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ANNUAL COMPLIANCE REPORT, 2010

Docket No. ACR2010

UNITED STATES POSTAL SERVICE
FY 2010 ANNUAL COMPLIANCE REPORT
(December 29, 2010)

Section 3652 of title 39 requires the Postal Service to provide, within 90 days after the end of each fiscal year, a variety of data on "costs, revenues, rates, and quality of service" in order to "demonstrate that all products during such [fiscal] year complied with all applicable requirements of [title 39]." The Postal Service hereby files its Annual Compliance Report (ACR) for FY 2010.

## I. Overview of Report

### A. Transition Issues

The FY 2007 ACR was the first ACR ever filed by the Postal Service. It covered a fiscal year that started several months prior to the passage of the Postal Accountability and Enhancement Act (PAEA), and during which the pricing approaches approved under the former requirements of the Postal Reorganization Act (PRA) were still in effect. These circumstances gave rise to a host of transition issues, as discussed at some detail in the first ACR. FY07 ACR (Dec. 28, 2007) at 1-3. The situation improved considerably in the FY 2008 and FY 2009 ACRs, as the Postal Service was able to report product costs aligned with the new product lists for most categories, and the Commission issued new procedural rules to cover the ACR filing.

There will nonetheless still be some transitional issues this year, as the Postal Service continues its efforts to put the new rules into practice. For example, the Postal Service for the first time is working to incorporate into the Cost and Revenue Analysis (CRA) report financial results for activities which were formerly considered "nonpostal," but after further consideration were added to the product list in the MCS as postal products. This is in accord with statements by the Commission in Order No. 391 (Docket No. MC2009-19, Jan. 13, 2010), in which the products were added to the Mail Classification Schedule (MCS) list. It seems likely that this effort will once again provide further opportunities for all participants to learn more about the most appropriate ways for this process to be conducted.

### B. Contents

Much of the information within this Report is included in materials appended as separate folders. A list of those materials is attached at the back of this Report as Attachment One. The appended materials are sequentially numbered and labeled as USPS-FY10-1, USPS-FY10-2, etc. Materials in the nonpublic annex (discussed below in Part V) are labeled as USPS-FY10-NP1, USPS-FY10-NP2, etc.[1] All materials on the list (both public and nonpublic) are submitted in an electronic format, although a few are submitted in hard copy format as well. Each item includes a Word (or PDF) document with a preface explaining the purpose, background, and structure of that material, as well as its relationship with the other materials.

Broadly speaking, there are four distinct major sets of items included in the appended material. The first set consists of the product costing material filed on an

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

annual basis in response to the Commission's periodic reporting rules. The focus of these materials, in terms of the ultimate output, is the Cost and Revenue Analysis (CRA) report.

The second set consists of the comparable costing material with respect to international mail, filed in recent years in response to the Commission's international reporting requirements. The focus of these materials, in terms of output, is the International Cost and Revenue Analysis (ICRA) report. The third set consists of material relating to intra-product cost analyses which include those analyses necessary for an examination of workshare discounts pursuant to section 3652(b) (a topic discussed in Part II.F below). This special cost study material generally focuses on categories below the product level. The fourth set is billing determinant information which, for both domestic and international mail, has generally been filed with the Commission on an annual basis, or more frequently, based on Periodic Reporting rules.

Therefore, all four of these major sets of material (CRA, ICRA, cost studies, and billing determinants) are familiar to the Commission, both from prior rate cases and ACRs. Moreover, they are presented in formats similar (if not identical) to what both the Commission and other parties participating in postal regulatory proceedings have seen and worked with in the past. In that sense, the Postal Service has sought to maximize the ease with which these materials may be reviewed.

One significant change that has been incorporated in previous ACRs and continues this year is that certain materials, which formerly were presented in one version containing information on both market dominant and competitive products, have now been split into two versions, one public, and the other nonpublic. The public versions of these materials are limited either to information on market dominant products, or to information on individual market dominant products and comparable aggregate information on competitive products as a whole (or, with respect to the Public CRA, aggregate information on five groups of competitive products). Correspondingly, the nonpublic versions are either limited to information on competitive products, or contain information on both types of products in contexts in which it is not possible to segregate the two. In the nonpublic versions, however, competitive product information is disaggregated to individual competitive products. This is discussed further in Part V. below.

### C. Roadmap

A separate roadmap document is included as USPS-FY10-9. The roadmap is a technical document that consolidates brief descriptions of each of the materials provided, as well as the flow of inputs and outputs among them. It also includes a discussion of any methodology changes between the FY 2010 analyses included in this Report and the Commission's methodologies in the FY 2009 Annual Compliance Determination. The document also includes the listing of special studies and the discussion of obsolescence required by Commission rule 3050.12.

### D. Methodology

The methodologies employed are in general also quite familiar to the Commission and parties that historically have been involved in postal ratemaking. Because heavy reliance is placed on replicating the methodologies used most recently by the Commission, the scope of new methodologies has been minimized. Postal operations and postal data collection are not entirely static, however, and consequently some minor changes in methodology are identified and discussed. This is done in two places. First, methodology changes are identified in a separate section of the roadmap document, USPS-FY10-9. Second, they are discussed in the Word (or PDF) preface accompanying each of the appended materials; often, this preface contains a discussion that is more detailed than that contained in the roadmap document. Thus, if a change relates to an area of particular interest to the reader, it may be useful to refer to the particular item in question, rather than relying exclusively on the roadmap document.

Overall, however, with some exceptions, including those which have been previously approved by the Commission in the proceedings discussed in the next paragraph, the basic costing methodologies applied are those most recently employed by the Commission. The Postal Service filed a number of proposals to change analytic principles since the filing of the FY 2009 ACR and they are summarized in the table below.

| **Proposal Number** | **Topic of Proposal** | **Date** | **Docket No.** | **Notice Order No.** | **Date** | **Disposition Order No.** | **Date** |
|---|---|---|---|---|---|---|---|
| One | Eliminate TRACS Rail sampling | 02/09/10 | RM2010-8 | 406 | 2/12/10 | 424 | 3/17/10 |
| Two | Sample size reduction for ODIS-RPW (FY2011) | 06/25/10 | RM2010-10 | 482 | 6/30/10 | | |
| Three | City street letter route treatment of direct bundles | 09/08/10 | RM2010-12 | 534 | 9/13/10 | | |
| Four | Assign IOCS window acceptance costs to host piece | 09/08/10 | RM2010-12 | 534 | 9/13/10 | | |
| Five | Rural treatment of prepaid parcels | 09/08/10 | RM2010-12 | 534 | 9/13/10 | | |
| Six | Change in ICRA calculation procedures | 09/08/10 | RM2010-12 | 534 | 9/13/10 | | |
| Seven | Mailflow-based model for mail processing costs for Standard Parcels and NFMs | 09/08/10 | RM2010-12 | 534 | 9/13/10 | | |
| Eight | Segment 14 treatment of empty equipment costs | 09/08/10 | RM2010-12 | 534 | 9/13/10 | | |
| Nine | New bundle sorting cost methodology in Standard Mail and First Class Mail Processing Cost Models | 12/20/2010 | RM2011-5 | 625 | 12/28/10 | | |

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|---|---|---|---|---|---|---|---|
| Ten | Assign mailhandler and clerk costs to country groups within IOCS | 12/20/2010 | RM2011-5 | 625 | 12/28 10 | | |
| Eleven | Report International Money Transfer Service for both Inbound and Out bound Prod. | 12/20/2010 | RM2011-5 | 625 | 12/28/ 10 | | |
| Twelve | Develop Alternative Data Inputs for Package Services Cost Models | 12/20/2010 | RM2011-5 | 625 | 12/28/ 10 | | |
| Thirteen | Develop New Parcel Select/Parcel Return Service Mail Processing Cost Model | 12/22/2010 | RM2011-6 | 626 | 12/28 10 | | |
| Fourteen | Develop Modified Parcel Select/Parcel Return Service Transportation Cost Model | 12/22/2010 | RM2011-6 | 626 | 12/28/ 10 | | |

With respect to those proposals still pending, in the absence of any direction to the contrary, the Postal Service is incorporating those methodologies into the ACR. Finally, section 3652(g) requires the Postal Service to submit, together with this Report, a copy of its most recent comprehensive statement. A copy of its FY 2010 Comprehensive Statement can be found at *usps.com*, and is also filed as USPS-FY10-17 in this proceeding. Similarly, a copy of the Postal Service's annual report to the Secretary of the Treasury regarding the Competitive Products Fund, required by section 2011(i) of title 39, is filed in this proceeding as part of USPS-FY10-39, along with the other Competitive Products Fund materials provided in accordance with Commission Rules 3060.20 through 3060.23.

## II. Market Dominant Products

### A. Applicable Requirements of Title 39

In its FY 2008 ACR, the Postal Service noted that the prices and fees in effect during the majority of FY 2008 were established using PRA procedures and applying PRA standards. By FY 2009, prices and fees in effect during the entire fiscal year had been established under PAEA procedures.[2] Therefore, whatever consideration of transitional issues regarding price setting standards may have been appropriate in FY 2007 and FY 2008 should no longer be necessary with respect to FY 2010.

A significant question regarding the requirements of title 39 arises with respect to cost coverage shortfalls. In the FY 2009 ACD (March 29, 2010), the Commission observed that "fourteen market dominant products and services failed to cover attributable costs, losing in the aggregate $1.7 billion." FY 2009 ACD at 6. Approximately $1.5 billion of the loss resulted from Periodicals ($642 million), Standard Mail Flats ($616 million), and Standard Mail Non-Flat Machinables (NFMs) and Parcels ($205 million). FY 2009 ACD at 65. The Commission stated that "[t]he problem of individual market dominant product revenues failing to cover either attributable or overhead costs was so pervasive in FY 2009 that it has become a systemic problem." ACD at 20. To address the problem, the Commission required the Postal Service to "develop and present a plan explaining how the Postal Service expects to increase cost coverage on these products to a level where each makes a reasonable contribution to institutional cost." FY 2009 ACD at 65. The Commission directed that the plan be included in the next ACR or in the next general market dominant price adjustment.

The Postal Service presented its plan in its request for an exigent rate increase in Docket No. R2010-4. The Postal Service detailed how price increases, efficiency improvements, and expected improving economic conditions would bring the fourteen products to full cost coverage. *See*, *generally*, Statement of James M. Kiefer on Behalf of the United States Postal Service (July 6, 2010), Docket No. R2010-4 (Kiefer

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[2] The only exceptions were a few carryover international rates.

Statement). The Postal Service estimated that its proposed price increases would result in ten of the fourteen products covering their attributable costs fairly quickly.[3] Kiefer Statement at 8. For the remaining four products – Outside County Periodicals, Within County Periodicals, Media Mail, and Standard Mail Flats – the Postal Service explained how the products could be brought to full cost coverage over a lengthier period. For example, the Postal Service presented a detailed plan for capturing efficiencies for Standard Mail Flats that, when combined with consecutive above average price increases, would result in full attributable cost coverage. *See* Operations Strategies for Capturing Flats Efficiencies, USPS-R2010-4/9 (July 6, 2010).

With the Commission's denial of the Postal Service's exigent rate increase request in Docket No. R2010-4, the Postal Service's plan for bringing the fourteen products to full attributable cost coverage is no longer workable. The results contained in the present ACR show that the cost coverage problem continues to exist and remains systemic. As the Postal Service has indicated to the Commission over the course of their joint work on the Periodical Study, even if the Postal Service achieves the most optimistic efficiency enhancements possible, it does not foresee that such enhancements, combined with annual rate increases within the statutory price cap, will result in Periodicals, Standard Mail Flats, and Standard Mail NFMs/Parcels reaching full attributable cost coverage. In other words, it seems impossible for the Postal Service, acting with the powers granted to it and within the constraints imposed by title 39, to present any realistic plan that would result in these products fully covering their

[3] Revised estimates later showed that one of the ten products, Standard Mail NFMs/Parcels, would reach near cost coverage but would not reach full cost coverage through the requested price increase alone.

attributable costs, much less making any contributions to institutional costs. Therefore, it seems most appropriate for the Commission to determine whether it can exercise any of its powers to remedy the cost coverage shortfall of the products in question.

Other parties have advocated that the Commission possesses such powers. Most notably, the Public Representative argued during the FY 2009 Annual Compliance Review that, while the price cap provisions and exigent rate increase provisions of title 39 are the cornerstone of the Postal Service's rate authority for market dominant products, the Commission possesses its own rate authority which it can exercise outside of Postal Service requests, even in some cases *sua sponte*. *See*, *e.g.*, Public Representative Reply Comments (Feb. 23, 2010), Docket No. ACR2009. The Greeting Card Association (GCA) similarly stated that the Commission has the statutory power to call for the Postal Service to increase certain market dominant rates in excess of the price cap. *See*, *e.g.*, Reply Comments of the Greeting Card Association (Feb. 23, 2010), Docket No. ACR2009. In light of these statements, it would be useful for the Commission to determine exactly what the contours of its powers are under title 39.

On the other hand, it is unclear to the Postal Service whether the Commission's statements in the FY 2009 ACD regarding the need for products to cover their attributable costs and make contributions to institutional costs are still operative, given the Commission's subsequent statements in Order No. 536 (September 14, 2010) in Docket No. RM2009-3 (Workshare Order) regarding products. In the Workshare Order, the Commission presented an analysis of the term "product" in title 39, as amended by the PAEA. Order No. 536 at 24-27. The Commission concluded that the product level is not the appropriate level for applying pricing standards, suggesting instead that the class level is the appropriate level. *Id.* at 27. It is not clear to the Postal Service how to reconcile this conclusion with the Commission's statements regarding cost coverage shortfalls in the FY 2009 ACD. If the Commission's statements in the Workshare Order regarding products mean that cost coverage shortfalls are acceptable at the product level so long as there is full attributable cost coverage and appropriate institutional cost contribution at the class level, then Commission action to remedy product-level cost coverage shortfalls may not be necessary.[4]

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

For FY 2010, with the limited exceptions indicated below, cost, revenues, and volumes for all market dominant products of general applicability are shown directly in the FY 2010 CRA (or ICRA). The exceptions are:

#### 1. International Reply Coupon Service

The ICRA reports only outbound revenue for this product and does not report any FY 2010 inbound and outbound costs or transactions.

#### 2. International Business Reply Mail Service

The ICRA reports outbound revenue and volume for this product, but does not report any FY 2010 outbound cost or inbound revenue, volume, and cost information.

#### 2. Negotiated Service Agreements (NSAs)

Information for domestic market dominant NSAs is presented in two ways in the ACR. First, on a fiscal year basis, the revenue, costs, and volumes for the NSAs have been extracted from the relevant product CRA lines. This extracted information is then

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[4] However, because the Periodicals class as a whole has a significant cost coverage shortfall, Commission action may still be necessary with respect to Periodicals.

shown in the line “Standard Mail Domestic NSAs”. (Incidentally, unlike in FY 2009, in FY 2010 there are no active NSAs that involve First-Class Mail.) These data are further disaggregated by individual NSA in USPS-FY10-30. In addition to this fiscal year information, data for the contract year are also presented in USPS-FY10-30. Commission Rule 3020.21(1) requires the net benefit calculation for each NSA to be conducted based on contract years, rather than fiscal years, to accommodate NSAs in which discounts are based on volume thresholds reached during a contract year. Those net benefit calculations also appear in USPS-FY10-30.

It is important to note that there is a distinction between the “net benefit calculations” and the data reported in the CRA line item for NSAs. The net benefit calculations are intended to isolate the incremental benefit of the NSA (i.e., the pieces that would not have been mailed if not for the NSA), whereas the CRA reports the entire volume related to the NSA, whether or not it is deemed “incremental.”

