by Periodicals was made necessary by current statutory obligations. [*Id.*, p. 134.]

The Commission's FY 2009 Annual Report to the President and Congress (Jan. 8, 2010) updated its estimate of the USO costs using FY 2008 costs (for Periodicals, a loss of $437 million) (pp. 30-31). In Docket No. PI2008-3, in its Reply Comments, Valpak opposed including losses from Periodicals in USO costs, and Valpak is still opposed. As discussed above, all classes are required to pay at least their attributable costs under section 3622(c)(2), and thus there is no statutory, logical, economic, or other justification for treatment of losses due to violation of 39 U.S.C. sections 101(d) and 3622(c)(2) as costs of providing universal service. Rationalizing losses in this manner, including those resulting from Periodicals, could doom the Postal Service to a perennial operating loss and, ultimately, to financial insolvency. Rationalizing a loss on any product most certainly is not the way to the healthy, robust, financially-independent postal system envisioned by PAEA.

Recommendations. It is submitted that, in the instant docket, based on the record, the Commission has a responsibility under PAEA with respect to the Periodicals class to:

(i) adopt the Postal Service finding that "the Periodicals class does not satisfy section 3622(c)(2) of title 39" and make the required finding that the Periodicals class for FY 2009 is not in compliance with 39 U.S.C. section 3622(c)(2), and then

(ii) enter such order under 39 U.S.C. section 3653(c) as the Commission determines best to abate the hemorrhage from Periodicals and move the class toward compliance with 39 U.S.C. section 3622(c)(2) over an established period of time.

Table II-2
Periodicals Class — Revenue, Cost, Coverage, and Cross-Subsidies
FY 1997 — 2009

	(1)	(2)	(3)	(4)
PRC CRA	Revenue	Cost	Coverage	Revenue-Costs
Year	($, mill.)	($, mill.)		($, mill.)
Under PAEA				
2009	2,038.0	2,680.0	76.04 %	-642.0
2008	2,294.9	2,732.1	84.00 %	-437.2
2007	2,187.9	2,635.6	83.01 %	-447.7
Subtotal	**6,520.8**	**8,047.7**	**81.03 %**	**-1,526.9**
Under PRA				
2006	2,124.8	2,487.6	85.42 %	-362.8
2005	2,068.9	2,431.6	85.08 %	-362.7
2004	2,100.0	2,323.3	90.39 %	-223.3
2003	2,139.6	2,196.2	97.42 %	-56.6
2002	2,066.9	2,280.4	90.64 %	-213.5
2001	2,106.9	2,367.1	89.01 %	-260.2
2000	2,076.3	2,354.8	88.17 %	-278.5
1999	2,017.7	2,213.1	91.17 %	-195.4
1998	1,972.8	2,129.0	92.66 %	-156.2
1997	1,964.6	2,038.5	96.37 %	-73.9
Subtotal	**20,638.5**	**22,821.6**	**90.43 %**	**-2,183.1**
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TOTAL	**27,159.3**	**30,869.3**	**87.98 %**	**-3,710.0**

2. Standard Mail

Even where a money-losing product is part of a profit-generating class such as Standard Mail, that product should not escape close analysis by the Commission. As discussed above, prices for each postal product should be established so that some reasonably assignable portion makes a contribution to institutional costs, in accord with the requirement of 39 U.S.C. section 101(d). If the price for every product at least exceeds attributable cost by some amount, however small, that, in turn, would assure satisfaction of the 39 U.S.C. section 3622(c)(2) requirement that classes cover their attributable costs.

As shown in Table II-1, *supra*, two Standard Mail products lost a combined **$830 million** in FY 2009. Even with these two money-losing products, the cost coverage for Standard Mail was **142.7 percent**. With Standard Mail Flats and Parcels/NFMs excluded from the calculation, the cost coverage of Standard Mail was **176.8 percent**. It cannot be said that these two Standard Mail products are being charged prices which generate a contribution to institutional costs in compliance with 39 U.S.C. section 101(d). Although there is no express requirement under section 101(d) for a finding of noncompliance as to the Standard Mail class, a finding certainly could be made that these two products do not make any contribution to institutional costs and, ergo, are in noncompliance with 39 U.S.C. section 101(d).

3. Package Services

For FY 2009, three Package Services **products** (Single-piece Parcel Post, Bound Printed Matter Parcels, and Media Mail/Library Mail) lost **$145.5 million**, and Package Services as a **class** lost **$53 million**. Although the problem for the Package Services class is new, for the reasons set out above, at least the underwater products need to be addressed by the Commission.

D. Postal Service Financial Instability Creates Urgency in Pricing Underwater Products.

Even when the Postal Service is operating in the black, it is neither appropriate nor fair for classes or products to be required to cross-subsidize other classes and products. In the current state of the Postal Service's financial situation, however, the matter is much more serious. The Commission faces an economic necessity to exercise its regulatory responsibility under PAEA to protect the financial health of the Postal Service.

In the past, it has been argued that if the Commission were to order the Postal Service to achieve immediate compliance pursuant to 39 U.S.C. section 3622(c)(2), there would be rate shock and a loss of volume. It now is clear, however, that it no longer is possible to take the indefinite wait-and-see approach of Docket Nos. ACR2007 and ACR2008, as that approach has not only (I) failed to correct the problem, it also (ii) failed to prevent the problem from becoming worse and now (iii) threatens to bring on the insolvency of the Postal Service. One cannot employ the same approach yet again and hope for a different result. It should not be a goal of either the Postal Service or the Commission to tolerate, or even foster growth in the volume or losses of, classes or products that fail to cover their attributable costs.

If prices must be adjusted to help the Postal Service achieve financial stability, it is the prices of **loss-making products** that should be adjusted upward.[14] These adjustments could

[14] Across-the-board increases only would perpetuate the inequities of the current price structure and continue to send the wrong pricing signals.

occur in steps instead of all at once, which will help reduce the immediate effects on mailers and maintain stability, but steps of some sort must be taken so the situation does not worsen yet again.[15]

III. A PERMANENT CONGRESSIONAL MODIFICATION IN THE SCHEDULE FOR ENDOWING THE POSTAL SERVICE RETIREE HEALTH BENEFIT FUND IS THE MOST IMPORTANT FACTOR IN THE POSTAL SERVICE ACHIEVING FINANCIAL STABILITY.

Section I, *supra*, demonstrates that if all existing statutory constraints on the Postal Service remain in place, there simply is no way that the Postal Service can continue making annual payments to the PSRHBF according to the schedule originally contained in PAEA between now and 2016. As pointed out in Section II, *supra*, 73 percent of the Postal Service's operating loss (exclusive of PSRHBF payments) and 46 percent of the Postal Service's reported total losses in FY 2009 came from underwater products (and classes), but the Postal Service has foresworn price adjustments for market-dominant products in calendar year 2010. This brings us to consideration of ways in which the financial burden on the Postal Service in FY 2010 can be addressed by Congressional action to reduce the annual amount of scheduled payments to the PSRHBF (discussed in this section) or other cost-cutting approaches that will increase the Postal Service's free cash flow (discussed in Section IV, *infra*). Without some fix

[15] It sometimes has been asserted naively that, under PAEA, losses from one class of mail have no effect on other classes because the other classes are "protected" from extraordinary rate increases by the price cap. One of many flaws in such assertions is revealed by the consideration of system-wide cost saving solutions such as the loss of Saturday delivery, where some mailers might feel much affected by the failure of some classes and products to pay (at least) their attributable costs.

being employed, the Postal Service seems destined either to default on its PSRHBF funding obligation due in September 2010, or have insufficient cash to continue operating in FY 2011.

A. Disadvantages Are Associated with Year-to-Year Congressional "Fixes."

In FY 2009, Congress waited until the last possible day — September 30, 2009 — before enacting a downward revision to the payment required last year to the PSRHBF, from $5.4 billion to $1.4 billion.[16] This one-time relief, together with the Postal Service borrowing of the maximum annual amount permitted under its statutory authority, enabled the Postal Service to be in compliance with PAEA without defaulting on its statutory obligation, while retaining sufficient liquidity to continue operating through FY 2010.

What Congress will do in 2010 with respect to the Postal Service's fiscal situation is unpredictable. One possibility is that last year's stop-gap scenario will be repeated in September 2010, and then again in September of each year up to and including FY 2016. That, however, is not a particularly good way to run a business. The reputation of the United States Postal Service as a reliable delivery service — particularly in a world of uncertainty where some of the nation's most respected businesses have gone through bankruptcy restructurings or passed into oblivion — has great value which should be protected. Repeated annual bouts of uncertainty and anxiety could induce at least some mailers to move toward alternatives, and that would be counterproductive to the goal of a financially-viable Postal Service able to continue contributing to the PSRHBF according to a more reasonable schedule.

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[16] *See* Pub. L. 111-68, section 164. A technical default appears to have occurred on September 30, 2009, as the statutory reprieve did not become effective until October 1, 2009, the day the bill was signed into law by President Obama. However, this was resolved as section 164 was retroactive to the enactment of PAEA.

B. Actuarial Estimates of Liability for Future Retiree Health Care Benefits Vary Widely.

The payment schedule contained in PAEA for endowing the PSRHBF was based on an actuarial estimate of future liability provided by the Office of Personnel Management ("OPM").[17] That estimate emanated from a sophisticated actuarial model. Like all such models, it necessarily incorporated assumptions about pertinent factors such as (I) future size of the labor force, (ii) future interest rates, (iii) inflation rate of medical expenses, etc.

Subsequent to passage of PAEA, the Postal Service Office of Inspector General ("OIG") conducted an independent actuarial study of future liability for retiree health care costs. The OIG study incorporated essentially the same factors, but it used different assumptions and obtained a somewhat lower estimate of future liabilities.[18]

In response to a request from Congress,[19] the Commission undertook an analysis of the different assumptions employed by OPM and OIG. Summary results of the two studies, as

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[17] As explained in the "Postal Regulatory Commission Review of Retiree Health Benefit Fund Liability as Calculated by Office of Personnel Management and U.S. Postal Service Office of Inspector General" (July 30, 2009) — "[t]he Postal Service Retiree Health Benefit Fund … cover[s] the Postal Service's liability for health care costs of current and future retirees…. OPM is required by law to calculate this liability each year for the Postal Service's financial statements. OPM calculates this liability by employing an actuarial model that uses certain economic assumptions to determine the present value of future benefits owed to active employees and annuitants." (P. 6.)

[18] http://www.uspsoig.gov/foia_files/ESS-MA-09-001R.pdf (July 22, 2009).