### C. Service Performance

During FY 2010, the Commission issued its final rules on periodic reporting of service performance measurement and customer satisfaction, which are codified at 39 C.F.R. Part 3055.[5] Among other things, Commission Rules 3055.20 through 3055.24 require annual reporting of service performance achievements at the national level for all market dominant products. Reporting is not required where the Commission has granted a semi-permanent exception or a temporary waiver,[6] nor, presumably, where a

[5] PRC Order No. 465, Order Establishing Final Rules Concerning Periodic Reporting of Service Performance Measurements and Customer Satisfaction, Docket No. RM2009-11, May 25, 2010.
[6] *Id.* at 21-23.

potential exception or waiver is awaiting final determination by the Commission.[7] The Postal Service's report, including information responsive to the criteria listed in Rule 3055.2(b)-(k), is included as USPS-FY10-29.

The Postal Service set for itself aggressive on-time targets of 90 percent or above for all market dominant products. Overall, the Postal Service has been successful in continuously improving these scores. For some products and in some districts, these targets have already been met or exceeded, but there are several instances where the scores have not yet been met at the national level. These targets are intended to guide longer-term improvement and are based on the evolution of Intelligent Mail barcode systems and on customers' participation in data collection that enables performance measurement at the necessary levels. The specific reasons why national scores have not been met are discussed in USPS-FY10-29.

### D. Customer Satisfaction with Market Dominant Products for FY 2010

Section 3652(a)(2)(B)(ii) requires the Postal Service to provide measures of the degree of customer satisfaction with the service provided for its market dominant products, also known as mailing services. In FY 2010, the Postal Service implemented a new approach for measuring customer experience and satisfaction with products and services.

[7] *Id.* at 21 ("Pending action on waivers or exceptions shall not act as a stay to providing *available* data." (emphasis added)). The Postal Service has explained why data are currently unavailable in connection with its pending requests for temporary waivers from annual reporting. *E.g.*, United States Postal Service Request for Temporary Waivers from Periodic Reporting of Service Performance Measurement, Docket No. RM2011-1, October 1, 2010.

### 1. Overview

The Customer Knowledge Management (CKM) group in Consumer Affairs at Postal Service Headquarters was responsible for survey measurement of the level of customer satisfaction with market dominant products during FY 2010 for USPS customers. Surveys were administered across each quarter of the year for two customer groupings – Residential and Small/Medium Business customers, and once per quarter for Large Business customers.

### 2. Background

In FY 2010, the Postal Service transitioned from a long-standing customer satisfaction measurement (CSM) system administered by The Gallup Organization, to a customer experience based measurement (Customer Experience Measurement, or CEM) system which focuses on sending and receiving mail, and Post Office and contact experiences. Results obtained through the CEM system cannot be compared to previous results because of material differences in survey methodology. The FY 2008 and 2009 CSM surveys were interim methodologies used until the new CEM system was in place for FY 2010.

### 3. Methodology

For the CEM system in FY 2010, Residential and Small/Medium business customers were randomly selected, contacted by mail and given the opportunity to complete either an online or a hard copy survey. Large business customers are randomly selected and contacted by mail and asked to complete a survey online. Residential and Small/Medium businesses are sampled sufficient to ensure at the Performance Cluster level, a minimum precision level of +/- 3 percentage points, at the

95 percent level of confidence per postal quarter. Large business customers are sampled in sufficient quantity to ensure at the national level a precision level of +/- 3 percentage points, at the 95 percent level of confidence per postal quarter.

To measure customer experience with market dominant products residential and small business survey respondents were asked to rate their product satisfaction using a six-point scale: *Very Satisfied*, *Mostly Satisfied*, *Somewhat Satisfied*, *Somewhat Dissatisfied*, *Mostly Dissatisfied*, and *Very Dissatisfied*. Respondents were also given the option of marking "*Don't Use Product*" and those that responded in this manner were not included in the calculations for satisfaction with market dominant products. Large business customers were asked which market dominant products they used, and then instructed to rate their satisfaction with their experience with those products. Customers who indicated that they did not use a product or were not familiar with a product were excluded from the calculated satisfaction ratings.

In FY 2010, instead of reporting a combined score for the top three box ratings (*Excellent*, *Very Good*, and *Good* in FY2009), the Postal Service began a more stringent reporting system, combining only top two box scores of *Very Satisfied* and *Mostly Satisfied*. The scores reported for market dominant products in FY 2010 result from combining only these *Very Satisfied* and *Mostly Satisfied* ratings.

### 4. Survey Results -- Ratings for Market Dominant Products During FY 2010

The table below reflects the CEM survey data responsive to the requirements in Section 3652(a)(2)(B)(ii). The results represent data from residential, small/medium business, and large business customer segments. For each row of data, the table indicates the mail service and the corresponding customer rating (combined "top two box" - Very Satisfied and Mostly Satisfied rating).

**Customer Satisfaction with Market Dominant Products (Mailing Services) - FY 2010**

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

### 5. Comparison of Results Across Fiscal Years

FY 2010 scores for market dominant products cannot be compared to scores from previous fiscal years due to the fact that the method of conducting the surveys has significantly changed from year to year. Methods used in FY2008 and FY 2009 were recognized as interim measures until the Postal Service could complete a solicitation process to select a supplier for its new Customer Experience Measurement (CEM) system. In FY 2008, a one-time panel study was conducted. In FY2009, each potential respondent received an invitation to participate in an online survey, either by mail for large commercial customers, or on their Point of Sale (POS) receipts from their visits to a Post Office for retail customers. In FY 2010 a new Customer Experience Measurement (CEM) system was launched in which randomly selected respondents and a different format and question set were used. Measurement of satisfaction with market dominant products was incorporated into this formal Customer Experience Measurement process.

The new CEM system offers the advantage of: (1) random selection of large numbers of respondents; (2) a better-defined six-point rating scale compared to a five-point scale used previously; and (3) the change to reporting a more stringent top two box satisfaction rating score rather than the top-three-box scores from previous years. In FY2011, results will be comparable to FY 2010.

## E. Product Analysis

### 1. FIRST-CLASS MAIL

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

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

Overall First-Class Mail volumes continued to decline at a significant pace in FY 2010. After experiencing an 8.6 percent decline from FY 2008 to FY 2009, First-Class Mail volumes declined another 6.6 percent from FY 2009 to FY 2010. First-Class Mail volumes were most significantly affected by the economic recession, but electronic diversion, which is an ongoing structural problem, continued to erode mail usage.

In FY 2010, First-Class Mail volume declined 5.6 billion pieces or 6.6 percent. Single-Piece Letters and Cards volume declined by 9.8 percent or 3.1 billion pieces, while Presort Letters and Cards declined by 3.5 percent or 1.7 billion pieces. By far the biggest percentage decline was in Flats (13.0 percent), although the overall volume is relatively small for this product.

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

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

Table 1: First-Class Mail Volume, Revenue, and Cost by Product

| Product | Volume (million) | Revenue ($million) | Attributable Costs | Contribution | Revenue/ Piece | Cost/ Piece | Unit Contribution | Cost Coverage |
|---|---|---|---|---|---|---|---|---|
| Single-Piece Letters/Cards | 28,585 | $12,753 | $7,776 | $4,977 | $0.446 | $0.272 | $0.174 | 164.0% |
| Presorted Letters/Cards | 46,225 | $15,975 | $5,399 | $10,576 | $0.346 | $0.117 | $0.229 | 295.9% |
| Flats | 2,484 | $3,118 | $2,148 | $970 | $1.255 | $0.865 | $0.390 | 145.1% |
| Parcels | 574 | $1,131 | $1,133 | -$1 | $1.969 | $1.972 | -$0.002 | 99.9% |
| Domestic NSA First-Class mail | 0 | $0 | $0 | $0 | | | | |
| First-Class Mail Fees | | $154 | | | | | | |
| Total First-Class Domestic Mail (incl. fees) | 77,869 | $33,131 | $16,455 | $16,676 | $0.425 | $0.211 | $0.214 | 201.3% |
| Outbound Single-Piece First-Class Mail Int'l | 334 | $690 | $363 | $327 | $2.063 | $1.085 | $0.978 | 190.1% |
| Inbound Single-Piece First-Class Mail Int'l | 346 | $204 | $258 | -$53 | $0.591 | $0.745 | -$0.154 | 79.3% |
| Total First-Class Mail | 78,549 | $34,025 | $17,075 | $16,950 | $0.433 | $0.217 | $0.216 | 199.3% |

As shown in Table 1, in FY 2010, First-Class Mail covered its attributable costs, and made a significant contribution toward the Postal Service's institutional costs. First-Class Mail prices did not increase in FY 2010.

**a. First-Class Mail Products**

First-Class Mail has six products: Single-Piece Letters/Postcards; Presorted Letters/Postcards; Flats; Parcels; Outbound First-Class Mail International; and Inbound Single-Piece First-Class Mail. Table 1 shows that (with the exception of Inbound Single-Piece First Class Mail and First-Class Mail Parcels) each of these products covered its attributable costs and made a contribution to institutional costs during FY 2010.

**i. Single-Piece Letters/Postcards**

This product consists of letter-shaped single-piece First-Class Mail and single-piece First-Class Mail cards. The cost coverage for this product in FY 2010 was 164.0 percent, which is reasonable given the value of First-Class Mail service. However, this product has experienced large volume drops, larger than the First-Class Mail class average. As pointed out above, the drop for this product between FY 2009 and FY 2010 was 9.8 percent, whereas the overall drop for First-Class Mail was 6.6 percent. As discussed above, the generally poor economic environment and the ready availability of electronic alternatives are the primary reasons for this decline.

**ii. Presorted Letters/Cards**

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

The cost coverage for First-Class Mail Presorted Letters/Cards was 295.9 percent, which is reasonable given the value that this product accords to business mailers who meet the presort requirements. In FY 2010 product volume declined 3.5 percent. While it is the largest product within First-Class Mail, continued presort volume declines create significant financial concerns.

The passthroughs for all categories were near 100 percent in the development for the prices implemented in May 2009 [Notice of Market Dominant Price Adjustment filed on February 10, 2009], prices which were in effect throughout 2010. Worksharing in First-Class Mail is discussed further in Section II.F of this report.

#### iii. Flats

The First-Class Mail Flats product includes both single-piece and presort mailings. Although most mail in this category is single-piece, presort prices are offered for Mixed ADC, ADC, 3-digit, and 5-digit sortation. Worksharing in First-Class Mail is discussed further in Section II.F of this report. The product's cost coverage was 145.1 percent.

#### iv. Parcels

The First-Class Mail Parcels product includes both single-piece and presort parcels (5-digit, 3-digit, ADC). Most parcels are mailed at single piece prices. Worksharing in First-Class Mail is discussed further in Section II.F of this report. The product's cost coverage was 99.9 percent.

### v. Outbound Single-Piece First-Class Mail International

Outbound First-Class Mail International consists of Single-Piece Letters, Postcards, Flats, and Parcels. The product's FY 2010 cost coverage was 190.1 percent.

### vi. Inbound Single-Piece First-Class Mail International

Inbound Single-Piece First-Class Mail International consists of single-piece Letters, Postcards, Flats, and Parcels sent from foreign postal administrations for delivery in the U.S. The Postal Service does not independently determine these prices for delivering foreign origin mail. Over a four-year period, prices for this product are set according to a Universal Postal Union (UPU) terminal dues formula established in the Universal Postal Convention. Because the UPU per item and per kilogram terminal dues rates were based on a percentage of the one-ounce retail Single Piece First-Class Mail rate and were not based on USPS costs, the FY 2010 cost coverage for this product was 79.3 percent. The Postal Service is working to improve the inbound cost coverage via bilateral agreements with some of our larger exchange partners in the upcoming calendar year.[8]

### b. First-Class Mail Incentive Programs

The First-Class Mail Incentive Program (the "Winter Sale") ran between October 1 and December 31, 2009. As reported in the data collection report filed on July 26, 2010, over 211 million pieces over volume thresholds were mailed by 170 customers, who earned rebates of $14.6 million. The Postal Service estimates that the program

[8] Inbound Single-piece First-Class Mail International at Non-UPU Rates are the result of a negotiation with Canada Post Corporation. Under the current bilateral agreement, southbound letter post rates from Canada increased in January 2010 (Docket No. R2010-2) and will increase again in January 2011.

generated over 142 million new pieces, and caused another 4 million to migrate from Standard Mail to First-Class Mail. This new volume produced approximately $34 million of new contribution, net of rebates paid.

### 2. STANDARD MAIL

Standard Mail is primarily used by businesses for advertising purposes. The class is also used by nonprofit customers for fundraising activities. It consists mainly of circulars and catalogs, but also includes some merchandise. Standard Mail is a commercial bulk mail class and requires a permit and a minimum of 200 pieces or 50 pounds of mail per mailing. Standard Mail pieces must weigh less than 16 ounces and must be presorted.

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

| Table 2: Standard Mail Volume, Revenue, and Cost by Product | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Product | Volume (million) | Revenue ($million) | Attribu-table Costs | Contri-bution | Revenue/ Piece | Cost/ Piece | Unit Contri-bution | Cost Cover-age |
| HD/Sat Letters | 5,428 | $737 | $349 | $388 | $0.136 | $0.064 | $0.072 | 211.4% |
| HD/Sat Flats & Parcels | 11,363 | $1,848 | $826 | $1,022 | $0.163 | $0.073 | $0.090 | 223.8% |
| Carrier Route | 9,428 | $2,223 | $1,560 | $663 | $0.236 | $0.165 | $0.070 | 142.5% |
| Letters | 48,301 | $9,205 | $5,106 | $4,099 | $0.191 | $0.106 | $0.085 | 180.3% |
| Flats | 7,049 | $2,579 | $3,161 | -$582 | $0.366 | $0.448 | -$0.083 | 81.6% |
| Parcels & NFMs | 682 | $602 | $780 | -$178 | $0.883 | $1.143 | -$0.261 | 77.2% |
| Domestic NSA Standard Mail* | 271 | $58 | $37 | $22 | $0.215 | $0.135 | $0.081 | 159.7% |
| Standard Mail Fees | 0 | $77 | $0 | | | | | |
| Total Standard Mail (Incl. fees) | 82,524 | $17,330 | $11,818 | $5,512 | $0.210 | $0.143 | $0.067 | 146.6% |
| | | | | | | | | |
| Former Regular & Nonprofit Regular ** | 56,033 | $12,386 | | | $0.221 | | | |
| Former ECR & Nonprofit ECR** | 26,220 | $4,808 | | | $0.183 | | | |

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

As shown in Table 2, in FY 2010 Standard Mail covered its attributable costs and made a significant contribution toward covering the Postal Service's institutional costs. Standard Mail prices did not change in FY 2010. Standard Mail is used by both commercial mailers and by qualified nonprofit mailers who receive preferred pricing. By law, when the Postal Service adjusts Standard Mail prices, the average revenue per piece for Standard Mail sent by nonprofit mailers must be 60 percent of the average revenue per piece for Standard Mail sent by commercial customers. For all of FY 2010 the ratio was 64.5 percent.

On November 29, 2009, Standard Mail instituted separate pricing for participating in the Full-Service IMb program. All non-parcel-shaped Standard Mail (except

Saturation flats) which meet specific barcode and other requirements may elect this pricing.

### a. Standard Mail Products

The Standard Mail class has six products: Letters; Flats; NFMs and Parcels; Carrier Route Letters, Flats and Parcels; High Density and Saturation Letters; and High Density and Saturation Flats and Parcels. Each product includes both commercial and nonprofit mail. Table 2 shows that each of these products, except Flats and NFMs/Parcels, covered its attributable costs and made a contribution toward institutional costs. In each of the last four fiscal years, these two products did not cover costs. This is of concern to both the Postal Service and the Commission. In the 2009 Annual Compliance Determination the Commission directed the Postal Service to develop a plan to improve the cost coverages of these products and include it in its next market dominant price adjustment. The Postal Service described its plans for improving the coverages of these products in its pricing statement in Docket No. R2010-4.[9]. These plans are discussed further in the respective product sections, below.

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

[9] Docket No. R2010-4, Statement of James M. Kiefer on Behalf of the United States Postal Service, July 6, 2010.

### 1) High Density and Saturation Letters

The Standard Mail High Density and Saturation Letters product is used by businesses to send geographically targeted messages to potential customers. It is used to communicate messages that do not require the most expeditious, and therefore more expensive, mail processing and delivery. Consistent with this lower level of service, its prices are below the prices for First-Class Mail Letters. High Density and Saturation Letters serve advertising markets in which business customers have many alternative options to convey their messages, such as local radio and television, handbills, telephone directories, etc. The Postal Service has long recognized this fact when pricing this product. To retain and grow the volume of High Density and Saturation Letters, the Postal Service has maintained the prices of these categories below the price of regular Standard Mail Letters, despite the fact that all categories of Standard Mail letters are increasingly processed and delivered via the same channels. The prices for this product did not change in FY 2010.

This product has the lowest overall prices offered by the Postal Service to send advertising mail. Nevertheless, based upon FY 2010 costs, the High Density and Saturation Letters product covered its attributable costs with a coverage of 211.4 percent, thereby making a contribution toward the Postal Service's institutional costs.

High Density and Saturation Letters are eligible for price discounts for dropshipping. Mailers who do this extra work pay lower prices consistent with the costs their worksharing avoids for the Postal Service. Based on FY 2010 avoided costs, the passthroughs of the dropship avoided costs for High Density and Saturation Letters were all below 100 percent. In Docket No. RM2009-3 the Commission determined that the Saturation letters pricing category was not a workshared category of High Density letters; therefore the pricing restrictions of section 3622(e) do not apply to the price differences between Saturation and High Density letters. A more detailed discussion of worksharing in Standard Mail and the Commission's determinations in Docket No. RM2009-3 is contained in Section II.F of this report.

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

**2) High Density and Saturation Flats/Parcels**

The Standard Mail High Density and Saturation Flats and Parcels product is used by businesses predominantly to send geographically targeted messages to potential customers. It is also used occasionally to distribute product samples to geographically concentrated markets. This product is used to communicate messages or deliver samples that do not require the most expeditious, and therefore more expensive, mail processing and delivery. Consistent with this lower level of service, its prices are below the prices for First-Class Mail flats and parcels. High Density and Saturation Flats and Parcels serve advertising markets in which business customers have many alternative options to convey their messages, such as local radio and television, handbills, telephone directories, etc., or to distribute samples. The Postal Service has long recognized this fact when pricing this product. The prices for this product did not change in FY 2010.

This product has the lowest overall prices offered by the Postal Service to send advertising flats or product samples. Nevertheless, based upon FY 2010 costs, the High Density and Saturation Flats and Parcels product covered its attributable costs with a coverage of 223.8 percent, thereby making a reasonable contribution toward the Postal Service's institutional costs.

High Density and Saturation Flats and Parcels are eligible for price discounts for dropshipping. Mailers who do this extra work pay lower prices consistent with the costs their worksharing avoids for the Postal Service. Based on FY 2010 avoided costs, the passthroughs of the dropship avoided costs for High Density and Saturation Flats and Parcels were below 100 percent. In Docket No. RM2009-3 the Commission determined that the Saturation flats and parcels pricing categories were not workshared categories of High Density mail; therefore the pricing restrictions of section 3622(e) do not apply to the price differences between Saturation and High Density flats and parcels. A more detailed discussion of worksharing in Standard Mail and the Commission's determinations in Docket No. RM2009-3 is contained in Section II.F of this report.

The Standard Mail High Density and Saturation Flats and Parcels product meets the public's need for a business-oriented, lower value, lower priced alternative to First-Class Mail flats and parcels options to reach geographically concentrated customers with advertising messages and lightweight merchandise samples. High Density and Saturation Flats and Parcels are required to be sequenced in delivery order (or to be addressed using sequenced detached address labels), allowing the Postal Service to deliver them more efficiently. The product is reasonably and fairly priced for the value its customers receive; it bears a fair share of the institutional cost burden of the Postal Service; and is available to business customers without undue discrimination. Therefore, the Standard Mail High Density and Saturation Flats and Parcels product promotes the policy goals of title 39.

**3) Carrier Route (Letters, Flats and Parcels)**

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

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

Carrier Route mail pieces are eligible for dropshipping discounts. Mailers who do this extra work pay lower prices consistent with the costs their worksharing avoids for the Postal Service. Based on FY 2010 avoided cost data, the passthroughs of the dropship avoided costs for Carrier Route mail pieces were all below 100 percent. Prior to Docket No. RM2009-3 the Commission had determined that there was a worksharing relationship between Carrier Route mail and High Density mail and, therefore, the pricing restrictions of section 3622(e) apply to the price differences between these categories. A more detailed discussion of worksharing in Standard Mail and the Commission's determinations in Docket No. RM2009-3 is contained in Section II.F of this report.

In FY 2010 the prices for Standard Mail Carrier Route pieces were unchanged Table 2 shows that, based upon FY 2010 costs, the Carrier Route Letters, Flats, and Parcels product covered its attributable costs with a cost coverage of 142.5 percent. This cost coverage shows that the Carrier Route product made a reasonable contribution toward the Postal Service's institutional costs.

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

**4) Letters**

The Standard Mail Letters product is used primarily for demographically targeted advertising, including fundraising by nonprofit organizations. It provides a way for businesses to communicate with customers, or potential customers, that does not require the most expeditious, and therefore, more expensive, mail processing and delivery. Consistent with these features, its prices are below the prices for First-Class Mail letters. Prices for Standard Mail Letters were unchanged in FY 2010.

Based upon FY 2010 costs, the Letters product covered its attributable costs with a coverage of 180.3 percent thereby making a reasonable contribution toward the Postal Service's institutional costs.

Standard Mail Letters are eligible for price discounts for presorting, prebarcoding and dropshipping. Mailers who do this extra work pay lower prices consistent with the costs their worksharing avoids for the Postal Service. Based on FY 2010 cost data, there are three discounts that exceed avoided costs out of a total of nine worksharing discounts for this product. Worksharing in Standard Mail is discussed further in Section II.F of this report.

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

**5) Flats**

The Standard Mail Flats product consists primarily of advertising flyers and catalogs that are demographically targeted. It is primarily used by businesses selling merchandise and for fundraising by nonprofit organizations. Like Standard Mail Letters it allows businesses to send existing or potential customers promotional material that does not require the most expeditious, and therefore, more expensive, mail processing and delivery. Consistent with these features, Standard Mail Flats prices are below the prices for First-Class Mail flats. In FY 2010 the prices for Standard Mail Flats did not change.

Table 2 shows that the Flats product had a cost coverage of 81.6 percent in FY 2010. The Postal Service believes that pricing and efficiency measures need to be taken to ensure that this product covers its costs and makes an appropriate contribution toward institutional costs.[10] In the 2009 ACD, the Commission directed the Postal Service to present a plan describing how it intended to improve the cost coverage of this product.[11] The Postal Service presented its plans in its pricing statement in Docket No. R2010-4 and in its flats strategy, also filed in that docket.[12]

Standard Mail Flats are eligible for price discounts for presorting, prebarcoding and dropshipping. Mailers who do this extra work pay lower prices consistent with the costs their worksharing avoids for the Postal Service. In FY 2010 all discounts but four were less than or equal to their respective avoided costs. Worksharing in Standard Mail is discussed further in Section II.F of this report.

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

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[10] Incidentally, this product shares many of the same characteristics of Carrier Route. The combination of these two products would result in a coverage that is slightly higher than 100 percent.
[11] 2009 ACD at 86-87.
[12] Docket No. R2010-4, Statement of James M. Kiefer on Behalf of the United States Postal Service at 31-32; USPS-R2010-4/9 (July 6, 2010).

### 6) Parcels and Non-Flat Machinables (NFMs)

The Standard Mail Parcels and NFMs product consists of parcel-shaped pieces that do not meet the eligibility standards for letters or flats. It is primarily used by businesses fulfilling merchandise orders, for sending marketing materials that do not meet the size restrictions for letter- and flat-shaped, mail, and for fundraising by nonprofit organizations. Like other Standard Mail products, it provides an option for businesses to send customers merchandise and promotional material that do not require the most expeditious, and therefore more expensive, mail processing and delivery. Consistent with these features, Standard Mail Parcels and NFMs prices are below the prices for First-Class Mail and Priority Mail parcels. In FY 2010, the prices for this product did not change.

As seen in Table 2, the Parcels and NFMs product coverage was 77.2 percent in FY 2010. The Postal Service believes that pricing and efficiency measures need to be taken to ensure that this product covers its costs and makes an appropriate contribution toward institutional costs. In the 2009 ACD, the Commission directed the Postal Service to present a plan describing how it intended to improve the cost coverage of this product.[13] The Postal Service presented its plans in its pricing statement in Docket No. R2010-4.[14] Part of that plan included a request for price increases averaging more than 23 percent for this product, aimed at significantly improving overall cost coverage.

On August 16, 2010, the Postal Service filed a request to move a portion of the mail currently in this product from the market dominant products list to the competitive

[13] 2009 ACD at 87.
[14] Docket No. R2010-4, Statement of James M. Kiefer on Behalf of the United States Postal Service at 31-32.

products list.[15] The Postal Service believes that these mail pieces, which are used predominantly for mail-order fulfillment already compete in the parcel shipping marketplace and so are rightly classified as competitive products. The remainder of the mail pieces in the Standard Mail Parcels and NFMs product are primarily used for marketing purposes and would remain on the market dominant list under the designation Marketing Parcels.[16] The Commission is currently considering this request.

Like other Standard Mail products, Parcels and NFMs are eligible for price discounts for presorting, prebarcoding, and dropshipping. Mailers who undertake this extra work pay lower prices consistent with the costs their worksharing avoids for the Postal Service. In FY 2010 all discounts but five were less than or equal to their respective avoided costs. Worksharing in Standard Mail is discussed further in Section II.F.

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

**b. Standard Mail Incentive Programs**

*Saturation Mail Incentive Program*: The Saturation Mail Incentive Program began with the price change on May 11, 2009, and ended on May 10, 2010. A total of 540 customers registered for the program, of which 348 qualified and remained in the program. Of those mailers remaining in the program, 178 earned rebates. These

[15] Docket No. MC2010-36
[16] The Marketing Parcels products would also include all parcels sent at nonprofit prices.

customers sent nearly 1.9 billion pieces (about 25 percent over their aggregate threshold), and earned rebates totaling $15.4 million on total postage of $300 million. The Postal Service estimates that the program generated over 350 million new pieces of Saturation mail, and produced about $18 million in new contribution.

*Standard Mail Volume Incentive Pricing Program*: The second Standard Mail Volume Incentive Pricing Program (the "Summer Sale 2010") ran between June 1 and October 31, 2010. As the data collection report (filed contemporaneously with this report) shows, over 1,132 million pieces over volume thresholds were mailed by 270 customers, earning rebates of $69.3 million.

### 3. PERIODICALS

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

The Postal Service did not increase Periodicals prices in 2010, in line with the commitment not to raise market dominant product prices during the year. However, due to further deterioration in its financial situation as a result of the extraordinary and exceptional impact of the recession, the Postal Service filed an exigent price change request for market dominant products on July 6, 2010, with the Commission.[17] The Postal Service's request included a proposed price increase of 8 percent on average for Periodicals to improve the Periodicals Class cost coverage in response to the concerns expressed by the Commission in its 2009 Annual Compliance Determination (ACD). However, on September 30, 2010, the Commission denied this exigent price change request.

Periodicals Mail has not been covering its attributable costs, and the cost coverage declined slightly in FY 2010. This continues to present a challenge to the Postal Service and mailers, since the Periodicals class does not satisfy section 3622(c)(2) of title 39, and publishers' margins are typically very low. In addition, the industry itself is facing challenges such as electronic alternatives, the high costs of paper and other non-postal costs, and a substantial decline in advertising during the economic downturn.

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

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

| Product | Volume (Million) | Revenue ($Million) | Attribu-table Costs ($Million) | Contri-bution ($Million) | Revenue / Piece ($) | Cost / Piece ($) | Unit Contri-bution ($) | Cost Cover-age (%) |
|---|---|---|---|---|---|---|---|---|
| Within County Periodicals | 695 | 73 | 98 | (25) | 0.105 | 0.142 | (0.036) | 74.2 |
| Outside County Periodicals | 6,574 | 1,793 | 2,391 | (598) | 0.273 | 0.364 | (0.091) | 75.0 |
| Fees | | 12 | - | - | - | - | - | - |
| Total Periodicals Mail (incl.fees) | 7,269 | 1,879 | 2,490 | (611) | 0.258 | 0.343 | (0.084) | 75.5 |

[17] Exigent Request, 2010. Docket No. R-2010/4.

#### a. Periodicals Products

The Periodicals Mail class has two products: Within County Periodicals and Outside County Periodicals. Table 3 shows that neither product covered its attributable costs in FY 2010. The total Periodicals' coverage was 75.5 percent. As discussed above, efforts are underway to determine what steps can be taken to improve Periodicals' contribution. Although Periodicals is challenged in terms of cost coverage, its important role in allowing for dissemination of educational, cultural, scientific, and information value to the recipient of mail matter is vital, and promotes the public policies of title 39.

#### b. Within County Periodicals

Within County prices are available for Periodicals that are entered in the county where they are published for delivery within that county. Other detailed requirements apply. Within County Periodicals prices are lower than Outside County prices, and in FY 2010 the Within County cost coverage was a little bit lower than that of Outside County. As shown in Table 3, Within County Periodicals' cost coverage was 74.2 percent in FY 2010. A PRC-approved methodology change regarding volume measurement contributed to this decline in the measured cost coverage.

#### c. Outside County Periodicals

Periodicals Mail that is not eligible for Within County Periodicals prices must pay Outside County prices. Certain categories, such as Nonprofit, Classroom, or Science of Agriculture publications, are separately authorized to qualify for Periodicals prices. There are other special provisions, including a discount for certain Outside

County periodicals of limited circulation, which reflect the societal benefit of information dissemination.

As shown in Table 3, Outside County Periodicals’ cost coverage was 75.0 percent in FY 2010.

### 4. PACKAGE SERVICES

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

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

Package Services prices did not change in 2010. As shown below in Table 4, the Package Services class failed to cover its attributable costs in FY 2010. The cost coverage for the domestic products in the class as a whole was 89.3 percent.