[19] The analysis was requested on June 15, 2009, by the Subcommittee on Federal Workforce, Postal Service, and the District of Columbia, Committee on Oversight and Government Reform, U.S. House of Representatives. *See* Commission Review of Retiree Health Benefit Fund Liability as Calculated by Office of Personnel Management and U.S. Postal Service Office of Inspector General (July 30, 2009), http://www.prc.gov/Docs/63/63987/Retiree%20Health%20Fund%20Study_109.pdf, p. 2.

well as the Commission's own recommended reconciliation, are shown in the Commission's recent Report to Congress, Table 9 (p. 48).[20] As shown there, the different assumptions resulted in estimated cumulative liabilities by 2016 that range from $90.5 billion to $147.9 billion (by OIG and OPM, respectively). The **$57.4 billion difference** between these estimates is substantial.

The existence of "competing" estimates illustrates that the original OPM liability estimate should not be viewed as carved in stone. This realization alone provides reasonable grounds to reconsider and possibly slow the rate at which the PSRHBF is funded, while ascertaining now and over each ensuing year which assumptions are turning out to be closer to future reality. This availability of serious alternative estimates demonstrates that the "correct" amount required to fund future retiree health benefits is a "moving target."

C. The Substantial Reduction in Postal Service Employment Needs to Be Recognized in Estimates of Actuarial Liability.

One of the more important assumptions in the actuarial models discussed above is the future size of the Postal Service's career workforce — the larger the future workforce, the higher will be future retiree health care benefits, and vice versa.

The Postal Service dramatically reduced its workforce, from 696,138 career employees at the end of FY 2006 to 623,128 at the end of FY 2009. USPS FY 2009 Annual Report, p. 75. A reduction in the career labor force by 73,000 — over 10 percent — represents a substantial change. Moreover, cost savings and planned reductions in operating expenses shown in the FY 2010 Integrated Financial Plan (p. 2) indicate that additional career workforce

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[20] *Id.*

reductions are anticipated this year, followed perhaps by still further reductions in subsequent years if mail volume continues declining.

Sizeable reductions in the career labor force are a strong indication that future retiree health care liabilities are likely to be less — perhaps substantially less — than those estimated prior to enactment of PAEA by OPM (which assumed no change in size of the workforce). A sizeable reduction in those future liabilities would allow funding to be stretched out over a longer period without jeopardizing the Congressional goal to endow the PSRHBF fully.

D. The Postal Service Office of Inspector General's Report of January 20, 2010 of Significant Over-Funding of Postal Service's Payments into the Civil Service Retirement System Cannot Be Relied on to Solve the Health Benefits Problem.

On January 20, 2010, the OIG released a new study of the Postal Service's share of Civil Service Retirement System ("CSRS") pension liability[21] by the Hay Group which purports to demonstrate that the system of funding the Postal Service's CSRS pension responsibility has resulted in the Postal Service overpaying $75 billion to the federal government's pension fund. The OIG study challenges the methodology used by OPM to distribute retirement costs for postal workers who were employed prior to 1971. The conclusion of the report was summarized by the OIG as follows:

> The OIG estimates that if the overcharge was used to prepay the Postal Service's health benefits fund, it would fully meet all of the Postal Service's accrued retiree health care liabilities and eliminate the need for the required annual payments of more than $5 billion. Also, the health benefits fund could immediately start

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[21] http://www.uspsoig.gov/foia_files/RARC-WP-10-001.pdf.

> meeting its intended purpose -- paying the annual payment for current retirees, which was $2 billion in 2009.[22]

The assumptions of the OIG study have not yet been tested, and it may be that OPM, the Office of Management and Budget ("OMB"), and the Commission may prefer a different methodology than that advocated in the OIG study. However, if Congress were to determine that the OIG study correctly estimates that the Postal Service has been overcharged for its retirement system liability, Congress could literally eliminate, or at least dramatically reduce, the annual Postal Service payment into the PSRHBF. Obviously, such a serendipitous solution to health care costs would be welcomed, but certainly cannot be assumed.

E. A Suggested Plan to Endow the PSRHBF over a Longer Period.

Funding of the PSRHBF can be stretched out in any number of reasonable ways. One option would require the Postal Service to continue funding for current retiree health benefits (as it is doing now and has done in the past) and, in addition, to contribute to the PSRHBF for future retiree health benefits the **greater of** either:

(I) an amount which, when added together with **interest earnings** on the current fund balance, would total **$2.5 billion**, or

(ii) an amount sufficient to maintain the fund balance at **40 percent** of the Actuarial Liability on the preceding October 1.

The fixed amount of $2.5 billion incorporated in **part (i)** of this option is designed to guarantee that the fund increase by a minimum of $2.5 billion per year, or $25 billion over the next 10 years, while concurrently giving the Postal Service substantial fiscal relief. The balance in the PSRHBF on September 30, 2009, was $35.482 billion. Postal Service FY 2009

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[22] *See* OIG home page at http://www.uspsoig.gov/.

SEC Form 10-K, p. 20. Thus, in 10 years part (i) would cause the fund balance to grow by another $25 billion, to at least $60 billion. In 2009 and 2008, interest earned on assets in the fund was, respectively, $1.472 and $1.265 billion.[23] Postal Service FY 2009 SEC Form 10-K, p. 21. Interest rates can vary, but if existing assets in the fund were to continue earning interest at around the same rate, then in order for the annual increase in fund assets to reach $2.5 billion, the Postal Service would need to contribute in the neighborhood of $1 billion to $1.25 billion each year, a much more manageable amount than the $5.4 billion-plus now required annually by the PAEA payment schedule.

Turning to **part (ii)** of this proposal, at the end of FY 2009 and FY 2008, the beginning Actuarial Liability on October 1 of each year amounted to, respectively, $86.1 and $80.8 billion. FY 2009 SEC Form 10-K, p. 20. The Actuarial Liability grew substantially, by $5.3 billion, and the fund balance represented 41.2 and 40.4 percent of the Actuarial Liability for FY 2009 and FY 2008, respectively. *Id.* If the Actuarial Liability were to continue increasing at a similar rate, the Postal Service might have to contribute more to the PSRHBF than would be required under part (i), but the annual contribution to the PSRHBF still could be reduced by up to $4 billion annually.

This option maintains the policy of pre-funding future retiree health care costs (but at a slower rate, far more consistent with the Postal Service's ability to pay).[24] At the same time, it

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[23] Reducing the required annual contribution by the Postal Service and extending the target date for full funding would permit a greater accumulation of interest income.

[24] The option discussed here similar to S. 1507 (111th Congress), which also would stretch out full funding of the PSRHBF. Under S. 1507, health care costs for current retirees would be paid from the PSRHBF, instead of by the Postal Service, while it would

keeps pressure on the Postal Service to generate free cash flow by controlling and reducing its operating costs, as well as by increasing revenues (discussed in Section IV, *infra*).

F. Recommendations.

In light of the substantial reduction in the postal career labor force that already has occurred, together with further reductions now planned for this fiscal year, Valpak would urge the Commission to:

(i) support a revision by OPM of the assumptions used in its previous actuarial study to establish the scheduled payments to the PSRHBF as contained in PAEA, and

(ii) use any such revision to update the Commission's Review of Retiree Health Benefit Fund Liability as Calculated by Office of Personnel Management and U.S. Postal Service Office of Inspector General of July 30, 2009.

Valpak would also urge that the Commission review the OIG Report issued on January 20, 2010, and advise Congress if it believes that overpayments to the CSRS fund have been made which could be applied to the PSRHBF.

After these analyses are completed, Valpak would urge the Commission to advise the relevant House and Senate Committees, and recommend that Congress modify current law to reduce the required annual contribution to the PSRHBF, thereby extending the target date for full funding.

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continue making annual payments to the PSRHBF according to a revised schedule.

IV. THE POSTAL SERVICE MUST BE ALLOWED MANAGERIAL FLEXIBILITY TO PURSUE AVAILABLE COST-REDUCING STRATEGIES TO ACHIEVE LONG-TERM FINANCIAL STABILITY.

The Postal Service is at risk of being unable to pay all of its FY 2010 obligations (Section I, *infra*) in part because its prices for money-losing products and classes are fixed for 2010 (Section II, *infra*) and in part because of unrealistic financial burdens imposed by PAEA (Section III, *infra*). If Congress proves unwilling to modify mandated contributions to PSHBRF, the Postal Service then will need to achieve significantly greater efficiency through reduction in operating costs, and this may require asking Congress to authorize (or at least not interfere with) the Postal Service's cost-cutting efforts (discussed in this Section IV).

A. The Postal Service Needs to Use Its Pricing Flexibility to Deal with Underwater Products and Classes, and thereby Enhance Profitability and Cash Flow.

PAEA imposed on the Postal Service a heavy financial requirement to fund the PSRHBF fully over a 10-year period, but also gave the Postal Service greater **pricing flexibility** so that it could operate in a more business-like manner and, hopefully, generate the increased revenues and cash flow necessary to meet that funding requirement. As indicated in Section II, *supra*, during the **last three fiscal years** several products (and entire classes) have failed to cover their attributable costs by **over $3 billion**.

In its FY 2008 ACD, the Commission implored and exhorted the Postal Service to use its pricing flexibility in ways that would reduce operating losses from money-losing products:

- **Prices** for individual classes and types of **service should produce sufficient revenue to cover their attributable costs.** [*Id.*, p. 4, emphasis added.]

- The Postal Service **did not use pricing flexibility** to set differential price increases that might have induced more efficient preparation of [periodicals]. [*Id.*, p. 4, emphasis added.]

- In the future, the Postal Service should either reduce the costs of handling flats or develop a pricing strategy which increases prices sufficiently to recover costs within a reasonable time frame…. The Postal Service should provide a long term strategy **to address continuing pricing preferences for a product line that lost $218 million.** [*Id.*, p. 5, emphasis added.[25]]

- To generate revenue the Postal Service **must concentrate on setting rates that** send the proper price signals to mailers and **increase contribution** for the Postal Service. Properly set prices serve the function of promoting allocative efficiency and at the same time maximize the Postal Service's net revenues. [*Id.*, p. 35, emphasis added.]

- One of the pricing objectives is flexibility; however, the Commission is concerned that some of the Postal Service's **pricing decisions may exacerbate the Postal Service's financial problems.** These areas include the decision to apply **low rate increases to categories of mail that contribute little or nothing to institutional costs.** [*Id.*, p. 37, emphasis added.]

- [In Periodicals] **efforts should be directed mainly at** cost control and **improved pricing signals** so that meaningful progress toward compliance with section 3622(c)(2) can be made. [*Id.*, p. 54, emphasis added.]

- Review of the Postal Service's filing shows that the **price-cost ratios** for bundle, sack, and pallets passthroughs **are significantly below 100 percent.** This was also the case in last year's ACD. [*Id.*, p. 57, emphasis added.]

- The need to bring Periodicals **revenues into closer alignment with attributable costs** is not simply a matter of achieving technical compliance with PAEA requirements for this class, but also of fostering broader assurances of systemwide financial stability and fairness to other mailers. … Both of these

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[25] Losses from this same product swelled to $622 million in FY 2009.