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

| Product | Volume (Million) | Revenue ($Million) | Attribu-table Costs ($Million) | Contri-bution ($Million) | Revenue / Piece ($) | Cost / Piece ($) | Unit Contri-bution ($) | Cost Cove rage (%) |
|---|---|---|---|---|---|---|---|---|
| Single-Piece Parcel Post | 61 | 615 | 749 | (134) | 10.014 | 12.199 | (2.185) | 82.1 |
| Bound Printed Matter Flats | 230 | 190 | 129 | 61 | 0.829 | 0.563 | 0.266 | 147.2 |
| Bound Printed Matter Parcels | 245 | 322 | 349 | (28) | 1.314 | 1.428 | (0.114) | 92.1 |
| Media Mail/Library Mail | 122 | 369 | 459 | (90) | 3.015 | 3.751 | (0.736) | 80.4 |
| Fees | | 3 | | | | | | |
| Inbound Surface Parcel Post | 1.1 | 17.0 | 11.5 | 5.6 | 15.640 | 10.525 | 5.114 | 148.6 |
| Total Package Services Mail (incl. fees)[18] | 659 | 1,515 | 1,698 | (185) | 2.299 | 2.576 | (0.281) | 89.3 |

### i. Package Service Products

The Package Services mail class has five products: Single-Piece Parcel Post; Bound Printed Matter Flats; Bound Printed Matter Parcels; Media Mail/Library Mail; and Inbound Surface Parcel Post (at UPU rates). Three of the four domestic products (Single-Piece Parcel Post, BPM Parcels and Media Mail) had cost coverages below 100 percent, leading Package Services to fail to cover its attributable costs. Among the domestic products, only BPM Flats covered its costs. The Postal Service is concerned about the financial condition of these products, and will consider several options to remedy the situation.

### b. Single-Piece Parcel Post

[18] Totals are calculated from unrounded numbers and then rounded. This is why the rounded totals do not always equal the rounded the subtotals in Table 4.

Any mailable matter that is not required to be sent using First-Class Mail, or to be entered as Periodicals, can be sent using Single-Piece Parcel Post. This product meets the needs of businesses and households for a lower cost way to ship parcels that do not require the most expeditious, and therefore more expensive, mail processing, transportation, and delivery. Consistent with this lower value of service, the prices for Single-Piece Parcel Post are below the prices for retail Priority Mail. Table 4 shows that Single Piece Parcel Post had a cost coverage of 82.1 percent in FY 2010. The Postal Service believes pricing and product actions need to be taken to improve Single-Piece Parcel Post's cost coverage. In Docket No. R2010-4, the Postal Service proposed an increase of 7 percent to move Single-Piece Parcel Post closer to covering its costs. Projections presented in that docket indicated that with expected cost improvements, this increase would have been sufficient to cover the product's attributable costs, assuming a full year of implementation of the higher prices.

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

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

### c. Bound Printed Matter Flats

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

The BPM Flats product meets the needs of businesses seeking to send customers promotional material that does not require the most expeditious mail processing and delivery. This allows the Postal Service to reduce its costs compared to products like Priority Mail. Consistent with these lower costs, BPM Flats prices are lower than the prices for similarly-shaped Priority Mail. Mailers can lower their cost of mailing even further by dropshipping, presorting, or prebarcoding. Mailers who do this extra work pay lower prices consistent with the costs their worksharing avoids for the Postal Service. In FY 2010, the passthroughs of the worksharing avoided costs for BPM Flats mail pieces are all at or below 100 percent, with two exceptions (the DBMC discount and the DDU discount). Worksharing in BPM Flats is discussed further in Section II.F. The BPM Flats rate design is more complex than that of Media Mail or Single Piece Parcel Post, but it is a business product and its users are overwhelmingly sophisticated commercial mailers for whom the complexity of the pricing schedules should pose no problems.

BPM flats prices did not change in FY 2010. Table 4 shows BPM Flats covered its attributable costs with a cost coverage of 147.2 percent in FY 2010. This cost coverage shows that BPM Flats made a reasonable contribution toward the Postal Service's institutional costs.

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

#### d. Bound Printed Matter Parcels

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

The BPM Parcels product mainly meets the needs of businesses seeking to fulfill customer orders for books and large catalogs that do not require the most expeditious mail processing, transportation, and delivery. This lower level of service allows the Postal Service to reduce its costs compared to products like Priority Mail. Consistent with its lower costs and value, BPM Parcels prices are lower than the prices for similarly-shaped Priority Mail. Mailers can lower their cost of mailing even further by dropshipping, presorting, or prebarcoding. Mailers who do this extra work pay lower prices consistent with the costs their worksharing avoids for the Postal Service. In FY 2010, the passthroughs of the worksharing avoided costs for BPM Parcels mail pieces are all at or below 100 percent (with the exceptions of the DBMC discount and DDU discount). Worksharing in BPM Parcels is discussed further in Section II.F. The BPM Parcels price design is more complex than that of Media Mail or Single Piece Parcel Post, but it is a business product and its users are overwhelmingly sophisticated commercial mailers for whom the complexity of the pricing schedules should pose no problems.

The prices for BPM Parcels did not change in FY 2010. Table 4 shows that BPM Parcels had a coverage of 92.1 percent in FY 2010. The Postal Service believes pricing and product actions need to be taken to improve BPM Parcels' cost coverage. In Docket No. R2010-4, the Postal Service proposed an increase of 7 percent to move BPM Parcels closer to covering its costs. Projections presented in that docket indicated that with expected cost improvements, this increase would have been sufficient to cover the product's attributable costs, assuming a full year of implementation at the higher prices.

The BPM Parcels product helps to meet the need for a business-oriented, lower value, lower priced alternative to Priority Mail to send books and large catalogs that cannot be sent using Standard Mail or BPM Flats products. The BPM Parcels product is reasonably and fairly priced for the value its customers receive, and is available to business customers without undue discrimination. Therefore, BPM Parcels product promotes the policy goals of title 39.

### e. Media Mail / Library Mail

Media Mail / Library Mail is a content-restricted product. By law, its content is restricted to books, noncommercial films, computer-readable media, and similar media items that typically have educational, cultural, scientific or informational value. Media Mail items cannot contain advertising, other than incidental announcements of books. This product is used by businesses and by the general public to send books and eligible media or other permitted items either for business, or for personal, educational, or literary purposes. Library Mail is a preferred-price category in this product. Libraries, educational institutions and certain other nonprofit organizations use Library Mail to send eligible items to their customers.[19] By law, Media Mail / Library Mail prices are unzoned and do not vary by distance.

Media Mail / Library Mail meets the needs of businesses, households, and eligible organizations for a low cost way to ship eligible materials that do not require the most expeditious, and therefore more expensive, mail processing and delivery. Consistent with this lower value of service, the prices for this product are below the prices for retail Priority Mail and Single Piece Parcel Post. The prices for Media Mail / Library Mail did not change in FY 2010. Table 4 shows that Media Mail/Library Mail's coverage was 80.4 percent in FY 2010.

Media Mail / Library Mail have simple price structure. Within each pricing category, the prices vary only by weight. The product has two worksharing pricing categories to meet the needs of business mailers, in addition to its single piece category that is used by both businesses and consumers. Media Mail / Library Mail users are

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

eligible for price discounts for presorting and prebarcoding. Mailers who do this extra work pay lower prices. The discounts for basic presorting and for prebarcoding are consistent with the costs their worksharing avoids for the Postal Service. In FY 2010 the passthroughs of the worksharing avoided costs for 5-digit presorting exceeded the 100 percent passthrough limit. Worksharing in Media Mail / Library Mail is discussed further in Section II.F of this report.

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

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

#### f. Inbound Surface Parcel Post (at UPU rates)

The Inbound Surface Parcel Post inward land rate (ILR) is priced by the UPU Postal Operations Council, which annually calculates the ILR according to cost-inflation (CPI-U) and USPS provision of value-added services, which include track and trace, home delivery, published service standards, liability acceptance, and availability of an internet-based inquiry system. The product's FY 2010 cost coverage was 148.6 percent. The ILR for this product will increase January 1, 2011.

## 5. SPECIAL SERVICES

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

| Product | Volume (Million) | Revenue ($Million) | Attributable Costs ($Million) | Contribution ($Million) | Revenue / Piece ($) | Cost / Piece ($) | Unit Contribution ($) | Cost Coverage |
|---|---|---|---|---|---|---|---|---|
| Caller Service | N/A | 93.9 | 30.6 | 63.3 | N/A | N/A | N/A | 306.7% |
| Certified Mail | 269.0 | 752.4 | 634.7 | 117.7 | 2.80 | 2.36 | 0.44 | 118.6% |
| COD | 0.8 | 6.5 | 8.2 | -1.7 | 7.82 | 9.88 | -2.07 | 79.1% |
| Insurance | 39.1 | 125.6 | 98.6 | 26.9 | 3.21 | 2.52 | 0.69 | 127.3% |
| Registered Mail | 3.0 | 47.8 | 42.6 | 5.2 | 16.11 | 14.35 | 1.77 | 112.3% |
| Stamped Envelopes | N/A | 16.1 | 2.2 | 13.9 | N/A | N/A | N/A | 744.9% |
| Stamped Cards | 29.3 | 0.9 | 0.6 | 0.3 | 0.03 | 0.02 | 0.01 | 139.3% |
| Other Ancillary Services | N/A | 1213.9 | 575.5 | 638.4 | N/A | N/A | N/A | 210.9% |
| Total Ancillary Services | N/A | 2,257.1 | 1,393.0 | 864.1 | N/A | N/A | N/A | 162.0% |
| Int'l Ancillary Services | 2.4 | 28.8 | 27.4 | 1.4 | 12.12 | 11.51 | 0 | 105.3% |
| Address Management Services | N/A | 85.8 | 21.8 | 64.0 | N/A | N/A | N/A | 393.3% |
| Change of Address Credit Card Authentication | 11.4 | 11.2 | 1.4 | N/A | 1.0 | 0.12 | N/A | N/A |
| Confirm | N/A | 2.7 | 1.1 | 1.6 | N/A | N/A | N/A | 244.2% |
| Int'l Reply Coupon Service | N/A | 0.0 | N/A | N/A | N/A | N/A | N/A | N/A |
| Int'l Business Reply Mail Service | 0.4 | 0.5 | N/A | N/A | 1.45 | N/A | N/A | N/A |
| Money Orders | 123.2 | 139.1 | 126.4 | 12.7 | 1.13 | 1.03 | 0.10 | 110.1% |
| Post Office Box Services | N/A | 813.2 | 675.5 | 137.7. | N/A | N/A | N/A | 120.4% |
| Total Special Services Mail | N/A | 3,325.4 | 2,227.9 | 1,097.5 | N/A | N/A | N/A | 149.3% |

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

**a. Ancillary Services**

The Ancillary Services are those Special Services that may only be used in conjunction with another product. Some of the services are quite small, whereas others such as Certified Mail contributed $752.4 million in revenue. Total revenues for all Ancillary Services in FY 2010 were $2.3 billion.

**b. International Ancillary Services**

International Ancillary Services generated $28.8 million in revenue in FY 2010 with a cost coverage of 105.3%.

**c. Address Management Services**

The Postal Service provides address management services to decrease the amount of undeliverable mail and to help mailers enter mail that has better address hygiene. Total revenue for Address Management Services was $88.5 million.

**d. Caller Service**

Caller Service includes revenues from both Caller Service and Reserve Number products. Caller Service allows business customers to pick up their box mail at a Post

Office call window or loading dock when the office is open.  Caller Service customers may choose when to pick up their mail and, accordingly, can have increased access to their mail even if the box section is not open.

Reserve Numbers allow a company to reserve a box number for future Caller Service use.  Caller Service and Reserve Number revenues were $93.9 million in FY 2010.

**e. Change-of-Address Credit Card Authentication**

To ensure that Change of Address Requests made either over the phone or via the Internet are valid, the Postal Service charges a fee of $1 to a credit card to ensure that the address for which the change is requested matches the address on the credit card used to pay the $1 fee.  In FY 2010, customers paid $2.7 million, but the Postal Service accrued only a portion of that revenue, since some of it is retained by the Credit Card vendors for administering this service.

**f. Confirm**

Confirm allows business subscribers to monitor specifically barcoded letters and flats as they are processed.  Confirm service generated $2.7 million in revenue in FY 2010.

**g. International Reply Coupon Service**

International Reply Coupon Service generated $67 in revenue in FY 2010.  The ICRA does not report costs for this service.

**h. International Business Reply Mail Service**

International Business Reply Mail Service generated $0.5 million in revenue in FY 2010.  The ICRA does not report costs for this service.

#### i. Money Orders

The three types of Postal Service Money Orders (APO/FPO, up to $500 and over $500) generated a combined $139.1 million in revenue in FY 2010.

#### j. Post Office Box Service

Post Office Box Service includes revenues from Post Office Box Rentals. Post Office Boxes are available in 5 different rental sizes and have seven different fee groups. Box rentals accounted for $813.2 million in revenues in FY 2010.

During FY 2010, the Postal Service received permission to move PO Boxes at 49 locations from Market Dominant to Competitive. This permission was granted in Order No. 473 in Docket MC2010-20 released on June 17, 2010. Only PO Boxes for rent in sizes 1-5 from these locations were moved from Market Dominant to Competitive. E-Boxes, Caller Service, and Reserve Number at these 49 locations continue to be Market Dominant. On June 17, 2010, there were approximately 32,000 rented boxes at these locations with approximately $3.8 million in annual revenue. This represents approximately 0.25 percent of total number of rented PO Boxes and 0.46 percent of the total FY 2010 revenue.

### 6. Negotiated Service Agreements

The Postal Service had two domestic market dominant Negotiated Service Agreements (NSAs) that were in effect during FY 2010, with Bradford Group and Lifeline Screening. Both domestic customers qualified for discounts. Details are provided in USPS-FY10-30. The two other market dominant agreements in effect during FY 2010 consisted of the bilateral agreements with Canada Post Corporation for inbound letter post.[20]

The domestic NSAs in effect in FY 2010 were intended to improve the net financial position of the Postal Service by driving the growth of profitable volume (and thus increasing overall contribution to institutional costs). By providing discounts on incremental pieces above a threshold, these NSAs encouraged customers to mail more pieces than they otherwise would have. Because those pieces still provided additional contribution to institutional costs, even after discounts were included, the NSAs contributed to the improvement of the net financial position of the Postal Service. The data in USPS-FY10-30 show that the amount of rebates paid pursuant to the NSAs in the contract years ending in FY 2010 was $138,756. Using the valuation method traditionally employed by the Postal Service, the calculations in USPS-FY10-30 show a cumulative net benefit (after rebates are deducted) of $46,405. Using the Panzar/Wolak approach employed by the Commission, however, the cumulative net effect was negative $7,319. Either way, the cumulative net effect of the NSAs was not sufficient to materially alter the reported overall contribution or cost coverage for Standard Mail.

The Postal Service has no reason to believe that none of these NSAs caused unreasonable harm in the marketplace. The scale of the domestic agreements was sufficiently small to make market effects unlikely, and similar functionally-equivalent NSAs were, or could have been, made available to similarly-situated mailers. The Canada Post Corporation agreements will not cause unreasonable harm to the

[20] *See supra* footnote 8.

marketplace, and there are no similarly-situated mailers with respect to inbound letter post from Canada under comparable operating conditions.[21]

### F. Workshare Discounts

With respect to each market dominant product for which a workshare discount was in effect during the reporting year, section 3652(b) of the PAEA requires that the Postal Service provide:

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

The data for workshare discounts can be found in USPS-FY10-3.[22] In that document, the workshare discounts are shown as the difference between the current prices of the workshared piece and a benchmark piece. Passthroughs are calculated for each discount as the ratio of the discount to the avoided cost. Per-item unit contribution is addressed at the product level in the CRA, reflecting data availability at this time.

The analyses presented in USPS-FY10-3 show the required information for workshare discounts. They do not analyze non-workshare price differences.

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[21] Commission Order No. 375, Order Concerning Bilateral Agreement with Canada Post for Inbound Market Dominant Services, December 30, 2009, at 8-9; Request of United States Postal Service to Add Canada Post – United States Postal Service Contractual Bilateral Agreement for Inbound Market Dominant Services to the Market Dominant Product List, Notice of Type 2 Rate Adjustment, and Notice of Filing Agreement (Under Seal), Docket Nos. MC2010-12 and R2010-2, November 19, 2009, at 6-7; Commission Order No. 163, Order Concerning Bilateral Agreement with Canada Post for Inbound Market Dominant Services, December 31, 2008, at 9-10.

[22] USPS-FY10-3 cites to the applicable cost studies that have also been filed.

Order No. 536

On September 14, 2010, the Commission issued Order No. 536 containing its decision in rulemaking Docket No. RM2009-3. The Order attempted to resolve some disputed interpretations of the worksharing provisions of the PAEA and provided direction for the implementation of those provisions. The Order most significantly impacted the way presort discounts are to be set for First-Class Mail presorted letters and for Carrier Route, High Density and Saturation Standard Mail. The Postal Service has petitioned the court of appeals to review aspects of Order No. 536, and nothing in this report is intended to waive any of the Postal Service's arguments to the court.

For First-Class Mail presorted letters and cards, Order No. 536 determined that a worksharing relationship existed between single-piece mail and presorted mail, but also determined that the former single-piece benchmark, Bulk Metered Mail, was obsolete and should no longer be used. Pending the selection of a more appropriate benchmark in follow-on Docket No. RM2010-13, presorted First-Class Mail prices need not be adjusted to ensure that the pricing of presort mail relative to single-piece mail complies with the provisions of section 3622(e).

The Commission also left in place its prior determination (disputed by the Postal Service and some other mailers) that High Density Standard Mail had a worksharing relationship with Carrier Route Standard Mail. On the other hand, the Commission determined that Saturation Standard Mail and High Density mail had no worksharing relationship. Consequently, the Standard Mail worksharing tables present avoided costs, discounts and passthroughs between the High Density and Carrier Route categories, but no longer between the High Density and Saturation categories.

In the analyses presented in USPS-FY10-3 the Postal Service used the Commission's accepted methodologies, as modified in Order No. 536.

In evaluating passthroughs for the 2010 ACR, the Postal Service notes that changes in costs between FY 2009 and FY 2010 result in some passthroughs increasing and some decreasing. In fact, some discounts now have passthroughs below 100 percent whereas the passthroughs for the same discounts estimated in the 2009 ACR were at or above 100 percent, and some discounts now have passthroughs greater than 100 percent, when they formerly were below. Overall, any evaluation of the statutory appropriateness of passthroughs needs to be made in the context not only of the calculated cost avoidance, but also considering all of the statutory criteria, such as the objective that prices be predictable and stable. An increase or decrease in a passthrough based on the cost avoidance calculated for a given Fiscal Year does not in itself trigger the requirement for an immediate price change. Rather, it is an indication that a specific discount / cost avoidance relationship needs to be fully re-evaluated in the context of all of the statutory criteria, as well as pending price adjustments. This re-evaluation will be undertaken by the Postal Service when it prepares its next price adjustment, and will then be reviewed by the Commission. This is consistent with the fact that section 3622(e) must, for reasons discussed previously by the Postal Service in its response to CIR No. 1 in Docket No. R2008-1, be applied over the long-term, as a principle that should guide pricing over a series of price adjustments. This comprehensive, long-term approach is especially critical given the fragility of the current business environment and the desirability of maintaining and encouraging mail usage.

### 1. FIRST-CLASS MAIL

#### a. Single-Piece Letters / Postcards

The First-Class Mail Single-Piece Letters and Cards product has just one worksharing discount, which is applicable to both Qualified Business Reply Mail (QBRM) Letters and QBRM Cards. The calculated passthrough in this report is 176.9 percent because of a significant reduction in avoided cost from 2.5 cents to 1.3 cents. In future rate adjustments the Postal Service will be mindful of the direction of this cost avoidance. In Docket No. R2009-2, the Postal Service passed through 100 percent of the avoided costs for both QBRM Letters and Cards.

#### b. Presorted Letters / Cards

This passthrough for Mixed AADC Automation Letters in relation to cost avoidance based on the Bulk Meter Mail benchmark is not applicable in this section in light of Order No. 356 (Order Adopting Analytical Principles Regarding Workshare Discount Methodology – September 14, 2010). In this order the Commission reaffirmed its belief that there is a worksharing relationship between single-piece letters and presort letters but the Bulk Meter Mail (BMM) benchmark is no longer valid. Until the resolution of Docket No. RM 2010-13 (establishing new benchmarks for workshared mail), BMM will not be used as the benchmark for estimating cost avoidances and discounts to derive Mixed AADC Automation Letter prices. Although the cost avoidance, discount, and passthrough for Mixed AADC Automation Letters is calculated, it is no longer a meaningful calculation in light of the above order.

Out of eight (BMM to Mixed AADC Automation Letters passthrough is shown but is no longer relevant based on above discussion) passthroughs in “FCM Bulk Letters and Cards,” only one exceeds 100 percent.

The passthrough for 3-Digit Automation Cards is 200 percent of avoided cost. This is because the cost avoidance for 3-Digit Automation Cards compared to AADC Automation Cards changed from 0.16 cents to 0.13 cents in FY2009, and has increased to 0.146 cents in the current filing. Since bulk mail prices are rounded to a tenth of a cent, the rounded amount declined from 0.2 cents to 0.1 cents, literally doubling the passthrough. Thus, a small reduction in cost avoidance between the FY 2008 and FY 2009 estimates cause this passthrough to double from 100 percent to 200 percent. In Docket No. R2009-2 the Postal Service estimated this passthrough to be 100 percent. The Commission’s review supported this assertion.

**c. Flats**

First-Class Mail Automation Flats passthroughs for ADC Automation Flats, 3-Digit Automation Flats, and 5-Digit Automation Flats, were 270.6 percent, 95.7 percent and 96.1 percent, respectively as reported in the Annual Compliance determination of 2009 (page 70, Table VII-2). The latest shrinkage in cost avoidances for the ADC and 3-Digit Automation Flats caused the first two passthroughs to increase to 277.3 and 108.9 percent, respectively. The cost avoidance for 5-Digit Automation Flats increased from 16.9 cents to 17.4 cents causing the 96.1 percent passthrough reported in ACD 2009 to 93.1 percent in the current filing. The change in cost methodology in Docket No. RM2008-2, Proposal 8 caused a significant shift in cost avoidances. The Postal Service will be mindful of these excessive passthroughs in future filings balancing it with other ratemaking considerations

#### d. Parcels

The resulting passthroughs within this product are 37.6 percent and 93 percent for 3-Digit and 5-Digit Presort Parcels, respectively. They are both lower than 100 percent, as they were in the ACD 2009 and Docket No. R2009-2. Given that First-Class Mail parcels' cost coverage is just below 100 percent, higher passthroughs for this product are not necessary or desirable at the present time.

### 2. STANDARD MAIL

#### a. Letters

Three passthroughs within this product exceed 100 percent: (1) the presort discount for automation AADC letters compared to automation mixed AADC letters, (2) the presort discount for nonautomation 3-digit nonmachinable letters compared to nonautomation ADC nonmachinable letters, and (3) the presort discount between nonautomation 5-digit nonmachinable letters and nonautomation 3-digit nonmachinable letters. In Docket No. R2009-2, the passthrough of the presort discount for automation AADC letters equaled 100 percent. The increase in the passthrough is due to lower avoided costs between FY 2009 and FY 2010. The new costs will be considered in the next general price change and the Postal Service expects that the discounts will be adjusted to be no higher than their respective avoided costs. In the 2009 ACR, the passthroughs of the presort discounts for nonautomation 3-digit nonmachinable letters and nonautomation 5-digit nonmachinable letters exceeded 100 percent. In the 2009 ACD, the Commission directed the Postal Service to align the discounts with avoided costs when it files its next general market dominant price adjustment. The Postal Service expects to make these adjustments in the next general price change.

### b. Flats

Four passthroughs within this product exceed 100 percent: (1) the presort discount between automation ADC flats and automation mixed ADC flats, (2) the presort discount between automation 3-digit flats and automation ADC flats, (3) the pre-barcoding discount between automation mixed ADC flats and nonautomation mixed ADC flats, and (4) the presort discount between nonautomation 5-digit flats and nonautomation 3-digit flats. In the 2009 ACR, the three presort discounts all had passthroughs that exceeded 100 percent. In the 2009 ACD, the Commission directed the Postal Service to align the discounts with avoided costs when it files its next general market dominant price adjustment. The Postal Service expects to adjust the presort discounts for automation 3-digit flats and nonautomation 5-digit flats in the next general price change to no more than their respective avoided costs.

In the 2009 ACR, the avoided cost for automation ADC flats compared to automation Mixed ADC flats rounded to zero. In FY 2010, the avoided costs declined further to a negative 0.2 cents per piece, indicating that the cost for ADC presorted flats was higher than the cost for Mixed ADC, essentially unpresorted, flats. The Postal Service finds this avoided cost data to be anomalous and does not believe that it can be reasonably used in pricing automation flats. To respond to this anomalous cost difference by setting the price for ADC flats above the price for Mixed ADC flats would send an inefficient signal to mailers that they should forego ADC presorting and instead tender unpresorted automation flats to the Postal Service. The Postal Service believes that this would lead to more inefficient operations and so justifies the current discount of 1.0 cent, pending resolution of the cost difference anomaly, using exception 3622(e)(2)(D).

In ACR 2009, the pre-barcoding discount had a passthrough of 200 percent. The Postal Service justified this passthrough under section 3622(e)(2)(D) of title 39. The excessive discount is necessary to encourage pre-barcoding of flats as a way to support the implementation of the Flats Sequencing System program. The Commission accepted the Postal Service's justification. A decrease in the avoided costs between FY 2009 and FY 2010 has increased the passthrough from 200 percent to 248 percent.

The Postal Service believes that it is still necessary to encourage as many flats as possible to be prebarcoded to ensure a successful implementation of the FSS program. Nevertheless, the Postal Service does not believe that a permanent extra incentive will be required to make the FSS program successful, and that it should be possible to gradually eliminate the excess incentive as the FSS program implementation unfolds. Therefore, while justifying the need for a temporary extra barcoding incentive as needed to not impede the efficient operation of the Postal Service, the Postal Service intends in its next general price change to move toward reducing the discount and its passthrough with the intent of eventually eliminating the added incentive. Until full elimination is possible, the Postal Service continues to justify the extra incentive under 3622(e)(2)(D).

### c. Parcels and NFMs

Five worksharing discounts for Standard Mail Parcels and NFMs exceed a 100 percent passthrough. These are the presort discounts between (1) NDC machinable parcels and mixed NDC machinable parcels, (2) NDC irregular parcels and mixed NDC irregular parcels, (3) SCF irregular parcels and NDC irregular parcels, (4) NDC NFMs and mixed NDC NFMs, and (5) SCF NFMs and NDC NFMs.

In FY 2010 the Commission approved the use of a new cost model for Standard Mail NFMs and Parcels. This new model has resulted in significant changes in the avoided cost estimates for NFMs and Parcels worksharing and has produced numerous instances where the current discounts exceed 100 percent of avoided costs, in some instances, significantly so. The presort discounts for NDC machinable parcels (compared to Mixed NDC machinable parcels), for NDC irregular parcels (compared to Mixed NDC irregular parcels), for SCF irregular parcels (compared to NDC irregular parcels), for NDC NFMs (compared to Mixed NDC NFMs), for SCF NFMs (compared to NDC NFMs) all exceed the newly developed estimates of avoided costs. The Postal Service does not intend to maintain these presort discounts permanently above avoided costs, although the large changes required to adjust some of the current discounts down to the new avoided costs may require a transition period to avoid rate shock. Nevertheless, the Postal Service will attempt to reduce or eliminate the excess discounts in the next general price change where it can do so without running the risk of rate shock. If rate shock appears to be a risk, the Postal Service would justify the excess passthroughs under 3622(e)(2)(B).

The Standard Mail NFMs and Parcels cost model does not estimate costs separately for pre-barcoded and non-barcoded Standard Mail NFMs and Parcels. The model does have an estimate of barcoding savings, but as in the past, that estimate is based on data from the 2008 BPM Parcels model. Based on the estimates developed from BPM Parcels barcoded savings data, the passthrough for the current non-barcoding surcharge is 178 percent. As discussed in the 2009 ACD, the Postal Service justifies the size of this surcharge under 3622(e)(2)(D) to promote a totally pre-barcoded incoming parcel mailstream which would allow elimination of keying stations at sorting facilities, and to facilitate implementation of electronic manifesting (a cost savings not incorporated in the barcoding savings estimate). In the 2009 ACD, the Commission found this surcharge to be justified at its present 7.0 cents. The Postal Service will re-examine this surcharge when it files for its next general price adjustment to determine whether some modification of the surcharge is warranted in light of the goals of the surcharge as well as the results of the new NFMs/Parcels cost model. At this time the Postal Service thinks it may be prudent to continue the surcharge at its current level, given the goals of the surcharge and the limited and indirect cost information used to develop the Standard Mail avoided costs under 3622(e)(2)(D).

#### d. High Density Parcels

The FY 2010 avoided costs between Carrier Route parcels and High Density parcels was a negative 13.0 cents per piece, meaning that cost estimate for High Density parcels was 13.0 cents higher than the corresponding cost estimate for Carrier Route parcels. The Postal Service finds this avoided cost data to be anomalous and does not believe that it can be reasonably used in pricing either Carrier Route or High Density parcels. High Density parcels are required to have a minimum density of 125 pieces per route, higher than the 10 piece minimum required for Carrier Route parcels. In addition, High Density parcels are required to be walk-sequenced, whereas Carrier Route parcels can be line of travel sequenced, a less-stringent sequencing requirement. For these reasons, the Postal Service expects that, all else being equal, it should be cheaper to process and deliver High Density parcels than Carrier Route parcels. The Postal Service believes that pricing High Density higher than Carrier Route parcels would send an inefficient signal to mailers to prepare and enter their parcels as line of travel sequenced Carrier Route parcels rather than as walk sequenced High Density parcels. Sending this signal to mailers solely on the basis of this anomalous cost data would lead to more inefficient operations and so the Postal Service justifies the current discount of 12.5 cents, pending resolution of the cost difference anomaly, using exception 3622(e)(2)(D).

### 3. PERIODICALS

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

**a. Outside County**

In the May 2009 price adjustment, five of the eighteen passthroughs listed as "presorting" were over 100 percent. Using the costs presented in this ACR, the number of passthroughs exceeding 100 percent remains the same.

For presorted flats there were two passthroughs that were slightly above 100 percent in the R2009-2 filing. Nonmachinable Nonautomation ADC Flats compared to Nonmachinable Nonautomation Mixed ADC Flats was 103.6 percent, while the passthrough for Nonmachinable Automation ADC Flats compared to Nonmachinable Automation Mixed ADC Flats was 105.6 percent. Given FY 2010 cost data, both of these passthroughs in the current filing are below 100 percent (73 percent and 58 percent, respectively). The passthrough for 3-digit sort compared to ADC sort for Nonmachinable Nonauto flats has gone up from 77.9 percent (R2009-2) to 134.5 percent in the current filing due to the updated cost studies. Similarly, for Nonmachinable Automation flats the 3-digit to ADC passthrough is 115.4 percent in the current filing compared to 92.3 percent in Docket No. R2009-2.

Passthroughs for Automation Letters are significantly above 100 percent; the impact in negligent given the volume is very small.

### b. Within County

The FY 2009 Within County cost avoidances are based on proxies from other classes of mail. While suitable for pricing purposes, these costs are not specific to Within County. All passthroughs are below 100 percent.

## 4. PACKAGE SERVICES

### a. Media Mail/Library Mail

The current 5-digit presort discounts for both Media Mail and Library Mail, exceed the FY 2010 estimated avoided costs. The Postal Service has been moving the passthroughs for these discounts closer to 100 percent for several years and expects to continue to move the discounts closer to avoided costs. In the meantime, the Postal Service justifies these discounts using 3622(e)(2)(C), since both Media Mail and Library Mail consist entirely of content having ECSI value.