> considerations highlight the **imperative need to … align the pricing structure more closely with cost incurrence,** and to employ pricing objectives that also send clear signals to mailers. [*Id.*, p. 58, emphasis added.]

These statements were directed, of course, at prices in effect during FY 2008 and those that would be taking effect on May 11, 2009. But, with specific reference to the price changes that the Postal Service planned to implement during FY 2009, the Commission stated:

> These adjustment ameliorate the need for the Commission to take immediate remedial action on prices and services. [*Id.*, p 1.]

To date, the Postal Service has adjusted prices on its money-losing products by only modest amounts at most. With hindsight, it is clear that the rates implemented in May 2009 did not improve the coverage (*i.e.*, move it any closer to 100 percent) for most of the Postal Service's loss-generating products. As a result, losses on products that failed to cover attributable costs, rather than diminishing, increased significantly in FY 2009, when **such products lost the** Postal Service **$1.7 billion**. In light of these developments, the Postal Service and Commission must consider whether and when pricing changes **for loss-generating products** should be implemented.[26]

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[26] The Postal Service's failure to use pricing flexibility for the purpose intended may be a reason for Congress to balk at allowing the Postal Service to cease Saturday delivery or close redundant facilities, which are among the cost-reducing options discussed below. After all, if the Postal Service fails to use its pricing flexibility to improve its own fiscal situation, it is unlikely that it would receive a sympathetic response from affected stakeholders or relief from Congress.

B. The Commission Should Urge Congress to Remove the Perennial Appropriations Rider under which the Postal Service Is Required to Maintain Six-Days-Per-Week Delivery.

On several occasions of late, Postmaster General Jack Potter has discussed publicly the idea of reducing delivery from six to five days per week as a means of reducing costs. Postmaster General Potter has recognized that the decision is not entirely his:

> It is possible that the cost of six-day delivery may simply prove to be unaffordable.... I reluctantly request that Congress remove the **annual appropriation bill rider, first added in 1983,** that requires the Postal Service to deliver mail six days each week. ["Postal Service Considers Cutting Delivery Day," Jan. 28, 2009 (emphasis added).[27]]

The most extreme result from eliminating the rider, with the greatest potential for significant cost savings, would be to implement such a change on a **nationwide, year-round** basis.[28] Once fully implemented, cutting service to 5 days per week potentially could result in savings as high as $3.5 billion annually.[29]

A less extreme version, with lower cost savings, would be for the Postal Service to reduce delivery to five days a week on a **seasonal** basis — *e.g.*, during summer months when mail volume is lighter and many people are not home to receive their mail on a timely basis

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[27] http://www.msnbc.msn.com/id/28897426/?GT1=43001.

[28] Some countries (*e.g.*, Australia, Canada, and Sweden) eliminated Saturday delivery many years ago.

[29] Two recent studies on potential savings from elimination of Saturday delivery have been made, one by the Postal Service and one by the Commission. The Postal Service estimates savings of $3.5 billion, and the Commission estimates savings of $1.93 billion. *See also* Congressional Research Service Report R40626, The U.S. Postal Service and Six-Day Delivery: Issues for Congress, Wendy R. Ginsberg, June 9, 2009 (http://www.postalconsumers.org/uploads/1/CRS_Day_Delivery_Study.pdf).

because they are away on vacation. This option would have universal effect, but only for a limited period of time each year, allowing the Postal Service to study its effect.

Still another possibility would be for the Postal Service to elect to reduce delivery to five days on **selected routes**, those that normally have high costs relative to volume (*e.g.*, normally light volume, or very low density rural routes), especially on Saturday. Advantages of either of the two reduced delivery options discussed here would be offset to some extent by reduced cost savings. Even modest reductions in delivery costs, however, combined with cost reductions elsewhere, could help the Postal Service increase its operating profits, free cash flow, and strengthen its ability to either fund the PSRHBF or reduce its long-term debt.

Reducing, or even eliminating, Saturday delivery in any form undoubtedly would reduce costs substantially, even though the amount of savings varies by the extent of the change. Many mailers seem to believe that a delivery cut-back would be acceptable if facilities remain open to receive and process mail. Quite different from the reaction of some in Congress, the American people favors such an approach. The most recent Gallup Poll on this topic found that, in order to address the Postal Service's financial problems, fully **two-thirds of persons surveyed favor a reduction** to five delivery days.[30]

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[30] When asked if they favor a proposal "to reduce the number of delivery days from six days a week to five," 14 percent "strongly favor" and 52 percent "favor." Only 10 percent "strongly oppose." Lydia Saad, "Americans OK With Fewer Mail Days to Fix Postal Budget," Gallup Poll (Jun. 26, 2009), http://www.gallup.com/poll/121268/americans-fewer-mail-days-fix-postal-budget.aspx. *See also* Jeffrey M. Jones, "Americans Advocate Reduced Services to Help Postal Service," Gallup Poll (Feb. 16, 2009), http://www.gallup.com/poll/114640/Americans-Advocate-Reduced-Services-Help-Postal-Service.aspx.

Delivery five days a week, in whatever form it might take, would require some time to plan and implement before any cost savings could begin to accumulate. Although significant potential savings and enhanced cash flow are possible from this source, they should not be expected to materialize overnight. Before the Postal Service possibly could realize any savings from five-day delivery, it will be up against the September 30, 2010 deadline for another PAEA-mandated payment to the PSRHBF. Thus, if this option were to be relied upon to help improve the long-term fiscal situation, some limited increase in borrowing authority also might be necessary or desirable (*see* Section IV.E, *infra*). In any event, the sooner Congress removes the appropriations rider, the sooner the Postal Service will have the managerial flexibility to set itself on the road to financial health.

C. The Postal Service Should Be Encouraged to Close Unnecessary Post Offices, Stations, Branches, and Processing Facilities.

Prior to 1971, when the PRA took effect, postal facilities were closed with some regularity.[31] Since PRA, and since PAEA, the Postal Service seems to have become more reluctant to close unnecessary postal facilities. Certainly, one can understand approaching this issue with caution. The record in (now pending) Docket No. N2009-1 illustrates that closure

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[31] Prior to 1970, the Post Office Department received an annual appropriation. Closure of redundant post offices helped reduce that appropriation, and from 1900 to 1970 the Post Office Department closed on average 600 post offices per year, with annual Congressional approval (if not urging). When Congress was paying the bill, it does not appear to have been overly reluctant to approve recommended closures. Although savings generated in any one year from closing post offices may not have been all that great, it is fair to say that cumulative savings from closing over 40,000 post offices has been substantial. "The Costs and Affordability of Universal Retail Postal Service," John Haldi, paper delivered at Conference on the Future of Universal Postal Service in the United States, Brookings Institute, June 18, 2002.

of almost any postal facility can be expected to generate controversy within each affected community, and no business wants or needs such controversy. Various impediments to closures have grown up.

- The Postal Service is precluded from closing "small post offices" purely for "operating at a deficit." 39 U.S.C. § 101(b).

- Since PAEA, the Postal Service is required to seek a Commission Advisory Opinion when it makes changes which substantially affect service nationwide. 39 U.S.C. § 3661(b). (The Postal Service has not sought to withdraw its request in Docket No. N2009-1, even though it now is clear that changes being proposed do not meet the "nationwide" statutory threshold, and the Postal Service has never made the requisite finding to establish Commission jurisdiction.)[32]

- Even though the ability to file an appeal with the Commission applies only to closing of a "post office," defenders of the status quo would read this clear statutory language as applying to "stations" and "branches" as well.[33]

- Some of those in Congress who chastize the Postal Service for not doing enough to cut costs can be found to raise the parochial argument — "Not in My District (State)."

It seems not to be understood that impeding closures, paradoxically, can impede the opening of new facilities, as restrictions on the ability to close any postal facility, once opened, act as a strong disincentive to establishment of new facilities, even where population growth indicates their desirability. Essentially freezing the retail network as it existed in 1970 is not an appropriate way to respond to demographic growth and shifts within the country.

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[32] *See, e.g.*, Valpak Initial Brief, Docket No. N2009-1 (Dec. 2, 2009), pp. 3-8.

[33] Legislation which would make cost-cutting by the Postal Service more difficult is occasionally introduced. *See, e.g.*, H.R. 658, 111th Congress.

Although the Postal Service has been somewhat timid, the Commission could be more supportive. It is submitted that it is completely consistent with the Commission's role as regulator (under the statutes cited above) for it to defend the Congressionally-vested managerial powers of the Postal Service (*see*, *e.g.*, 39 U.S.C. § 403) to cut costs necessary to ensure its financial stability. Indeed, the Commission's role in reporting to Congress could be seen to include urging the revision or repeal, as appropriate, of existing provisions of law that impair Postal Service finances.

In any given year, cost savings from gradual reform and evolution of the retail postal network might appear modest because many closed facilities likely would be from the smaller categories. Nevertheless, such savings would be cumulative. Over a period of 10 to 15 years, reducing the retail network by as many as 4,000 to 5,000 post offices and using lower cost alternatives to serve the affected communities could result in cost reductions of several hundred million dollars annually.[34] The Commission needs to help the Postal Service realize cumulative savings from this source, as over time such savings add up and could make a significant contribution to free cash flow and the ability to fund the PSRHBF or reduce long-term debt.[35]

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[34] The Postal Service does not publish a separate budget or financial accounting for its retail operations.

[35] Closing **redundant postal facilities** not only would increase the Postal Service's free cash flow, but with every reduction in the number of employees it also would reduce the **liability for future retiree health benefits**.

D. Closure and Consolidation of Mail Processing Plants Could Be Subject to a Military Base Closing Provision.

Employment at each mail processing plant oftentimes numbers in the thousands. Consequently, consolidation and streamlining of the mail processing network is an area where considerable cost reductions also might be achieved. At the same time, shifting employment from one location to another obviously has local effects which generate opposition and resistence to any change in the status quo.

Generally, the location where mail is processed should be of no consequence or concern to either recipients or mailers. Nevertheless, in response to the local opposition which a closure announcement inevitably generates, any effort to close a particular plant and consolidate operations can meet with Congressional resistence. In this respect, the situation faced by the Postal Service is not unlike that of the U.S. Department of Defense when it wants to close military installations.

To facilitate network changes that are desirable from the viewpoint of efficient operations, the President's Commission on the Postal Service recommended that closure of major postal facilities be handled in a manner similar to closings of military installations.[36] Senator Thomas R. Carper (D-DL) previously proposed establishing a Postal Network Optimization Commission to reduce the number of postal facilities in a manner similar to that

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[36] President's Commission on the United Sates Postal Service, Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service: Report of the President's Commission on the United States Postal Service (July 31, 2003) (available at http://www.ustreas.gov/offices/domestic-finance/usps/pdf/freport.pdf).

used to close military bases.[37] In this way the Postal Service also could realize cost savings that potentially total billions of dollars over a 10-year period. Here again, however, little or no savings this fiscal year are to be expected.

E. An Increase in the Statutory Debt Limit Would Have only Slight Transitional Benefit.

While a Congressional increase in the statutory debt limit would help relieve the Postal Service's looming liquidity problem, in the absence of any other reforms such as those discussed herein, such a measure would be more in the nature of a band-aid than a real solution. Increased borrowing to fund the PSRHBF essentially would transfer off-balance sheet obligations onto the Postal Service's balance sheet — *i.e.*, as obligations to the PSRHBF are paid, they would be replaced by obligations to the U.S. Department of the Treasury. The Postal Service then would have an **on-balance sheet debt** to Treasury instead of an **off-balance sheet debt** to the PSRHBF. Should it ever come to pass that the Postal Service is unable to meet its obligations, the Postal Service's liabilities then would become Treasury's liabilities. In other words, until the PSRHBF is fully funded **and the Postal Service is relatively free of long-term debt,** it would not be correct to regard the PSRHBF as truly being endowed. That is why the Postal Service also needs to be able to generate extra free cash flow, in the form of "profits," from operations.

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[37] S. 1285 (108th Congress).

In summary, increasing the Postal Service's borrowing authority (which has not been changed since 1990),[38] would help stretch out the period over which the Postal Service could fund a reduced annual obligation without being in a recurring "crisis mode" as regards potential insolvency. By itself, however, this change is not a solution as it does not address adequately the more fundamental issues of cost reduction and revenue enhancement.

F. Recommendation

Valpak urges the Commission to ensure proper postal pricing for underwater classes and products to mitigate and ultimately stop the dangerous hemorrhage of postal funds. Moreover, Valpak urges the Commission to report to Congress about the urgent need of the Postal Service to have the flexibility, as needed, to move to 5-day delivery, to increase its efficiency, reduce its costs, increase revenues, and increase its free cash flow. It is hoped that if the Commission, as the regulator, candidly presents to Congress the problem along with a reasoned analysis of alternatives, this would reduce the likelihood that Congress would impede the Postal Service's necessary efforts.

V. STANDARD MAIL COSTING HAS IMPROVED, BUT SOME COSTING QUESTIONS REMAIN.

A. FY 2009 Shows Improvements in Standard Mail Costing.

Following its review of costing in the FY 2007 ACR, the Commission concluded:

> The Postal Service should support its annual report with more complete explanations, and discuss data which may be perceived

[38] In 1990, the statutory debt ceiling was increased from $10 billion to $12.5 billion in 1991, and to $15 billion each subsequent year. 39 U.S.C. § 2005(a)(2).

> as **anomalous**, such as large variations in unit costs. [FY 2007 ACD, p. 91 (emphasis added).]

In the FY 2008 ACR review, Valpak posed several questions about **anomalous** costs, as well as about others warranting further explanation, within Standard Mail, particularly with respect to Detached Address Labels ("DALs") (*see* Section V.B, *infra*). *See* Docket No. ACR2008, Valpak Initial Comments, pp. 25-40. In its Determination, the Commission noted that "the Postal Service should look to improve the accuracy of DAL costing and volume measurement" (FY 2008 ACD, p. 64).

Valpak is appreciative of the Commission's support for accurate costing, as well as the progress that the Postal Service has made. The instant ACR shows improvement in costing, with fewer anomalous results, but costing issues still remain.

Most price differences among products and rate categories in Standard Mail are based on the sum of mail processing and carrier costs, which account for 90 percent or more of the costs attributed to the products and rate categories. The behavior of these costs, then, and their sum, are matters of great interest.

In the FY 2007 and FY 2008 Compliance Reports, a question existed about why the cost of **Saturation letters** came out higher than the cost of **High-Density letters**. Historically, and intuitively, due to Saturation letters' bulk nature, faster casing speed (where manual operations are employed), and to the advantageous option of taking Saturation letters directly to the street as a "third" bundle (which incurs no cost for delivery point sequencing or carrier casing), one certainly would expect costs to be no higher than for High-Density letters, and probably lower.

In FY 2007, the cost of High-Density letters was 0.22 cents lower, and in FY 2008 it was 0.76 cents lower than the cost of Saturation letters. In the instant ACR, it is 0.18 cents lower. Since the expectation would not be for the difference to be zero, but rather for the cost of High-Density to be higher, as it is for flats by almost 4 cents, this relationship continues to be counter-intuitive. In its FY 2008 Determination, the Commission referred to this relationship as "anomalous" (p. 59). In its instant ACR, the Postal Service also refers to this relationship as anomalous, and states that any associated passthrough problem is justified under sections 3622(e)(2)(D) and 3622(e)(3)(A), if it is viewed as a workshare issue. Valpak does not view it as a workshare issue (*see generally* Valpak Initial Presentation on Workshare Discount Issues, Docket No. RM2009-3), but remains concerned about the costing peculiarity.

If one looks into the difference of 0.18 cents, it is seen that the mail processing cost is 0.007 cents lower (for High-Density) and that the carrier cost is 0.173 cents lower. A cost difference of 7 one-thousandths of a cent is certainly not large. If it is statistically significant, it could be associated with the proportion that is delivery point sequence ("DPS'd"). And the carrier difference of 0.173 cents could also be associated with both the proportions DPS'd, cased, and taken to the street as a "third" bundle. That seems unlikely, however, as an increase in the proportion DPS'd would be expected to decrease the carrier cost. These costs, of course, are inter-related.

The Postal Service could be asked to provide more perspective on the component costs by breaking them into sub-components and tracing the relationships through time, consistent with the Commission's request for a "more complete explanation," noted above.

Other cost results also raise questions. For example, from FY 2008 to FY 2009, the mail processing cost of High-Density letters increased 47.8 percent while the same cost for Carrier Route decreased 40.2 percent, and the carrier cost of Carrier Route letters decreased 20.1 percent. Similarly, a number of mail processing and carrier costs in the Regular category, both letters and flats, increased by more than 15 percent. On a year-to-year basis, this variability is far more than one would hope for.

Valpak believes reliable cost studies are important. Of course, fluctuations due to sampling can occur, but additional analysis would seem warranted, as analyses into questionable results can uncover methodological errors that need to be corrected or other improvements that need to be made.

B. The Postal Service Has Improved Data for Detached Address Labels.

In the FY 2008 Compliance Report, billing determinants showed about 902 million DALs, but the city and rural carrier systems showed only 641 million. The difference, 261 million pieces, was unaccounted for. It seemed too large to be the number exiting through the non-carrier channels of Post Office Boxes, contract routes, and general delivery.[39]

This year, the billing determinants (USPS-FY09-4) show 732 million DALs and the carrier systems show 642 million (USPS-FY09-19, UDCInputs09, tab DALs). This result would seem a substantial improvement. Whether this smaller difference of 90 million pieces is

[39] We assume that pieces treated as firm holdouts and those going to addresses with unique 5-digit ZIP Codes, that may have a dedicated bin on a sorting machine, are counted in one of the carrier systems. It would be helpful to have an outline of the various exit channels and the associated categories in which the pieces are counted.

reasonable for the non-carrier channels is open to question. Some further analysis by the Postal Service would appear warranted.

As part of the process of moving the costs of DALs to flats, the UDCInputs file shows a **total cost** for **rural carriers** (in-office and delivery) of 2.0 cents for DPS'd letters and 5.3 cents for non-DPS'd letters, but 3.5 cents for boxholder letters. For **city carriers**, **street costs only**, it shows a cost of 2.3 cents if DPS'd or cased, and 1.7 cents if carried as a "third" bundle (tabs Rural DAL Costs and City DAL Costs). These figures do not include costs for the DPS operations (and associated handling) for either carrier group. The surcharge for DAL usage is 1.7 cents.

Except for any possible adjustment that might arise if the cost of handling addressed Saturation flats were to be greater than the cost of unaddressed Saturation flats with DALs, it appears that the surcharge is considerably less than the additional cost.

An associated question concerns the effect of the surcharge as a price signal. Judging from the numbers in the carrier systems (641 million in FY 2008 and 642 million in FY 2009), the volume of DALs essentially remains unchanged. Should the volume of DALs increase, the additional cost would be greater than the additional revenue, which would worsen the Postal Service's finances. No one wants that to happen. A decline in the volume of DALs, on the other hand, could help the Postal Service, which raises the question, again, of whether the surcharge is high enough. One of the perils of pricing under a cap is that if costs are not followed, efficiency properties are lost, under-priced services are often overused, and finances can be made worse.

VI. THE COST COVERAGE ON HIGH-DENSITY/SATURATION LETTERS REMAINS TOO HIGH AND NEEDS TO BE LOWERED.

A. Introduction.

The FY 2009 cost coverage for the **Standard Mail class** as a whole was **142.7 percent**. Coverages of products within the class, however, deviate significantly from the average. Elasticities also differ significantly between the former ECR subclass (bolded, below) and Regular subclass. Coverages and elasticities are shown in Table VI-1.

Table VI-1
Standard Mail
Cost Coverages by Product and
Elasticities by Former Subclass

Category[1]	Cost Coverage	Commercial Elasticity[2]
High-Density/Saturation Letters	**214.3%**	**0.839[3]**
High-Density/Saturation Flats/Parcels	**238.8%**	
Carrier Route	**144.0%**	
Regular Letters	173.2%	0.244[4]
Regular Flats	82.1%	
Regular NFM/Parcels[5]	75.2%	
Standard Class Weighted Average	142.7%	

Notes:
1. Products include Nonprofit components
2. Absolute value
3. Corresponding ECR Nonprofit elasticity = 0.542
4. Corresponding Regular Nonprofit elasticity = 0.165
5. The volume of NFM/Parcels is about 0.8 percent of the volume of the Standard class.

Source: Cost coverages — USPS-FY09-1; and
Elasticities — USPS demand analysis submitted January 20, 2010.

Examination of Table VI-1 shows several striking results.

Coverages. Of the six products within Standard Mail, **two** had cost coverages **under 100 percent**, demonstrating that current prices did **not cover their attributable costs**. Coverage of Regular Flats was only 82.1 percent, and coverage of Regular NFM/Parcels was even worse — 75.2 percent.

Two of the other products within Standard Mail had cost coverages **over 200 percent**, demonstrating that, for these products, current prices **recovered well more than double attributable costs**. At least in part to offset money lost on the two Standard Mail products discussed above, the Postal Service has set rates which generate a **214.3 percent** coverage for High-Density/Saturation Letters, and a **238.8 percent** coverage for High-Density/Saturation Flats/Parcels.