### b. BPM Flats and BPM Parcel

The current DNDC drop ship discounts for BPM Flats and BPM Parcels and the current DDU drop ship discounts for BPM Flats and BPM Parcels all exceed the FY 2010 estimated avoided costs. The Postal Service does not intend to maintain permanently these discounts above their respective avoided costs. In its next general price adjustment, the Postal Service intends to adjust these discounts to no more than avoided costs, provided these adjustments can be made without undue risk of rate shock to the affected mail categories.

## III. Competitive Products

### A. Applicable Requirements of title 39

In its FY 2008 ACR, the Postal Service noted that the rates and fees in effect during the majority of FY 2008 were established using PRA procedures and applying PRA standards. By FY 2009, however, rates and fees in effect during the entire fiscal year had been established under PAEA procedures.[23] Therefore, whatever consideration of transitional issues regarding rate setting standards may have been appropriate in FY 2007 and FY 2008 are no longer necessary with respect to FY 2010.

### B. Product-by-Product Costs, Revenue, and Volume

For FY 2010, cost, revenues, and volumes for competitive products of general applicability are directly shown in the FY 2010 CRA (or ICRA). In the Public CRA (USPS-FY10-1), the total competitive products row shown in the FY 2008 CRA has been disaggregated (as it was in the FY 2009 CRA) into five groups – Total Express Mail, Total Priority Mail, Total Ground, Total International Competitive, and Competitive Services. The constituent products for each of those groups are listed in a table in the attached Application for Non-Public Treatment of the Non-Public Annex (Attachment Two). Those groups are further disaggregated in the Nonpublic CRA (USPS-FY10-NP11). For competitive products not of general applicability, available data on international customized mailing agreements (ICMs) for FY 2010 are presented in the ICRA materials within USPS-FY10-NP2. For domestic competitive products not of general applicability, information is provided in USPS-FY10-NP27.

[23] The only exceptions were a few carryover international rates.

### C. Section 3633 Standards

The competitive product pricing standards of section 3633 have been implemented by the Commission at 39 C.F.R. § 3015.7. This section discusses the available FY 2010 data with reference to those standards.

First, subsection 3633(a)(1) states that competitive products should not be cross-subsidized by market dominant products. The Commission's regulations define the most appropriate test for this standard as the incremental cost test for the aggregation of competitive products.[24] Simply stated, if the aggregate revenues from competitive products equal or exceed the aggregate incremental costs of competitive products, then competitive products overall are not being cross-subsidized by market dominant products. Before FY 2009, no such measure of incremental costs for competitive products was available. Under these circumstances, the regulations specify use of a proxy, consisting of competitive products' attributable costs, supplemented by any causally-related group-specific costs (for the group of competitive products).[25] Starting in FY 2008, the Postal Service has endeavored to identify causally-related group-specific costs for competitive products, presented this year in FY10-NP10.

Starting in FY 2009, the Postal Service also presented an estimate of the incremental costs for competitive products, albeit an incomplete one. It continues to provide such an estimate this year. As explained in the Petition for Proposal Twenty-Two (filed on Oct. 23, 2009), the Postal Service is presenting what can be termed a "hybrid" estimate of incremental costs, in which an estimate of the aggregate incremental costs of domestic competitive products (including group specific costs) is

[24] *See* 39 C.F.R. § 3015.7(a).
[25] *Id.*

added to the estimate of the attributable costs for international competitive products. The “hybrid” characterization reflects the blending of an actual estimate of domestic incremental costs with an attributable cost proxy for international incremental costs. The need for the “hybrid” approach is caused by the structure of the ICRA, which precludes direct application of the incremental cost model to international products. But, as demonstrated in Proposal Twenty-two, the “hybrid” estimate is nonetheless an improvement over the full proxy used before FY 2009 of attributable costs for both domestic and international competitive products, plus group specific costs. The “hybrid” approach provides stronger protection against cross-subsidy than the full proxy approach.

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

INCREMENTAL COST CALCULATION FOR TOTAL COMPETITIVE PRODUCTS

| | Attributable Cost (000s) | Group Specific (000s) | Incremental (000s) | Hybrid Incremental (000s) |
|---|---|---|---|---|
| Domestic Competitive | $ 5,277,773 | $ 39,027 | $ 5,406,826 | $ 5,406,826 |
| International Competitive | $ 979,112 | $ - | na | $ 979,112 |
| Total Competitive | $ 6,256,884 | $ 39,027 | na | $ 6,385,937 |

Source: USPS-FY10-NP10.

The total competitive hybrid incremental cost is $6,385,937 thousand, which is the sum of the hybrid incremental costs for domestic competitive mail and the hybrid incremental costs for international competitive. The Commission in the past used attributable cost plus group specific cost for the cross-subsidy test. That proxy would provide a cost floor of $6,295,911 thousand ($6,256,884 + $39,027). The hybrid provides a preferred cost floor because it includes at least some properly calculated incremental costs, and is a better approximation of the true incremental costs required for the test.[26]

The hybrid incremental costs of $6.386 billion are well below total competitive products revenue of $8.678 billion (shown on page 3 of USPS-FY10-1). Therefore, based on these estimates, it is clear that competitive products in FY 2010 were not cross-subsidized by market dominant products, and thus were in compliance with subsection 3633(a)(1).

Second, subsection 3633(a)(2) requires that each competitive product cover its attributable costs. Comparing the revenue of each competitive product shown in the Nonpublic CRA (USPS-FY10-NP11) with its attributable costs suggests that all of the competitive products are covering their attributable costs, with the exception of: Inbound International Expedited Services and Competitive International Insurance. The Postal Service furnishes the following comments on each such product:

| **Product** | **Comment** |
|---|---|
| Inbound International Expedited Services | All Inbound International Expedited Services (inbound EMS) is reported in aggregate. As per Docket No. CP2009-57, inbound EMS charges were raised in January 2010, and hence the price increase for CY 2010 would not be reflected in the first quarter of the postal fiscal year. Moreover, the Postal Service is again raising Inbound International Expedited Services 2 rates this coming January as per Docket No. CP2010-90. Further, estimates for the Inbound International Expedited Services 2 in Docket No. CP2010-90 were shown to |

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

| | |
|---|---|
| | satisfy the statutory pricing criteria for competitive products. It should be noted that the results are based on the booked revenue version of the ICRA.[27] |
| Competitive International Insurance | Insurance largely affected the performance of all competitive international ancillary services. The Postal Service notes that the price for competitive international insurance is scheduled to rise on January 2, 2011, as a result of the changes in Docket No. CP2011-26. The Postal Service is studying possible undercounting of insurance revenue, but is unable to offer a definitive explanation as to whether the revenue for insurance is understated at this time. |

Third, subsection 3633(a)(3) states that competitive products must collectively cover what the Commission determines to be an appropriate share of the Postal Service's institutional costs. In its regulations, the Commission has determined that an appropriate minimum share is 5.5 percent of total institutional costs.[28] Page 3 of USPS-FY10-1 shows total institutional costs of $34.006 billion. Applying the 5.5 percent to that figure yields a target contribution of $1.870 billion. To evaluate achievement relative to that target, we once again refer to page 3 of USPS-FY10-1, and subtract total competitive attributable costs of $6.257 billion from total competitive product revenue of $8.678 billion, leaving an aggregate competitive product contribution of $2.421 billion. The target is exceeded, and the requirement of subsection 3633(a)(3) has been met.

[27] We note that the imputed version of the ICRA shows better financial performance for Inbound International Expedited Services. Similar disparities between the booked and imputed versions for Inbound International Expedited Services also arose in last year's ACR. In the FY 2009 ACD, the Commission acknowledged that "[t]he differing financial results for Inbound Expedited Services are not a consequence of any postal management action. Rather, such results are a consequence of a Commission-mandated methodological change requiring the use of booked revenues and expenses for purposes of analyzing the financial performance of all products." FY 2009 ACD at 121. As a result, in last year's ACD, the Commission recommended "no additional action on the part of the Postal Service." *Id.*

[28] *See* 39 C.F.R. § 3015.7(c).

## IV. Market Tests

The only market tests of experimental products offered under the provisions of section 3641 in FY 2010 were the Collaborative Logistics market test and the Sample Co-op market test.

### A. Collaborative Logistics

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

All of the customer outreach, field operations integration, identification of available space and transit times and pricing negotiations are conducted by the Business Opportunity Development group in Postal Headquarters. Movements of freight are tracked through a variety of measures and facilitated by a Shared Transportation Control Center (STCC). Service performance for full truckload (FTL) and less than truckload (LTL) has been excellent, with, for example, 98.4 percent and 98.2 percent respectively for Quarter 3.

Total volume (measured as pallet positions sold) for FY 2010 was 25,004, and total revenue was $1,667,856, which exceeded total costs. Cost information for this competitive market test is provided under seal as part of USPS-FY10-NP27.

The Postal Service has had many instances of spot market requests which included one time shipments that required local pickup and delivery drayage. This would require a significantly larger management structure as well as adding transportation. The Postal Service has demurred on such requests thus far, but is currently exploring partnerships with companies who can provide that local drayage as a complement to our larger network. We are using Intelligent Mail Barcode scanning to provide visibility into pallet movements and plan to apply Lean Six Sigma practices to improve scan rates.

**B. Sample Co-Op Market Test**

The Postal Service conducted a "market test of experimental products" offered under the provisions of section 3641 in FY 2010 to test the viability of a co-op box of samples. The experimental product was authorized by the Commission in Order No. 452, Docket No. MT2010-1 (May 5, 2010).

The Sample Co-op box is a parcel containing an assortment of product samples from multiple consumer packaged goods (CPG) companies mailed to the companies' target consumers, with the companies sharing the postage costs. The purpose of the market test was to gain information concerning the potential market for the Samples Co-Op Box and the value to CPGs and consumers and to better understand any operational requirements and costs that need to be taken into consideration.

In May 2010, in conjunction with our fulfillment partner, 200,000 co-op boxes, branded "Sample Showcase" were mailed to consumers ---20,000 who opted in online from across the country, as well as to 180,000 targeted households in Charlotte, NC and Pittsburgh, PA. Since the purpose of the experiment was to test the viability of the concept, no revenue was generated. Direct costs to the Postal Service of the experiment were estimated at approximately $250 thousand, although, given the somewhat unique structure of the experiment, those costs will not be entirely representative of all aspects of future offerings of this nature. Two versions of the sample showcase box were mailed. Version 1 weighed less than 1 lb, whereas version two weighed slightly over 1 lb. The mailing was accompanied by extensive analytics, including a pre-mailing survey, a "box survey" assessing perceptions, and a "product survey" that provided conversion and brand awareness statistics. The test market provided strong evidence that the Sample Showcase offers high value to brands by converting consumers into brand buyers, as well as by strongly enhancing product awareness.

Based upon the results of this test, the Postal Service is optimistic that the product will provide a great value to both consumers and business entities and are working to extend the product to a full national offering.

Further, no noticeable impact on operational efficiency was observed. Market test results also confirmed that the design of the piece worked extremely well. Moreover, no results of the experiment indicated that offering this product created an inappropriate competitive advantage for the Postal Service or any mailer.

## V. Nonpostal Services

Commission Rule 3050.21(i) requires the ACR to include estimates of the costs, volumes, and revenues for nonpostal services. Since this rule was not adopted until late in FY 2009 and Docket No. MC2008-1 was still pending, the Postal Service was limited in what information it could provide in the FY 2009 ACR. In this ACR, the Postal Service has attempted to improve its reporting, but the information provided below is generally comparable to what has been provided previously.

Because Order No. 154 (Dec. 19, 2008) indicated that certain offerings would be treated as competitive, however, certain data for those offerings have been redacted on the following table. The unredacted version of the table is filed, under seal, as part of the Preface document of USPS-FY10-NP27. For each item for which costs have been redacted, however, the revenues do exceed the costs.

## FY 2010 NONPOSTAL PRODUCTS

| Product | | FY 2010 Amount (000) |
|---|---|---|
| **Migratory Bird** | | |
| | Revenue | $209 |
| | Expense | $447 |
| | Net Income (Loss) | ($238) |
| | Volume (000) | 600 |
| **Passports** | | |
| | Revenue | $216,253 |
| | Expense | 131,554 |
| | Net Income (Loss) | $84,699 |
| | Volume (000) | 6,797 |
| **Passport Photos** | | |
| | Revenue | $46,330 |
| | Expense | $16,617 |
| | Net Income (Loss) | $29,713 |
| | Volume (000) | 3,089 |
| **Officially Licensed Retail Products (OLRP)** | | |
| | Revenue | $6,026 |
| | Expense | USPS-FY10-NP27 |
| | Net Income (Loss) | USPS-FY10-NP27 |
| | Volume (000) | 335 |

| | | |
|---|---|---|
| **FedEx Dropboxes** (Drop Box Alliance Revenue) | | |
| | Revenue | USPS-FY10-NP27 |
| | Expense | |
| | Net Income (Loss) | USPS-FY10-NP27 |
| **Meter Manufacturers Program** | | |
| | Revenue | $17 |
| | Expense | |
| | Net Income (Loss) | $17 |
| **Electronic Postmark (EPM)** | | |
| | Revenue | $250 |
| | Expense | USPS-FY10-NP27 |
| | Net Income (Loss) | USPS-FY10-NP27 |
| **MoverSource (IMAGITAS)** | | |
| | Revenue | $139,705 |
| | Expense | $102,450 |
| | Net Income (Loss) | $37,255 |
| **Licensing Programs Other Than Officially Licensed Retail Products (OLRP)** | | |
| | Revenue | $1,909 |
| | Expense | USPS-FY10-NP27 |
| | Net Income (Loss) | USPS-FY10-NP27 |
| **Hybrid Mail** | | |
| | Revenue | $ 446 |
| | Expense | USPS-FY10-NP27 |
| | Net Income (Loss) | USPS-FY10-NP27 |

Additionally, Commission Order No. 391, at 11 (January 13, 2010) requires the Postal Service to report current fees and revenues for certain services included in the MCS under Address Management Services. Five of those services (MAC, MAC Gold, MAC Batch, Advance, and Z4INFO) had zero revenue for FY 2010, while PAVE had revenue of $1660 and PAGE had revenue of $500 over the year. Further details can be found in Section III of the Preface to USPS-FY10-30.

## V. Nonpublic Annex

Section 3652(f)(1) contemplates the use of a nonpublic annex for documents or other materials that the Postal Service considers exempt from public disclosure, pursuant to 39 U.S.C. § 410(c) and 5 U.S.C. § 552(b). In particular, section 410(c)(2) exempts from mandatory disclosure "information of a commercial nature…which under good business practice would not be publicly disclosed." In previous years, the ACR had a nonpublic annex containing, generally speaking, the following: (1) the billing determinants for domestic and international competitive products, (2) the ICRA, and all supporting documentation underlying the ICRA, and (3) data for international customized agreements with customers. Starting in FY 2008, the nonpublic annex also included *nonpublic* versions of the CRA and Cost Segments and Components reports that provided disaggregated as well as aggregated information for competitive products, plus versions of the CRA "B" workpapers, the CRA model, the files relating to the costing data systems (IOCS, CCCS, RCCS, and TRACS), and special cost study workpapers or other similar background materials which contained sensitive disaggregated information on competitive products. Additionally, though, the FY 2008 and FY 2009 ACRs also included *public* versions of those materials, which provided detailed information on market dominant products, but in which information on competitive products (if any) had been aggregated.

For this year, in accordance with section 3652(f)(1) of title 39, a complete listing of what is within the FY 2010 nonpublic annex is provided in the attached list of documents. *See* Attachment One. In general, the FY 2010 nonpublic annex contains the same type of materials which were provided in the FY 2009 nonpublic annex.