Elasticity and Coverages. Within the former ECR subclass, the elasticity of Carrier Route would be expected to be similar in magnitude to the 0.244 elasticity of the Regular categories. And since about 36 percent of the volume of former ECR is Carrier Route, elasticity of the two High-Density/Saturation products, if measured separately, would be expected to be above, perhaps well above, the elasticity for the three products together — 0.839.[40] This means, looking at both elasticity and pricing together, that:

- **highest-coverage** products have **significant price sensitivity,** and
- **lowest-coverage** (and negative coverage) products are largely **price insensitive.**

[40] Although the lower elasticity of the Nonprofit categories would reduce these elasticities somewhat, Nonprofit ECR is only 7.8 percent of total ECR volume.

B. Cost Coverages Are Far from Optimal.

Regardless of whether viewed in terms of:

(i) the profitability of the Postal Service, or

(ii) economic efficiency, or

(iii) value of service, or even

(iv) basic notions of fairness,

one concludes that categories with **relatively elastic demand** should have **relatively low cost coverages**.[41]

The existing situation, then, is not optimal. In fact, it is upside down. Coverages of Carrier Route, Regular Flats, and Regular NFM/Parcels should be increased (the latter two now having **negative coverage**), and coverage of High-Density/Saturation products should be decreased. Moving in these directions has the added advantage that an increase in prices for money-losing products Regular Flats and Regular NFM/Parcels would help them cover their attributable costs.

One could argue that movement toward optimal positions should occur in small steps instead of large ones, to reduce negative effects on mailers and help maintain stability, but steps should be taken. We can identify no postal policy considerations in Title 39 of the U.S. Code that support the current pricing relationships.[42]

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[41] Notions of fairness are subjective, and a mailer of Standard Mail Regular letters may wonder why he/she should pay a markup of 114.3 percent when Standard Mail Regular Flats mailers are "paying" a markup of negative 17.9 percent (*i.e.*, not even covering costs).

[42] Section 3622(b)(4) provides that "pricing flexibility" be accorded the Postal Service. But it would be strange indeed to give this section weight in the context of a

C. Prior Commission Treatment of Coverage Issues.

Standard Mail coverage issues are not new. They were raised in the FY 2008 Compliance Review. *See, e.g.*, Valpak Initial Comments, Docket No. ACR2008, pp. 43-58. There, the Commission, by example, explained that the financial health of the Postal Service can be affected positively and rather significantly by pricing appropriately so as to align cost coverages inversely with elasticities. FY 2008 ACD, pp. 35-36. Specifically, the Commission showed that if, in a base position, **elastic-product X** has a **coverage of 133.3 percent** (rate = 2, cost = 1.5) and **inelastic-product Y** has a **coverage of only 120 percent** (rate = 3, cost = 2.5), total contribution would be increased more by giving a 30 percent increase to Y (and a 10 percent increase to X) than by giving a 10 percent increase to Y (and a 30 percent increase to X). That is, the relatively inelastic product should be given the larger percentage increase, as well as an increase in its relatively low coverage. *See id.,* pp. 35-37, Exhibits 1 and 2. This Commission analysis should apply to the situation shown in Table VI-1.

The Commission then showed[43] that if, in a different base position, the cost coverage of elastic-product X is 146.7 percent (rate = 2.2, cost = 1.5) and coverage of inelastic-product Y already is a much higher 780.0 percent (rate = 3.9, cost = 0.5), total contribution would be

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Compliance Review. If the ACD is designed to assess Postal Service compliance with the provisions and policies of Title 39 of the U.S. Code, did Congress really want the Commission to exempt pricing decisions made by the Postal Service because doing otherwise would reduce its flexibility? Flexibility is not the same as freedom from Commission review as to compliance with other statutory requirements.

[43] Some of the Commission's discussion is couched in terms of unit contribution; it should be noted that since 1970 the Commission has given percentage cost coverages the most attention, and analysis of percentage coverages appears to better reveal an optimal pricing position than does analysis of unit costs.

reduced by giving the larger percentage increase to inelastic-product Y (which would increase its extremely high coverage even further). FY 2008 ACD, p. 36, Exhibit 3. In other words, a focus on contribution (or on economic efficiency or value of service) would lead to an optimum situation of a relatively low elasticity being associated with a relatively high coverage, **but only to a point**. In the example of the Commission, the coverage of 780.0 percent for the inelastic product would be much too high and needs to be brought down.[44] That situation obviously does not apply to the six products shown in Table VI-1, *supra*.

D. Significant Pricing Adjustments Are Needed, and Not Making Any Adjustments Now Forebodes Even Larger Adjustments Later.

The need to take pricing steps toward a more profitable position takes on added importance when finances are dire, as they are for the Postal Service now, as discussed in Section I, *supra*. Despite this urgency to give proper pricing signals to mailers, however, the Postal Service has announced an intention to take no steps toward adjusting market dominant product prices in 2010. FY 2009 ACR, p. 40, n11. The Postal Service's rationale for not adjusting market-dominant prices in 2010 is understandable. Of course, no pricing adjustments means no change in relative prices, and no change in incentives or signals to mailers.

Future consequences of the Postal Service freezing relative prices is informed by a prior instance when the Postal Service declined to change relative rates — Docket No. R2005-1, where the Postal Service proposed an across-the-board increase. The Commission agreed at

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[44] All optimums have this characteristic. That is, from a low position one moves up to the optimum, and from a high position one moves down to the optimum.

the time, but pointed out that the size of some increases in the next docket quite possibly could be relatively large, due to the need to catch up.

The need for catch-up adjustments in a future period likely will exist again in the next round of pricing changes, as elasticity and cost changes are recognized, the latter possibly associated with changes in operations.

In last year's Compliance Determination, the Commission noted that proposed pricing increases (Docket No. R2009-2, with prices implemented on May 11, 2009) would be taking steps toward solving what it saw as problems. *See, e.g.*, FY 2008 ACD, p. 67. In the instant docket, with the Postal Service having announced postponement of pricing changes, the Commission does not have the option of deferring to almost contemporaneous rate adjustments. Therefore, Valpak would urge the Commission to observe in its ACD (as it did in Docket No. R2005-1), that in the next pricing adjustments, steps of a more pronounced nature would be in order for:

- underwater products, as well as
- rationalizing coverage for all Standard Mail products — including a significant reduction in the coverage of High-Density/Saturation products.

VII. THE POSTAL SERVICE'S FY 2009 ACR FAILS TO ADDRESS ALL PAEA-REQUIRED ASPECTS OF SERVICE PERFORMANCE.

A. Introduction.

PAEA requires the Postal Service to provide measures of the level of service, described in terms of both **speed** and **reliability**, for its market dominant products. 39 U.S.C. § 3652(a)(2)(B)(i) (emphasis added). This required performance-reporting is designed to enable the Commission to measure Postal Service compliance with one of the most important objectives for the new, modern ratemaking system — "to maintain high quality service standards established under section 3691." 39 U.S.C. § 3622(b)(3).

The Postal Service's FY 2009 ACR contains only a brief section on "Service Performance." FY 2009 ACR, pp. 9-14. Supplementary data and information are available in the 2009 Comprehensive Statement on Postal Operations (p. 60) and on the Postal Service website.

Reporting of service performance by the Postal Service is the subject of currently-pending Docket No. RM2009-11 ("Periodic Reporting of Service Performance Measurements and Customer Satisfaction"). Comments by parties were filed in that docket on November 2, 2009, and reply comments on December 1, 2009. At the time the FY 2009 ACR was filed on December 29, 2009, the Commission had not yet issued its Order regarding data to be reported, as well as the required format for those data.

Despite the absence of finalized reporting requirements, it might have been hoped that the Postal Service's presentation of service performance this year would show a substantial improvement in the depth, scope, and organization of information provided. The improvement, however, is only marginal. As discussed herein, the presentation in the FY 2009 ACR does little to advance the state of the art since Docket No. ACR2008, which underscores the importance of the pending rulemaking in Docket No. RM2009-11.

B. Reliability, Consistency of Service, and Tail-of-the-Mail Have Been Addressed Only Partially.

PAEA requires that the level of service be measured in terms of both **speed** and **reliability** of delivery. These two different aspects of service performance require that two separate, independent statistics be submitted to measure and report the level of service.[45]

In the FY 2009 ACR (p. 12), the Postal Service again provides a table with data summarizing the percent of mail delivered on-time for the following items:

I. First-Class single-piece letters,
ii. single-piece International First-Class letter mail, and
iii. package services.

These data for FY 2009 can be viewed as a direct measure for **speed** of delivery.

Reliability of service can be measured in different ways, with tail-of-the-mail data representing one such measure. The FY 2008 Annual Compliance Determination stated that:

> for FY 2009 quarter one, the Postal Service began posting on its website quarterly on-time service performance and **tail-of-the-mail data** for market dominant products. FY 2009 quarter one on-time and **tail-of-the-mail data** is available for First-Class Single-piece Mail by district for overnight, 2-day, and 3-day to five-day delivery.... On-time performance for Standard Mail is reported by destination entry and by end-to-end.... Periodical on-time performance and **tail-of-the-mail** is reported by region. Package Service's on-time performance and **tail-of-the-mail** is available by district. [*Id.*, p. 44 (emphasis added).]

Interestingly, tail-of-the-mail data for FY 2009 **quarter one**, to which the above ACD statement refers, now have been **removed** and **replaced** on the website by similar data for **FY**

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[45] It is well known that the variance of a statistical distribution is independent of the mean. Thus, if variance were to be used as a measure of reliability, it would be independent of whatever measure is used for speed of delivery.

2009 quarter four.[46] Tail-of-the-mail data for prior quarters no longer are readily available on the website, nor are summary annual data on tail-of-the-mail provided, either in the ACR or the website (or in the Comprehensive Statement on Postal Operations). These data may have been archived somewhere, but the website does not indicate where they can be found. Thus, **comparable annual** data for both speed and reliability of service are not readily available, even for single-piece First-Class letters.

C. Comparisons of FY 2009 Performance Data with that of Prior Years and Performance Targets Approved by the Governors Are Limited.

The FY 2009 ACR does not report comparable data from prior years (*i.e.*, FY 2007 and FY 2008), as the data presented are for FY 2009 only. However, performance data for prior years, along with targets for FY 2009 and FY 2010, are shown in the 2009 Comprehensive Statement, but only for First-Class Mail (p. 60). Regrettably, the Comprehensive Statement does not provide any similar performance data for Package Services or international single-piece First-Class Mail, the other two products for which on-time data are given on page 12 of the ACR.

With respect to First-Class Mail, as noted in Commission Order No. 380 commencing this docket, the Postal Service narrative in its ACR indicates that the EXFC system has been expanded from **463** 3-digit ZIP Code areas to **892** 3-digit ZIP Code areas. It also states that "a higher proportion of postcards and flats were included, as well as higher proportions of handwritten pieces as opposed to machine printed," which better reflects single-piece First-

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[46] If the Postal Service intends to continue to remove important performance information from its website each year, perhaps the Commission could capture this information and preserve it for the public on its website.

Class Mail makeup. FY 2009 ACR, p. 13. The good news from this is that the expanded information base has revealed operational shortfalls, and that information in turn is being used to improve service to and from the 429 newly-included 3-digit ZIP Code areas.[47] However, the implication is that data for prior years were less representative than this year's data, hence actual systemwide performance in prior years would appear to have been overstated to some unknown degree.[48]

For Periodicals and Standard Mail, the Postal Service's website contains only limited performance data for the fourth quarter of FY 2009, along with important disclaimers. Such limited data as are available indicate a significant gap between actual performance and FY 2010 targets. For example, during the summer months only 75.9 percent of Periodicals were delivered on-time, and 4.2 percent were delivered more than three days late. For Standard Mail, results are recorded separately for destination-entered and origin-entered mail (reported as "end-to-end"). For Standard Mail letters and non-saturation flats, results from the fourth quarter pilot effort are reported to have been as follows:

	% On-Time	Within +1 Day	Within +2 Days	Within +3 Days
Destination Entry	89.0%	95.6%	97.8%	99.0%
End-to-End	58.2%	66.5%	78.0%	85.8%

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[47] This illustrates the adage "that which gets measured gets acted upon."

[48] The previously reported data, although perhaps not entirely representative, were made available (with no disclaimer as to representativeness) on the implicit assumption that some data are better than no data. Of course, this is true. One must start somewhere, and nothing worthwhile is gained if perfection is allowed to become the enemy of the good.

For origin-entered mail, the service standard allows more (supposedly adequate) time for extra handling and transportation than for destination-entered mail. Despite this lengthier standard, the limited pilot data for origin-entered Standard Mail not only indicate problems in meeting the standard, but also help explain the strong preference among users of Standard Mail to have their mail entered at destination facilities. The Postal Service needs to improve on-time performance for both Periodicals and Standard Mail without adversely impacting First-Class performance.

D. Performance Targets Are Again Notable by Their Absence.

Any evaluation of performance must assess (a) actual service performance against (b) performance targets in order to ascertain whether the Postal Service is achieving its planned goals. In its FY 2008 ACD, the Commission noted:

> [i]n February 2009, the Postal Service posted its FY 2009 targets on its Rapid Information Bulletin Board System (RIBBS) webpage.... The targets are available for First-Class Mail, Standard Mail, Periodicals, Package Services and Special Services. [*Id.*, p. 44.]

Even though the Postal Service currently has limited performance data for classes of mail other than First-Class, it would have been useful to publish the FY 2009 targets approved by the Postal Service Board of Governors ("Board") for all classes in this year's ACR.[49] When performance targets are located on a different website than actual performance data, and neither website cross-references the other, the system cannot be described as either transparent

[49] Under the Postal Service's current procedure, the existing targets may well be replaced by targets for FY 2011 even before next year's FY 2010 ACR is submitted for review.

or user-friendly. The ACR needs to pull these different threads together in one convenient place, where they can be compared and analyzed. Hopefully, this form of reporting will be required for the FY 2010 ACR.

On-time targets for FY 2009, which are a proxy for **speed** of delivery, already have been removed and replaced on the web page with FY 2010 targets, some of which are as follows:

Mail Class	**FY 2010 Target**
First-Class Mail (single-piece and commercial):	
• Overnight	96.6%
• Two-Day	94.1%
• Three-Day+	92.8%
Packages Services	90.0%
Periodicals	91.0%
Standard Mail (origin and destination entry)	90.0%
Express Mail (next day)	96.7%
Parcel Select	98.0%

The goals, or targets, are independent of actual performance. Insofar as they tell mailers what the Postal Service is aiming for and indicate what mailers either might expect or hope for, they constitute useful information.

Despite the ready availability of Board-approved performance goals on the RIBBS website, the 2009 Comprehensive Statement on Postal Operations states that:

> The Postal Service continues to refine its performance measurement processes and develop new systems to expand the services that are measured and reported.... As baselines are established and measurement systems improved, additional services **may be added as corporate goals in the future**. [2009 Comprehensive Statement, p. 60 (emphasis added).]

Rather than allude to future possibilities, the goal of transparency would be better served by having the Comprehensive Statement either include all existing performance goals or reference where they can be found, even though reliable data may not be available yet. The goals, after all, do not depend upon data availability.

Finally, we note that no goals or targets have been published by the Postal Service for **reliability** of service — *e.g.*, the number of days within which, say, 99 percent of each mail product is expected to be delivered.[50]

E. Pertinent Service Performance Information for Retail Package Services Is Lacking.[51]

As noted *supra*, FY 2009 on-time delivery performance for retail single-piece ground package services appears as a single datum in the table on page 12 of the FY 2009 ACR. Although that table does not show comparable prior data, the percentage of retail packages receiving timely delivery in FY 2009, 63.9 percent, coincidentally is exactly the same as was reported in the FY 2008 ACR. As was the case in the FY 2008 ACR, the FY 2009 ACR narrative contains no discussion of this 63.9 percent on-time performance which, at best, could

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[50] Commission Order No. 380 solicits "public comment on whether any service standards in effect during FY 2009 were not met." Order No. 380, p. 3. As noted *supra*, service standards for speed of delivery (on-time performance) for FY 2009 were not included in the ACR, and now have been replaced on the Internet by FY 2010 standards. For reliability of delivery, no service standards are known to have been established for FY 2009. The Commission will understand, hopefully, the difficulty involved in commenting on service standards and performance targets that either are not available or are non-existent.

[51] Valpak, again, makes brief observations regarding delivery confirmation and Package Services, not because it uses these products, but because it is concerned that a precedent not be established that available performance data need not be reported or discussed as part of each ACR. Continued economic viability of the Postal Service depends on across-the-board improvements in performance for all products.

be described as lackluster.[52] And, with respect to the extent of delivery **reliability** for packages not delivered on time, this year's ACR leaves the reader to guess how many days in excess of the service standard were required before 99 percent of all packages were delivered (or, alternatively, the percentage of packages delivered in excess of three days beyond the delivery standard).[53]

Finally, like its FY 2008 ACR, the Postal Service's FY 2009 ACR again fails to include required "narrative information regarding any new initiatives to improve service performance of retail package services." FY 2007 ACD, p. 55. Unless the Postal Service has no plans or initiatives underway for improving delivery performance for retail package services, this void continues for yet another year.[54]

F. Performance of Delivery Confirmation Service Should Be Reported and Discussed by the Commission in this Year's ACD.

The basis for measuring on-time performance of package services is the delivery confirmation service — an optional auxiliary service for which users pay a separate fee. In its comments on the FY 2008 ACR, Valpak noted that:

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[52] As indicated above, the target for on-time delivery of packages services for FY 2010 is 90.0 percent, which is far above the actual on-time delivery reported for FY 2009 (the target for FY 2009 was not included in last year's ACR and is no longer available on the Postal Service's RIBBS website).

[53] In view of the fact that performance is based solely on packages that receive both an initial start-the-clock scan and a final stop-the-clock scan, this information should be readily available from the existing delivery confirmation data base.

[54] Also, the 2009 Comprehensive Statement does not contain any data or discussion concerning Package Services.

> The FY 2008 ACR does not discuss or provide data on the number of packages that were scanned initially but which subsequently have no scan showing either actual or attempted delivery. In order to assess reliability of the delivery confirmation service itself (as opposed to on-time delivery of packages), basic data are needed on the number and percentage of retail packages with delivery confirmation that have no stop-the-clock scan. [Docket No. ACR2008, Valpak Initial Comments on the USPS FY 2008 Annual Compliance Report, p. 63.]

In its FY 2008 ACD, the Commission noted Valpak's observation and stated:

> The Postal Service provides no information on the number of total packages receiving an initial scan nor did the Postal Service provide the total number of packages getting a final scan. For example, if the Postal Service fails to get a start and an end scan on a delivery confirmation mail piece, the mail piece data is not included when the performance score is calculated. Limiting data evaluation to only those mail pieces with both a successful start and end scan **can bias results.** The failure to understand the magnitude of the missing records would hinder the evaluation of whether or not a Delivery Confirmation scan is the **appropriate service performance measurement tool** for Package Services. [FY 2008 ACD, p. 42 (emphasis added).]

It obviously would be desirable to have data on the number of initial scans with no final stop-the-clock scan for whatever reason. Such data should be readily available from the existing delivery confirmation system data base. Nevertheless, this year's ACR neither contains any such information, nor does it discuss the issue. Further, if such information is available somewhere on the Postal Service's website, the ACR provides no indication as to where it is located. Accordingly, Valpak would suggest that the Commission request from the Postal Service, in this docket, data on the number of initial scans with no corresponding stop-the-clock scans during FY 2009, and publish the information in its ACD.

G. Information and Data Pertaining to Service Performance Need to Be Compiled and Presented in a Single Document.

Order No. 380 notes that the Postal Service appended to its ACR for FY 2009 four basic data reports:

(1) the Cost and Revenue Analysis ("CRA");
(2) the International Cost and Revenue Analysis ("ICRA");
(3) models of costs avoided by worksharing; and
(4) billing determinant information.

Each of these four reports contains, and is limited to, information on mail volume and financial data. Each is familiar to the Commission and the interested public; each is well-organized; and, collectively, they bring together much useful information.

Information relevant to service performance is scattered in various places, and cross-references between the various sources are not provided by the Postal Service. Valpak would suggest that service performance data and other pertinent information need to be consolidated and presented, preferably, in one comprehensive report.

By way of illustrating the current scatter-shot approach, performance **targets** for **speed** of delivery (*i.e.*, percent of mail delivered on-time) for all major classes of mail can be found on the Postal Service's RIBBS website.[55] That website, however, does not tell users where to find actual on-time performance data that can be compared with the established targets. Nor, as noted *supra*, does the RIBBS website provide any **targets** for **reliability** of delivery, such as the number of days within which 99 percent of each product is expected to be delivered. FY 2009 and FY 2010 targets for First-Class Mail can be found in the 2009 Comprehensive

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[55] Performance targets for various special services, such as delivery confirmation, do not seem to be available anywhere.

Statement (p. 60), along with actual speed of delivery data, but the document does not point users to the RIBBS website for targets regarding other classes of mail.

The FY 2009 ACR contains a table with **full-year** data for **speed** of delivery (*i.e.*, percent of mail delivered on-time) in FY 2009 for First-Class single-piece mail and Package Services (p. 12), but neither the ACR nor the Comprehensive Statement provide any data on **reliability** of delivery, nor do they indicate where such data can be found. The Postal Service webpage that presents service performance data provides data for only the **latest quarter**, and does not indicate where one can find **annual** data on reliability to go along with the **annual** data presented on page 12 of the FY 2009 ACR. Nor does the Postal Service webpage with performance data indicate that targets can be found on the RIBBS website.