Moreover, regarding the split of materials between public and nonpublic documents and files, the FY 2010 materials continue important differences introduced in FY 2009. First, in the Public CRA, rather than aggregating all competitive product information into one row, that row has been disaggregated into five rows, each presenting information for a group of competitive products. The five groups are Total Express Mail, Total Priority Mail, Total Ground, Total International Competitive, and Competitive Services. The rows in the Nonpublic CRA which have been rolled up into each of those five rows in the Public CRA are listed in a table in the attached Application for Non-Public Treatment of the Nonpublic Annex. *See* Attachment Two, page 11-12. Second, as it did last year, the nonpublic annex this year includes information on individual domestic competitive product Negotiated Service Agreements (NSAs), provided in USPS-FY10-NP27. Third, because they were prepared on very short notice, FY 2008's public versions of certain supporting documentation (e.g., CRA model, B workpapers, etc.) did not necessarily flow smoothly. Starting last year, great effort was devoted to preserving linkages in the public versions, and the situation in that regard thus improved substantially. Over the course of Docket ACR2009, no issues arose regarding this matter, and the successful practices of FY 2009 have been continued this year. Once again, however, to preserve a unified set of source documents, the data reported in the ACR come from the non-public versions. Should any discrepancies arise between public and nonpublic versions because of issues such as rounding, the nonpublic versions would take precedence.[29]

[29] As it does every year, the Postal Service encourages any participant having difficulties working with any of its documentation, public or nonpublic, to contact Postal Service counsel to initiate informal dialogue to resolve any problems as quickly as possible. Given short timeframes, joint efforts at direct cooperation would seem to have

Of course, another major difference between FY 2009 and FY 2008 with respect to the nonpublic annex was the promulgation of the Commission's final rules on treatment of confidential material. Docket No. RM2008-1, Order No. 225 (June 19, 2009). As a consequence of those rules, as it did last year, the Postal Service is once again providing the attached Application for Nonpublic Treatment of Materials regarding the nonpublic annex. Perhaps more importantly, however, eligible individuals who seek to examine what has been filed in the nonpublic annex may expect to get a prompt response to a request to view such materials under standard protective conditions. See Commission Rule 3007.40.

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

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the highest probability of promptly resolving technical difficulties, to the mutual benefit of all concerned.

was consistently followed by the Postal Service in the numerous ICMs and other international agreements filed with the Commission during the course of this fiscal year.

Of course, while ICMs have been common in the past for international competitive products, the Postal Service has only rather recently under the PAEA begun to negotiate similar contract pricing arrangements with respect to domestic competitive products. Domestic customers for competitive products who under the PRA could influence the postal prices they paid only by participation in postal rate proceedings can now directly negotiate with the Postal Service for what they view as more favorable prices for their particular circumstances. Access to virtually any cost information on competitive products may give them an advantage in the negotiation process which, by definition, could act to the detriment of the Postal Service during that same negotiation process. These developments require reassessment to achieve an equilibrium that respects the Postal Service's enhanced competitive role, and the Commission's new responsibilities. Indeed, the language of the PAEA calls for such an equilibrium.[30]

Costing information for products as a whole, or for specific product features, tend to be highly confidential in the business world, and the Postal Service should be able to protect them in accordance with industry standards. The ability of the Postal Service to negotiate favorable contracts could be severely compromised if costing information becomes available either to the customers with whom the Postal Service is negotiating, or to competitors who might also be seeking to negotiate contracts with the same customers. Postal Service's competitors, for example, could use such information to target their efforts and undercut the Postal Service's prices. The Postal Service is

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

aware of no competitor or private shipping company of comparable size and scope that releases cost information regarding specific products to the public.


Respectfully submitted,

UNITED STATES POSTAL SERVICE

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# LIST OF MATERIALS PROVIDED BY THE UNITED STATES POSTAL SERVICE FOR PURPOSES OF THE FISCAL YEAR 2010 ANNUAL COMPLIANCE REPORT

| Number | |
|---|---|
| USPS-FY10-1 | FY 2010 Public Cost and Revenue Analysis (PCRA) Report |
| USPS-FY10-2 | FY 2010 Public Cost Segments and Components Report |
| USPS-FY10-3 | FY 2010 Discounts and Passthroughs of Workshare Items |
| USPS-FY10-4 | FY 2010 Market Dominant Billing Determinants |
| USPS-FY10-5 | Cost Segment and Components Reconciliation to Financial Statements and Account Reallocations (Reallocated Trial Balances) |
| USPS-FY10-6 | General Classification of Accounts (Formerly Handbook F-8) |
| USPS-FY10-7 | Cost Segment 3 Cost Pools & Other Related Information (Public Portion) |
| USPS-FY10-8 | Equipment and Facility Related Costs |
| USPS-FY10-9 | FY 2010 ACR Roadmap Document |
| USPS-FY10-10 | FY 2010 Special Cost Studies Workpapers - Letter Cost Models (First and Standard) |
| USPS-FY10-11 | FY 2010 Special Cost Studies Workpapers - Flat Cost Models (First and Standard) & Periodicals Cost Model |

USPS-FY10-12 Standard Mail Hybrid/Parcel Cost Study

USPS-FY10-13 FY 2010 Special Cost Studies Workpapers - Drop Ship Cost Avoidances for Periodicals and Standard Mail

USPS-FY10-14 Mail Characteristics Study (Public Portion)

USPS-FY10-15 FY 2010 Special Cost Studies Workpapers – Bound Printed Matter Mail Processing Cost Model / Media Mail – Library Mail Mail Processing Cost Model

USPS-FY10-16 FY 2010 Special Cost Studies Workpapers - Bound Printed Matter Transportation Costs / Bulk Parcel Return Service Cost Model

USPS-FY10-17 2010 Comprehensive Statement of Postal Operations

USPS-FY10-18 FY 2010 ECR Mail Processing Unit Costs

USPS-FY10-19 FY 2010 Delivery Costs By Shape

USPS-FY10-20 FY 2010 Window Service Cost by Shape

USPS-FY10-21 FY 2010 QBRM and BRM Costs

USPS-FY10-22 FY 2010 Bound Printed Matter Mail Processing Costs

USPS-FY10-23 MODS Productivity Data

USPS-FY10-24 FY 2010 Non-Operation Specific Piggyback Factors (Public Portion)

USPS-FY10-25 FY 2010 Mail Processing Piggyback Factors (Operation Specific)

| | |
|---|---|
| USPS-FY10-26 | FY 2010 Mail Processing Costs by Shape (Public Portion) |
| USPS-FY10-27 | FY 2010 Nonprofit Mail Cost Approximations |
| USPS-FY10-28 | FY 2010 Special Cost Studies Workpapers – Special Services (Public Portion) |
| USPS-FY10-29 | Annual Report on Service Performance for Market Dominant Products |
| USPS-FY10-30 | FY 2010 Market Dominant NSA Materials |
| USPS-FY10-31 | FY 2010 CRA Model (Model Files, Cost Matrices, and Reports) (Public Version) |
| USPS-FY10-32 | FY 2010 CRA “B” Workpapers (Public Version) |
| USPS-FY10-33 | Rule 3050.14 Alternative Format Report (Public Version) |
| USPS-FY10-34 | City Carrier Cost System (CCCS) Statistical and Computer Documentation (Public Version) |
| USPS-FY10-35 | Rural Carrier Cost System (RCCS) Statistical and Computer Documentation (Public Version) |
| USPS-FY10-36 | Transportation Cost Systems (TRACS) Statistical and Computer Documentation (Public Version) |
| USPS-FY10-37 | In-Office Cost System (IOCS) Statistical and Computer Documentation (Public Version) |
| USPS-FY10-38 | USPS Market Dominant Product Customer Satisfaction Measurement Survey Instruments |
| USPS-FY10-39 | FY 2010 Competitive Products Fund Reporting Materials |

| | |
|---|---|
| USPS-FY10-40 | 2010 Rural Mail Count |
| USPS-FY10-41 | International Market Dominant Billing Determinants |

BELOW ITEMS WILL BE DESIGNATED AS NONPUBLIC ANNEX:

| | |
|---|---|
| USPS-FY10-NP1 | FY 2010 Competitive Product Billing Determinants |
| USPS-FY10-NP2 | FY 2010 International Cost and Revenue Analysis (ICRA) Report (Hard Copy & Excel) |
| USPS-FY10-NP3 | FY 2010 International Cost Segments and Components Report (Hard Copy & Excel) |
| USPS-FY10-NP4 | FY 2010 ICRA Domestic Processing Model (Cost Matrices, Reports, Control File, & Changes) |
| USPS-FY10-NP5 | FY 2010 ICRA Overview/Technical Description |
| USPS-FY10-NP6 | FY 2010 International Cost Segment Spreadsheets |
| USPS-FY10-NP7 | Cost Segment 3 International Subclass Costs by Cost Pools (Volume Variable Cost Pools) |
| USPS-FY10-NP8 | FY 2010 International Competitive Products Billing Determinants |
| USPS-FY10-NP9 | FY 2010 Miscellaneous International Data |
| USPS-FY10-NP10 | FY 2010 Competitive Product Incremental and Group Specific Costs |

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|---|---|
| USPS-FY10-NP11 | FY 2010 Nonpublic Cost and Revenue Analysis (NPCRA) Report (Hard copy & Excel) |
| USPS-FY10-NP12 | FY 2010 Nonpublic Cost Segments and Components Report (Hard copy & Excel) |
| USPS-FY10-NP13 | FY 2010 CRA Model (Model Files, Cost Matrices, and Reports) |
| USPS-FY10-NP14 | FY 2010 CRA "B" Workpapers (Nonpublic Version) |
| USPS-FY10-NP15 | FY 2010 Special Cost Studies Workpapers – Parcel Select / Parcel Return Service (PRS) Mail Processing Cost Model (Nonpublic Portion) |
| USPS-FY10-NP16 | FY 2010 Special Cost Studies Workpapers - Parcel Select/ Parcel Return Service (PRS) Transportation Cost Model (Nonpublic Portion) |
| USPS-FY10-NP17 | FY 2010 Special Cost Studies Workpapers Parcel Select / Parcel Return Service (PRS) Cube-Weight Relationship Estimation (Nonpublic Portion) |
| USPS-FY10-NP18 | Cost Segment 3 Cost Pools & Other Related Information (Nonpublic Portion) |
| USPS-FY10-NP19 | FY 2010 Non-Operation Specific Piggyback Factors (Nonpublic Portion) |
| USPS-FY10-NP20 | FY 2010 Mail Processing Costs by Shape (Nonpublic Portion) |
| USPS-FY10-NP21 | In-Office Cost System (IOCS) Statistical and Computer Documentation (Nonpublic Version) (Source Code and Data on CD-ROM) |

| | |
|---|---|
| USPS-FY10-NP22 | City Carrier Cost System (CCCS) Statistical and Computer Documentation (Nonpublic Version) (Source Code and Data on CD-ROM) |
| USPS-FY10-NP23 | Rural Carrier Cost System (RCCS) Statistical and Computer Documentation (Nonpublic Version) (Source Code and Data on CD-ROM) |
| USPS-FY10-NP24 | Transportation Cost Systems (TRACS) Statistical and Computer Documentation (Nonpublic Version) (Source Code and Data on CD Rom) |
| USPS-FY10-NP25 | Mail Characteristics Study (Nonpublic Portion) |
| USPS-FY10-NP26 | FY 2010 Special Cost Studies Workpapers – Special Services (Nonpublic Portion) |
| USPS-FY10-NP27 | 2010 Competitive NSA & Nonpostals Materials |
| USPS-FY10-NP28 | Rule 3050.14 Alternative Format Report (Non-Public Version) |
| USPS-FY10-NP29 | Cost Segment and Components Reconciliation to Financial Statements and Account Reallocations (Reallocated Trial Balances) (Nonpublic Version) |

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

In accordance with 39 C.F.R. § 3007.21 and Order No. 225,[1] the United States Postal Service (Postal Service) hereby applies for nonpublic treatment of certain materials filed under seal with the Commission. The materials covered by this application consist of the entire Nonpublic Annex of the FY10 ACR. The Nonpublic Annex includes 29 separate folders, as shown on the List of Materials provided as Attachment One to the ACR. As is apparent from that List, the majority of these folders have a corresponding public folder. In many instances, a set of material has been divided into a portion that relates to Market Dominant products, and a portion that relates to Competitive products. In those instances, the public folder includes the portion of material relating to Market Dominant products, and the nonpublic folder includes the portion of materials relating to Competitive products. In many other instances, two versions of materials are prepared. The nonpublic versions present summary information, or contain the background material from which summary information has been developed, in which Competitive product data have been disaggregated to the product level. The corresponding public versions present summary information, or contain the background material from which summary information has been developed, in which Competitive product data have been aggregated above the product level. In still other instances, a nonpublic folder contains information about Competitive products, and there is no corresponding public folder, because there is no corresponding need for similar information relating to Market

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

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

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

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

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

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

The Postal Service believes that the only third parties that have a proprietary interest in the materials submitted in connection with the FY 2010 Annual Compliance Report are (1) entities, including foreign postal operators, holding competitive negotiated service agreements (NSAs) in FY 2010 for which data are reported on a contract-specific basis, (2) FedEx Express with respect to data concerning Global Express Guaranteed (GXG), (3) the Canada Post Corporation (CPC), (4) Correos de México, and (5) other foreign postal operators who tendered postal items to the Postal Service, or to whom the Postal Service tendered items, in FY 2010 at rates not of general applicability. Except with respect to the fourth category as described below, the Postal Service gives notice that it has already informed each third party, in compliance with 39 C.F.R. § 3007.20(b), of the nature and scope of this filing and its ability to address its confidentiality concerns directly with the Commission.

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

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

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

- For the Inbound Direct Entry Contract with New Zealand Post Limited: Rachael Manson, Client Solutions Manager, +64 4496 4334, rachael.manson@nzpost.co.nz;
- For the Inbound Direct Entry Contract with China Post Group: Mr. Zhu Lei, Deputy Manager, International Operations, China Post EMS and Logistics Corporation (China Post Group), +86 10 67 077 331, zhulei@ems.com.cn;
- For the Inbound Direct Entry Contract with Hongkong Post: Jeremy Wan, Senior Manager, International Letters, +852 2921 6026, jeremy_wan@hkpo.gov.hk, and Elaine Chik, Manager, International Letters, +852 2921 2115, elaine_chik@hkpo.gov.hk;
- For the Inbound Direct Entry Contract with P&T Express Service Joint Stock Company: Ms. Dang Thi Bich Hoa, General Director, +84 43 757 5588, hoadb@ems.com.vn;
- For the Royal Mail Inbound Air Parcel Post Agreement: Simon Batt, Director, International Products, Parcelforce Worldwide (Royal Mail Group Limited), +44 780 109 2254, simon.batt@parcelforce.co.uk; and
- For the China Post Group Inbound International Expedited Services 1 agreement: Mr. Zhao Yugang, Deputy Managing Director, Department of International Cooperation, +86 10 66 599 665, zhaoyugang@postmail.com.cn.

Because the Postal Service maintains that the remaining competitive NSA customers' identities are commercially sensitive and should not be publicly disclosed, the Postal Service employees responsible for providing notice to these third parties are:

- Elizabeth A. Reed, Attorney, Pricing and Product Support, whose telephone number is (202) 268-3179 and whose email address is elizabeth.a.reed@usps.gov; and
- Mr. James J. Crawford, Business Development Specialist, Global Business, whose telephone number is 202-268-7714 and whose email address is james.j.crawford@usps.gov.