Unless the Postal Service plans to expand its Comprehensive Statement to provide data for all products, similar to that found on page 60 regarding First-Class Mail, a new comprehensive report on service performance may be needed — one that can take its place alongside the four existing basic reports set out above.

H. Future Accountability and Transparency: Progress in Presenting Service Performance Information.

In a world characterized by almost instant communication options, actual service performance for many postal products needs substantial improvement, most especially as regards reliability. Continued financial viability of the Postal Service may depend on across-the-board improvements in performance, not only in First-Class Mail, but also in all other classes.

As noted in the above discussion regarding the expanded ZIP Codes in EXFC, that which gets measured and reported, gets acted upon. The flip side to that maxim is — that which is neither measured nor reported, tends to be ignored. These early ACR dockets should not establish a precedent that available performance data need not be reported in a meaningful manner, or be the subject of serious discussion as part of each ACR. It is within the Commission's control where to set the bar as to what is minimally acceptable for reporting of service performance.

VIII. DIFFICULTIES CREATED BY TIMING OF ACR AND PRICING CHANGES

In Docket No. ACR2008, Valpak offered the following comments:

> PAEA requires the Postal Service's annual compliance report to be filed 90 days after the end of the fiscal year, or at the end of December of each year, and limits the period of the Commission's review to 90 days, or by the end of March of the following year.... As an exercise of its pricing prerogatives, the Postal Service has announced plans to ... change prices for market dominant products each May. The conflux of PAEA deadlines and the Postal Service pricing schedule creates two significant challenges for the Commission.
>
> First, during each fiscal year every product will have two different rates....
>
> Second, by the time the Commission completes its Annual Compliance Determination, the Postal Service has already announced its price changes for the year. [Valpak Initial Comments, pp. 4-5.]

The Commission responded in its FY 2008 ACD as follows:

> The Commission agreed that the challenges identified by Valpak exist. However, Valpak did not suggest, and the Commission is unaware of, any actions that the Commission could take to eliminate those challenges. The schedule for the annual compliance review is fixed by law. The schedules for market dominant and competitive product rate adjustments are, by virtue of the PAEA, the prerogative

> of the Postal Service so the Commission cannot dictate when the Postal Service should make its rate adjustments. [FY 2008 ACD, pp. 100-101.]

Valpak understands that this is not a matter on which the Commission has the statutory authority to impose its will on the Postal Service. Nevertheless, Valpak again raises the issue in Docket No. ACR2009, in an effort to generate discussion among the Postal Service, the Commission, and mailers as to whether a different price adjustment schedule would work better for all when viewed in conjunction with the current annual compliance review cycle, which is fixed by statute and has its roots in the government's fiscal year. Indeed, it could be that current circumstances may lend themselves to moving toward a more rational ACD/pricing cycle.

The Postal Service commitment to avoid any price adjustment in calendar year 2010 leads to the strong possibility that price adjustments could be made in early January 2011. Particularly as CPI-U is in the process of switching over into positive numbers in early 2010, it is entirely possible that the Postal Service might want to notice price adjustments in October 2010 for implementation in early January 2011. One likely schedule for such a pricing adjustment would be approximately as follows:

Pricing Calendar

- USPS Notice of Price Adjustment — October 5, 2010 (Tuesday)
- Mailer Comments Due — October 25, 2010 (Monday)
- Commission Order — November 8, 2010 (Monday)
- Pricing Adjustment — January 3, 2011 (Monday)

Under this scenario, the pricing calendar would overlap only slightly with the statutory Annual Compliance Determination schedule.

Annual Compliance Determination Calendar

• USPS FY 2010 ACR filing	December 29, 2010 (Wednesday)
• Initial Comments	January 31, 2011 (Monday)
• Reply Comments	February 11, 2011 (Monday)
• Commission issues ACD	March 29, 2011 (Tuesday)

These two schedules would improve, but not solve, the problem of rapidly incorporating in price adjustments the recommendations in the most recent ACD.

- Under the schedule used in FY 2007 and FY 2008, the Commission's ACD (March 29) came about **10.5 months** before the Postal Service Notice of Price Adjustments (mid-February of the next year).

- Under the schedule that may obtain in FY 2011, the Commission's ACD (March 29, 2010) would come **7 months** before the Postal Service notices its price adjustments (October 5, 2010).[56]

It would be the next pricing adjustment which could bring complete "rationalization" to the pricing/ACD cycle. To that end, Valpak would like to propose for discussion a schedule for annual pricing adjustments that it believes would be optimal, given the constraints of current law. Of course, the only optimal schedule for price increases would be to have no price increases at all. That said, the current mid-May price change no doubt is found problematic by some mailers. No matter what date is selected for price adjustments, some mailer or category of mailers can be anticipated to object.

Proposed Pricing/ACD Schedule. Under the Valpak proposal, the Postal Service would give notice of new prices in July for implementation on October 1, the beginning of the Postal Service's fiscal year.

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[56] One additional benefit of these schedules is that it would help to unpack the events now crammed predominantly into the second quarter of each fiscal year — between December 29, when the Postal Service files its ACR with the Commission through Commission's issuance of its ACD on March 29 (followed by a price adjustment in mid-May).

Pricing Calendar

• USPS Notice of Price Adjustment	July 1
• Mailer Comments Due	July 21
• Commission Order	August 4
• Pricing Adjustment	October 1

Annual Compliance Review Calendar

• USPS FY 2010 ACR filing	December 29
• Initial Comments	January 28
• Reply Comments	February 11
• Commission issues ACD	March 29

With this schedule, the Postal Service's ACR and the Commission's ACD would relate to a fiscal year with only one set of prices throughout. This would allow the Postal Service three full months to consider the Commission's ACD, which, under PAEA, becomes available by the end of March. The ACD, which reflects concerns of mailers and the Commission, could be recognized more quickly and effectively. If Postal Service finances permit, a price adjustment on October 1, 2012 (21 months after a January 2011 change), would result in three increases over 40.5 months — a greater-than-expected period of price stability for mailers.[57]

- May 15, 2009 (19.5 months)
- January 3, 2011 (21 months)
- October 1, 2012

[57] Otherwise, a price increase on October 1, 2011, would result in three increases over a 28.5-month period:

- May 15, 2009 (19.5 months)
- January 3, 2011 (9 months)
- October 1, 2011

IX. THE FY 2009 ACR LACKS CERTAIN NSA INFORMATION WHILE REVEALING THE DEFICIENCIES OF UTILIZING NSAs FOR MARKET-DOMINANT PRODUCTS.

A. Reporting Is Incomplete — Only Selected Information about Market-Dominant NSAs Has Been Provided to the Public.

The FY 2009 Annual Compliance Report discusses negotiated service agreements ("NSAs") for market-dominant products briefly: on pages 7-9, and pages 56-58. Data on market-dominant NSAs are provided in USPS-FY09-30.[58] (Additionally, NSA data are incorporated into overall First-Class Mail data presented in Table 1 (p. 22) and Standard Mail data presented in Table 2 (pp. 26-27).)[59]

Although the Postal Service has provided some information on pending NSAs for market-dominant products, other important information is lacking. For example, the Postal Service's report appeared to contain no information on the last six months of the Bank of America Corporation ("BAC") NSA, although the entirety of its last contract year was within FY 2009. Also, the Postal Service reported a significant amount — $13 million — in largely-unexplained administrative expenses for the BAC NSA.[60]

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[58] USPS-FY09-30 states that it "reports **revenues** and **volumes** associated with Market-Dominant NSAs that were in effect during FY09 and had been in effect for one year by the end of FY09. It also calculates the **costs** and **incremental values** of those NSAs." USPS-FY09-30, Word document, p. 1 (emphasis added).

[59] The Postal Service initially filed an Application for Nonpublic Treatment of Materials NSAs for Competitive Products as Attachment Two with its ACR, but no such application with respect to any information about market-dominant NSAs. *See* FY 2009 ACR, Attachment Two, pp. 16-19.

[60] On January 15, 2010, Valpak filed a motion in this docket requesting that the Commission issue an information request to the Postal Service asking for missing data and explanations. *See* Valpak Motion for Issuance of Commission Information Request

B. Assessment of the Market-Dominant NSA Program in FY 2009.

With reference to its three "tiered-discount" market-dominant NSAs which were in effect for some part of FY 2009, the Postal Service declares that "on the whole, they **succeeded.**" FY 2009 ACR, p. 56 (emphasis added). In the aggregate, the Postal Service states that three mailers received **$388,000 in rebates**. The FY 2009 **cumulative net benefit**, after those rebates, varies depending the approach used:

- Postal Service's approach — **$1.8 million**; or
- Panzar/Wolak approach — **$328,000**.

Those three NSAs are termed "volume-growth NSAs" — Bookspan, The Bradford Group, and Life Line Screening.

On the other hand, the BAC NSA is not so described. USPS-FY09-30, Word document, p. 1-2. When filed, it was described as a "pay for performance" NSA. United States Postal Service Request for a Recommended Decision, Docket No. MC2007-1, p. 2 (Feb. 7, 2007). Indeed, any modest successes of the three "volume-growth" NSAs were

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Concerning Certain Costs Related to Negotiated Service Agreements, Docket No. ACR2009 (Jan. 15, 2010). Valpak's motion requested the Commission to ask the Postal Service to furnish these data and explanations, including why those fairly extraordinary administrative expenses for the BAC NSA were not included in the Postal Service's original application for that NSA. The Postal Service responded on January 22, 2010 seeking nonpublic treatment for important market-dominant NSA cost information. *See* United States Postal Service Response to Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Motion for Issuance of Commission Information Request Concerning Certain Costs Related to Negotiated Service Agreements (Jan. 22, 2010) and Valpak Opposition to Postal Service Application for Nonpublic Treatment (Jan. 26, 2010). As previously noted (p. 2, *supra*), the Commission issued Order No. 401, treating Valpak's opposition as an application or motion requesting early termination of nonpublic status.

dwarfed by overall failure of the market-dominant NSA program. Regarding the BAC NSA, the Postal Service admits:

- its "net cost … was around **$25 million**," and
- it "failed to produce measurable mail-processing efficiency improvements." *Id.*, p. 57.

When the BAC NSA is included, customers qualified for a discount in three market-dominant NSAs. The net value (using the Postal Service's approach), measured by NSA contract year, is as follows :[61]

Bookspan	$ 0
The Bradford Group	1,079,935
Life Line Screening	727,197
Bank of America Corporation	-23,513,857
TOTAL net value	$ -21,706,726

Separate examination of each NSA helps explain the problem with the market-dominant NSA program.

1. Bookspan NSA

The Bookspan NSA contract period was June 2008 – May 2009. Bookspan's before-rates forecast was 75 million pieces, but, despite rebates offered in its NSA, its actual volume was only 58.9 million. Accordingly, Bookspan failed to qualify for any discount under its NSA. No rebates were paid. Excluding any costs of administering this contract, the NSA had zero net value for the Postal Service.

[61] USPS-FY09-30, FY2009 Market Dominant NSA Materials. File: ACR_NSA_FY09_report.xls, Tab: Net Value

2. The Bradford Group NSA

The contract period for The Bradford Group NSA was June 2008 – May 2009. Bradford was paid $300,171 in discounts, leaving a net value to the Postal Service of $1,079,975 using the Postal Service's method, and $245,609 using the Commission's ("Panzar-Wolak") approach.

3. Life Line Screening NSA

The Life Line Screening NSA contract period was August 2008 – July 2009. Life Line Screening was paid $88,187 in discounts, leaving a net value to the Postal Service of $727,197 using the Postal Service's method, and $82,560 using the Commission's ("Panzar-Wolak") approach.

4. Bank of America Corporation NSA

The first contract year for the Bank of America Corporation NSA was April 2008 – March 2009.[62] According to one tab, rebates paid amounted to $2,438,222.[63] According to another tab, however, the rebates were $7,297,113.[64] This latter tab has an unexplained "Allocated Rebate" for regular letters in column 5, of $4,858,892, which is not included in the Incentives Paid tab. The difference between these various rebate numbers is not explained.

The contract was terminated effective September 30, 2009,[65] and the loss set forth above with respect to the BAC NSA appears to omit the last six months of FY 2009. *Id.*

The BAC NSA reports an administrative cost of $13,000,000, allocated as $3,250,000 per quarter. *Id.* However, only two quarters of these administrative costs are funneled into

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[62] In its FY 2008 ACD, the Commission did not include any results from the BAC NSA in its tabulation financial contribution/loss results (since the FY 2008 ACR was limited to NSAs with a contract year that ended during FY 2008). The Commission explained:

> The Postal Service reports that the established methodology yields an **estimated net contribution loss of $3.8 million**.... The Postal Service goes on to state that it has identified other costs for consultants, software and hardware used solely for this agreement, which add an **additional $2.6 million** in FY 2008 costs. With the addition of these costs, which were not identified previously for this or any other NSA, the Postal Service estimates **it lost $6.4 million in contribution in the first six months of the Bank of America agreement**. The Postal Service's response **does not identify the extent to which it is achieving the operational benefits that it expected** to "provide a convincing reason, despite any estimated reduction in contribution, for proceeding with implementation of the NSA." [FY 2008 ACD, p. 84 (emphasis added).]

[63] USPS-FY09-30, FY2009 Market Dominant NSA Materials. File: ACR_NSA_FY09_report.xls, Tab: IncentivesPaid.

[64] USPS-FY09-30, FY2009 Market Dominant NSA Materials. File: ACR_NSA_FY09_report.xls, Tab: MC2007-1 Bank of America.

[65] *See* Postal Service Notice Concerning Termination Date of Negotiated Service Agreement (Oct. 16, 2009).

the FY 2009 CRA.[66] It appears that the other $6.5 million may have been reallocated to FY 2008 — even though this $6.5 million cost appears not to have been included in the FY 2008 CRA when filed with the FY 2008 ACR. This net cost of this NSA appears to have changed over time.

- In Docket No. ACR2008, in its **March 13, 2009**, response to Commission Information Request No. 5, Question 7, the Postal Service reported the net cost of the BAC NSA in **FY 2008** to be **$6.4 million**.

- The Postal Service revised this information in its year one Data Collection Report filed **July 30, 2009**; the new net cost for **FY 2008** was **$13.2 million**.

Obviously, with termination of the agreement and recalculation of the depreciation of the administrative costs, costs previously filed for FY 2008 are no longer accurate.

The Commission has no process for revising either its data or its ACD for a prior year, so when charge-backs are made retroactive, as here, these BAC NSA costs seem to have been lost for all time. It would seem that some Commission or accounting rules would preclude pushing costs backwards into closed fiscal years, and we urge the Commission to consider

66 USPS-FY09-30, FY2009 Market Dominant NSA Materials. File: ACR_NSA_FY09_report.xls, Tab: "For CRA".

implications of allowing such a procedure.[67] Any cumulative accounting of NSAs for market-dominant products certainly should have a mechanism for including all costs of all such NSAs.

The Postal Service reports that "net operating improvements" for the BAC NSA were $3,330,224. *Id.* This amount is cited without page reference to the Year One Data Collection Report as the source, yet we have been unable to find it in the Report. Elsewhere, the Postal Service candidly and clearly admits that the BAC NSA "failed to produce measurable mail-processing efficiency improvements…." *See* FY 2009 ACR, p. 57. It should be remembered that the Postal Service did not justify the BAC NSA based on volume growth or projected profitability, but rather that it would help the Postal Service to achieve "operational efficiency." *Id.*

5. Disclosure of Any Functionally-Equivalent NSA Payments and Analyzing Harm to the Marketplace

Costs of Functionally-Related NSAs. The Postal Service's FY 2009 ACR provides no information on the Capital Ones Services, Inc. ("Cap One") NSA complaint (Docket No. C2008-3), the settlement of that complaint, or the costs to defend that complaint. Certainly, if a payment was made to Cap One to settle the complaint, it would have been made based on Cap One's right to a "functionally-equivalent" NSA under 39 U.S.C. section 3622(c)(10), and

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[67] In response to Valpak's motion for the issuance of a Commission Information Request on NSA costs, the Postal Service responded that the administrative costs of $13 million for contract year one related to the BAC NSA. The Postal Service stated simply that "the administrative costs were not anticipated at the time of litigation of Docket No. MC2007-1." Postal Service Response, unnumbered p. 2. As to the size of those costs, the Postal Service appears to represent to the Commission that those costs originally were to be amortized over the anticipated three-year contract term but, when the contract was terminated, all of the costs were reallocated. *Id.* However, it is not clear what has occurred, especially with respect to the six-month period, April–September 2009.

therefore paid in lieu of offering Cap One its own NSA. Likewise, there could have been other banks or other mailers which made demands on the Postal Service for an NSA functionally-equivalent to the BAC NSA, and were paid to waive their right to such an NSA, where no formal complaint was ever filed. If any such payments were made, accountability and transparency would require their discussion and reporting as costs of the NSA program. Even if no payments were made directly to a mailer, the presumably substantial costs incurred in defending the Cap One Complaint, and possibly settling other such claims, have not been, but should be, reported as a cost of the market-dominant NSA program.

Harm to the Marketplace. The Postal Service asserts that it "has no reason to believe that any of these NSAs caused unreasonable harm in the marketplace." FY 2009 ACR, p. 58. However, the Cap One complaint illustrates that providing an NSA to one of the nation's largest banks, while denying a functionally-equivalent one to other similarly-situated banks and other mailers, creates unfairness in the marketplace. Unreasonable harm to the marketplace is a test established in PAEA. 39 U.S.C. § 3622(c)(10). Without transparency about the Postal Service's market-dominant NSA program, neither the Commission nor the public can have certainty about its effect on the marketplace.

B. Niche Classifications Remain Preferable to NSAs for Market-Dominant Products.

The information provided by the Postal Service on market-dominant NSAs in its FY 2009 ACR reinforces the observations and arguments submitted by Valpak in several NSA proceedings as well as in comments on the FY 2008 ACR — that NSAs for market-dominant products are inherently problematic, and that either changes in the general tariff schedule or niche classifications are preferable to NSAs because they are available simultaneously to all eligible mailers, and either of these two options preserves a level playing field among mailers at all times.[68]

CONCLUSION

Difficult financial times clearly have hit the Postal Service hard. But sometimes it takes difficult times to make hard decisions. Valpak believes that if wise financial decisions are made now — by Congress, the Commission, and the Postal Service — the Postal Service could survive virtually any onslaught that the economy may throw at it. If the Postal Service is able to:

- obtain from Congress a moderation of the schedule for payment into the PSRHBF, it could save up to $4.0 billion annually;
- obtain from Congress the latitude to curtail six days per week delivery, it could save as much as $3.5 billion annually;
- consolidate and close unnecessary post offices, stations, branches, and postal operations facilities, it could save additional hundreds of millions of dollars annually; and

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[68] *See generally* Docket No. MC2002-2, Valpak Initial Brief (Apr. 3, 2003), pp. 31-32; *see also* Matthew H. Robinson, Margaret Cigno, and J.P. Klingenberg, Negotiated Volume Discounts in a Regulated Post, presented at the Center for Research in Regulated Industries' 26th Annual Eastern Conference, Skytop, Pennsylvania, May 16-18, 2007 (mimeo) http://www.prc.gov/prc-docs/library/refdesk/techpapers/prcstaff/NSA paper 2007.pdf.; John Haldi and William J. Olson, Evaluating Negotiated Service Agreements for Market Dominant Products Under PAEA, presented at the Center for Research in Regulated Industries' 27th Annual Eastern Conference, Skytop, Pennsylvania, May 15, 2008) (mimeo) http://lawandfreedom.com/site/postal/NSAs_PAEA.pdf. *See also, e.g.*, Valpak Initial Comments, Docket No. ACR2008 (Jan. 30, 2009), pp. 40-43. A niche classification that illustrates this better approach was the Commission's approval regarding averaging for weight-averaged nonletter-size business reply mail in Docket No. MC99-2. A (temporary) change in the general tariff schedule that had the merit of being simultaneously available to all qualified mailers is illustrated by the Summer Sale.

- properly price its underwater products over an established period of time, it could save much of the $1.75 billion it lost in FY 2009, annually.

Indeed, the Postal Service should not choose among these measures — it should adopt them all — and as rapidly as possible. For if it does, it could enter a new pricing paradigm that may be essential for the next several years — a period of **price stability for all profitable products** — year after year, through good times and bad.

Every year, electronic competition continues to erode whatever remaining monopoly the Postal Service may have over market-dominant products. Virtually all forms of hard copy — bills and invoices, check, advertisements, books, periodicals, etc. — are under assault from new electronic media. The landscape for hard copy material of all types has been altered fundamentally. Mail can remain a competitive and viable means of communication in the 21st Century, but to keep up, the Postal Service will have to streamline its operations, nurture all of its profitable products through rate stability, and improve service performance, dramatically for some products. Improving the Postal Service while keeping it financially healthy is the best way to fulfill all current and future obligations to postal employees. It is hoped that the Commission and all mailers will cooperate to support the Postal Service in cutting necessary costs at this critical time.

Respectfully submitted,

William J. Olson
John S. Miles
Jeremiah L. Morgan
WILLIAM J. OLSON, P.C.
370 Maple Avenue West, Suite 4
Vienna, Virginia 22180-5615
(703) 356-5070

Counsel for:
Valpak Direct Marketing Systems, Inc. and
Valpak Dealers' Association, Inc.