The International Cost and Revenue Analysis (ICRA) report and supporting documentation contain data specific to GXG service, which the Postal Service offers in partnership with FedEx Express.[3] The Postal Service identifies James H. Ferguson, Corporate Vice President, Customer and Business Transactions, FedEx Corp. & General Counsel, FedEx Corporate Services, Inc., as the appropriate contact on behalf of FedEx Express. Mr. Ferguson's telephone number is (901) 434-8600, and his email address is jferguson1@fedex.com.

The International Cost and Revenue Analysis (ICRA) report contains data for various products that is specific to CPC. These data pertain to various categories of inbound mail that CPC tenders in a "customer" capacity and to categories of outbound mail that CPC delivers for the Postal Service in a "supplier" role, in both cases pursuant

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

to CPC's negotiated bilateral agreement with the Postal Service. The Postal Service identifies Ewa Kowalski as the appropriate contact on behalf of CPC. Ms. Kowalski's telephone number is (613) 734-6201, and her email address is ewa.kowalski@canadapost.postescanada.ca. CPC has requested that any communications regarding confidential treatment of these data be sent with a courtesy copy to Dennis Jarvis, Director, International Business, Canada Post Corporation. Mr. Jarvis's telephone number is (613) 734-8149, and his email address is dennis.jarvis@canadapost.ca.[4]

The ICRA report also contains inbound and outbound international mail data specific to Correos de México, the public postal operator for Mexico, and in which Correos de México might be deemed to have a proprietary interest. Due to language and cultural differences as well as the sensitive nature of the Postal Service's relationship with Correos de México, the Postal Service proposes that a designated Postal Service employee serve as the point of contact for any notices to Correos de México.[5] The Postal Service identifies as an appropriate contact person Guadalupe

[4] In the event of a request for early termination of non-public treatment under 39 C.F.R. § 3007.31, a preliminary determination of non-public status under 39 C.F.R. § 3007.32, or a request for access to non-public materials under 39 C.F.R. § 3007.40, the Postal Service notes, on CPC's behalf, that differences in the official observation of national holidays might adversely and unduly affect CPC's ability to avail itself of the times allowed for response under the Commission's rules. In such cases, CPC has requested that the Postal Service convey its preemptive request that the Commission account for such holidays when accepting submissions on matters that affect CPC's interests. A listing of Canada's official holidays can be found at http://www.pch.gc.ca/eng/1266366005340.

[5] The Postal Service acknowledges that 39 C.F.R. § 3007.21(c)(2) appears to contemplate only situations where a third party's identification is "sensitive" as permitting the designation of a Postal Service employee who shall act as an intermediary for notice purposes. To the extent that the Postal Service's proposal might be construed as beyond the scope of this exception, the Postal Service respectfully

Contreras, Acting Business Systems Manager, International Postal Affairs. Ms. Contreras's phone number is (202) 268-4598, and her email address is guadalupe.n.contreras@usps.gov.

The ICRA report contains rate information and other information that might be deemed proprietary to postal operators who are partners in the E Parcels Group arrangement. For the same reasons as for Correos de México, the Postal Service proposes that a designated Postal Service employee serve as the point of contact for any notices to the relevant postal operators. The Postal Service identifies as an appropriate contact person Giselle Valera, Executive Director, Global Finance and Business Analysis. Ms. Valera's phone number is (202) 268-5931, and her email address is giselle.e.valera@usps.gov.

Finally, the ICRA report contains rate information and other information that might be deemed proprietary to postal operators whose governments are members of the UPU. For the same reasons as for Correos de México, the Postal Service proposes that a designated Postal Service employee serve as the point of contact for any notices to the relevant postal operators. The Postal Service identifies as an appropriate contact person Flori McClung, Manager, UPU Relations. Ms. McClung's phone number is (202) 268-2603, and her email address is flori.mcclung@usps.gov. In view of the practical difficulties, the Postal Service has not undertaken to inform all affected postal operators about the nature and scope of this filing and about the ability to address any confidentiality concerns directly with the Commission as provided in 39 C.F.R. §

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requests a waiver that would allow it to designate a Postal Service employee as the contact person under these circumstances, in light of the practical considerations outlined herein.

3007.20(b). To the extent that the Postal Service's filing in the absence of actual notice might be construed as beyond the scope of the Commission's rules, the Postal Service respectfully requests a waiver that would allow it to forgo providing a notice to each postal operator. It is impractical to communicate with dozens of operators in multiple languages about this matter.

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

The materials in the Nonpublic Annex fall into several categories. The first category is the Nonpublic CRA, and all of the background materials feeding into the Nonpublic CRA. These materials, in general, show cost information at the product level, including disaggregated information for Competitive products. These materials are found in folders USPS-FY10-NP11, USPS-FY10-NP12, USPS-FY10-NP13, USPS-FY10-NP14, USPS-FY10-NP18, USPS-FY10-NP21, USPS-FY10-NP22, USPS-FY10-NP23, USPS-FY10-NP24, USPS-FY10-NP26, USPS-FY10-NP27, and USPS-FY10-NP28. Descriptions of the contents of these folders can be found in the roadmap document, filed as USPS-FY10-9. The roadmap indicates the corresponding public folder which contains information similar to that in nonpublic folder, except that, in the public folder, the cost information for Competitive products is generally aggregated into one Competitive products row. Therefore, examination of the corresponding public folder should allow a person to understand the nature of the contents of the nonpublic folder, and evaluate accordingly.

A second category consists of Special Cost Studies materials that provide cost information below the product level for Competitive products. These materials are found in folders USPS-FY10-NP15, USPS-FY10-NP16, USPS-FY10-NP17, USPS-FY10-NP19, USPS-FY10-NP20, and USPS-FY10-NP25. Again, descriptions of the contents of these folders can be found in the roadmap document, filed as USPS-FY10-9. The roadmap indicates the corresponding public folder which contains information similar to that in the nonpublic folder, except that, in the public folder, the cost information below the product level relates to Market Dominant, rather than Competitive products. Therefore, examination of the corresponding public folder should allow a person to understand the nature of the contents of the nonpublic folder, and evaluate accordingly.

A third category consists of the International CRA (ICRA) and the supporting documentation. These materials are found in folders USPS-FY10-NP2 through USPS-FY10-NP7, and USPS-FY10-NP9. Collectively, they present the inputs and the analyses used to attribute and distribute costs to International products. In general, the ICRA follows the same basic methodologies used in the CRA -- dividing accounting data into cost segments and components, distributing the attributable costs within segments to products, and summing the total attributable costs of a product across segments. Descriptions of the contents of the individual ICRA-related folders can be found in the roadmap document, USPS-FY10-9. There are no corresponding public folders.

A fourth category is the Competitive product billing determinants. These are found in USPS-FY10-NP1 for domestic Competitive products, and USPS-FY10-NP8 for International products. They are comparable in format to the Market Dominant billing determinants presented in USPS-FY10-4, but include the corresponding information for

Competitive products. Again, examination of the corresponding public folder should allow a person to understand the nature of the contents of the nonpublic folder, and evaluate them accordingly.

Another folder in the Nonpublic Annex is USPS-FY10-NP10, which presents the application of the incremental cost methodology set forth in the Petition for Proposal Twenty-two (filed on Oct. 23, 2010, and considered as part of Docket No. RM2010-4) to Competitive products. The outputs of that application are shown in the text of the FY 2010 ACR itself, and USPS-FY10-NP10 merely provides the background materials supporting those outputs. The incremental cost model used in USPS-FY10-NP10 is comparable to the model employed in USPS-T-18 in Docket No. R2006-1, and the group specific costs are based on the same type of analysis considered by the Commission as Proposal One in Docket No. RM2008-2, and applied (to Market Dominant products) in USPS-FY08-33. The contents of USPS-FY10-NP10 are described in the roadmap document, USPS-FY10-9.

In general, the premise of this application is that, for Competitive products and certain market dominant international products, disaggregated cost data (and detailed volume and revenue data, such as that provided in billing determinants) constitute commercially-sensitive information and should not be publicly disclosed. The Postal Service is therefore placing all such information in the Nonpublic Annex, and filing it under seal. One exception to this approach appears in the Public CRA. The Public CRA (USPS-FY10-1) presents some disaggregated data for Competitive products, but those data are not disaggregated down to the product level, as they are in the Nonpublic CRA (USPS-FY10-NP11). Instead, in the Public CRA, the Postal Service is breaking out data for Competitive products into five Competitive product groups. Those groups are Total Express, Total Priority, Total Ground, Total International Competitive, and Total Competitive Services. (The product rows in the Nonpublic CRA that are rolled up into each of the five Competitive product group rows in the Public CRA are shown in the table below.) At this level of disaggregation, the Postal Service has been unable to identify any of its major competitors that are publicly disclosing a potentially greater amount of disaggregated competitive cost data. The Postal Service maintains that the further disaggregation shown in the Nonpublic CRA should thus appropriately remain confidential. The Postal Service believes that the approach jointly embodied in its Public CRA and Nonpublic CRA prudently maximizes the amount of information available to the public, keeping such information as detailed as possible without prompting the competitive concerns outlined in the following section below.

| **Category in Public Version CRA** | **Categories Rolled in from Nonpublic Version CRA** |
|---|---|
| Total Express Mail | Domestic Express Mail<br>Domestic Express Mail NSAs |
| Total Priority Mail | Domestic Priority Mail<br>Domestic Priority Mail NSAs<br>Priority Mail Fees |
| Total Ground | Parcel Select Mail<br>Parcel Select NSAs<br>Parcel Return Service Mail<br>Parcel Return Service NSAs |
| Total Competitive International | Outbound International Expedited Services<br>Inbound International Expedited Services<br>Outbound Priority Mail International<br>Inbound Air Parcel Post<br>International Priority Mail (IPA)<br>International Surface Airlift (ISAL)<br>International Direct Sacks M-Bags<br>Inbound Surf. Parcel Post (at Non-UPU Rates)<br>Outbound Intl Negotiated Serv. Agreement Mail |

| | |
|---|---|
| | Inbound Intl Negotiated Serv. Agreement Mail<br>International Money Transfer Service<br>International Ancillary Services |
| Total Domestic Competitive Services | Premium Forwarding Service<br>Address Enhancement Services<br>Greeting Cards<br>Shipping and Mailing Supplies<br>Post Office Box Service |

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

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

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

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

**Cost Information**

Information relating to the costs of producing products is generally considered to be among the most sensitive commercial information. The CRA and ICRA present data and statistics for products that would provide competitors with valuable information, enabling them to better understand the Postal Service's cost structures, operational capabilities, and its pricing and marketing strategies. This confidential information includes per-piece costs in several analytical categories (attributable costs, volume variable costs, and product-specific costs), as well as cost contribution and cost coverage (margin) by product. Such information would be extremely valuable to competitors in assessing the strengths and weaknesses of various postal products.

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

**Volume and Revenue Information**

Competitors could use the product-specific revenue, pieces, and weight information to analyze the Postal Service's possible market strengths and weaknesses and to focus sales and marketing efforts on those areas, to the detriment of the Postal

Service. Disclosure of this information would also undermine the Postal Service's position in negotiating favorable terms with potential customers, who would be able to ascertain critical information about relevant product trends (*e.g.*, average revenue per piece, average weight per piece). Finally, as explained in greater detail below, disclosure would expose certain foreign postal operators and other customers to the same competitive harms, to the extent that a category is associated with a single customer or a small group of customers. The Postal Service considers these to be highly probable outcomes that would result from public disclosure of the material filed nonpublicly.

**Billing Determinants**

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

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

**Negotiated Service Agreements**

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

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

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

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

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

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

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

**International Product Information**

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

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

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

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

**Hypothetical:** The CRA and ICRA provide data by product that indicate total revenues, attributable costs, volume variable costs, product specific costs, and per-piece attributable costs, contribution, and cost coverage (margin). These data are broken out by individual product and separated between products purchased through public schedules and those purchased through contract rates (NSAs). Hypothetically, this information is made public. Competitors use it to gain a refined understanding of the relative strengths and weaknesses of the Postal Service's product lines (domestic and international), the individual strengths and weaknesses of particular products, and the degree to which products are sold through public schedules, compared to contract pricing arrangements. Financial analysts for the competitors relay their assessments to colleagues in the competitors' marketing and investment divisions. This information provides a better foundation to enable competing firms to make decisions regarding investments and product design in their own product lines. Based on such assessments, for example, firms that have individual products for domestic express service (overnight), international express service, or package service comparable to Priority Mail determine that they have potential for competitive gain against the Postal Service in these areas and, accordingly, decide to allocate investments in improved operations, supplier arrangements, and technologies to improve their competitive positions. To the extent that these decisions actually make the firms more competitive, the Postal Service loses existing or new business.

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

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

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

**Harm: The various companion reports, sub-reports, workpapers, special cost and other studies, and documentation contained in the Nonpublic Annex would provide detailed and refined knowledge and understanding of the individual costs, cost structures, contributions, and cost coverages (margins) of individual postal products and contract pricing agreements. These materials, which produce and support the summary data and statistics contained in the CRA and ICRA, would provide highly detailed information regarding operational procedures used to produce the products, the costs and relative efficiencies of**

**operations and sub-operations, and the amount and character of overhead, including the relative proportions of volume variable and overhead costs. Companion reports and sub-reports provide detailed functional analyses of Postal Service costs within a framework that is well-understood, or easily learned, from information in the Public Annex, or from familiarity with or research into past postal rate cases. Public disclosure would therefore be tantamount to publishing virtually every detail regarding the relative costs and efficiencies of providing postal competitive products. This information would provide blueprints for competitors, suppliers, and mailers who might seek to negotiate favorable contract rates. The information would better enable them to make favorable operational, investment, pricing, and marketing decisions in relationships with the Postal Service. The results would be loss of existing or future business for the Postal Service, or the erosion of total revenues, contributions, margins, and overall financial stability.**

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

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

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

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

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

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

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

A more pointed variant on this hypothetical pertains to Inbound Surface Parcel Post (at Non-UPU Rates). Because this category is associated with a single foreign postal operator (Canada Post Corporation or CPC), a competing delivery service provider with access to this information can use it to determine the average per-item and per-pound price offered by the Postal Service to CPC, as well as the average weight of Surface Parcel Post items from Canada. The competitor can use that information as a baseline to negotiate with freight companies to develop lower-cost alternatives and entice CPC's volume away from the Postal Service's domestic delivery network.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Hypothetical:** For Inbound Air Parcel Post, a competing package delivery service determines what the Postal Service would need to charge its customers (which may include foreign postal operators) and meet its minimum statutory obligations for cost coverage and contribution to institutional costs. The competing package delivery service then sets its own rates for products similar to those the Postal Service offers other postal operators under that threshold and markets its ability to beat the Postal Service's price for inbound air parcels. By sustaining this below-market strategy for a relatively short period of time, the competitor, or a group of the Postal Service's competitors acting in a likewise fashion, freezes the Postal Service out of the inbound air parcel delivery market.

**Hypothetical:** For Inbound Surface Parcel Post (at Non-UPU rates) and Canada Post Bilateral for Inbound Competitive Services, another postal operator sees the price and concludes that there may be some additional profit margin between the rates provided to Canada Post and the statutory cost coverage that the Postal Service must produce in order for the agreement to be added to the competitive products list. That postal operator then negotiates lower prices with the Postal Service on its own behalf or uses its knowledge to offer postal customers lower prices than they currently receive. Either or both ways, the Postal Service loses market share and contribution.

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

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

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

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

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

None.

***Conclusion***

For the reasons discussed, the Postal Service asks that the Commission grant its application for nonpublic treatment of the Nonpublic Annex of the FY 2010 ACR.

## CERTIFICATE OF SERVICE

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

Eric P. Koetting

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