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POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

ANNUAL COMPLIANCE REVIEW, 2012	Docket No. ACR2012

UNITED STATES POSTAL SERVICE
FY 2012 ANNUAL COMPLIANCE REPORT
(December 28, 2012)

The United States Postal Service hereby submits its Fiscal Year 2012 Annual Compliance Report (ACR or Report). The Report is submitted pursuant to 39 U.S.C. § 3652, which requires the Postal Service to file with the Postal Regulatory Commission, within 90 days after the end of each fiscal year (FY), a variety of data on "costs, revenues, rates, and quality of service," in order to "demonstrate that all products during such year complied with all applicable requirements of [title 39]."[1]

[1] Unless specified otherwise, section numbers used herein refer to statutory provisions in title 39, United States Code.

I. OVERVIEW OF REPORT

A. Contents

This Report consists of both the present document and underlying data appended as 73 separate folders. The present document contains only the most salient information from those folders, in order to demonstrate compliance with title 39. The reader should refer to the appended folders for more detailed information. A list of the appended folders appears at the end of this document at Attachment One.[2] Each folder includes a preface document explaining its purpose, background, structure, and relationship with other materials in the Report.

Broadly speaking, there are three types of data in the appended folders: (1) product costing material; (2) intra-product cost analyses; and (3) billing determinants. The focus of the product costing material, in terms of ultimate output, is the Cost and Revenue Analysis (CRA) report, at USPS-FY12-1, and the International Cost and Revenue Analysis (ICRA) report, at USPS-FY12-NP2.[3] The intra-product cost analyses make possible the examination of workshare discounts presented in Section II below.

[2] The folders are sequentially numbered and labeled as USPS-FY12-1, USPS-FY12-2, etc. Folders in the nonpublic annex, discussed in Section VI below, are labeled as USPS-FY12-NP1, USPS-FY12-NP2, etc. (with "NP" signifying "nonpublic").

[3] Commission Rule 3050.14 requires that the CRA be presented in two formats, one reflecting the current Mail Classification Schedule (MCS), and another reflecting the classification structure in effect prior to the adoption of the Postal Accountability and Enhancement Act of 2006 (PAEA). The latter format is referred to as the Alternative CRA; this year it appears at USPS-FY12-NP28. As the MCS has changed over time from the pre-2007 classification structure, and particularly with the recent transfer of products from the market dominant list to the competitive list, preparation of the Alternative CRA has become a far more complex task. Indeed, because several of the classifications in the Alternative CRA no longer exist, it is virtually impossible for postal data systems to identify and track costs, volumes and other necessary data for those classifications. Thus, increasingly, the information shown in the Alternative CRA reflects assumptions more than it does actual data. In light of this, and in light of the fact that six years have passed since the enactment of the PAEA, the Postal Service believes that the continued utility of the Alternative CRA is questionable, and in any case that its utility is now outweighed by the effort and expense needed to prepare it. Accordingly, the Postal Service intends to petition the Commission to lift the requirement to prepare the Alternative CRA for future ACRs, by striking the second sentence of Commission Rule 3050.14.

The billing determinants set forth the volume and calculated revenue for each rate cell of every mail product.

As in previous ACRs, certain materials are presented in two versions, one public and the other nonpublic. The public versions of these materials are limited to information on individual market dominant products, and aggregate information on either competitive products as a whole or large groups of competitive products. Correspondingly, the nonpublic versions contain either disaggregated information on competitive products or information on both market dominant and competitive products in contexts in which it is not possible to segregate the two. This is discussed further in Section VI below.

Section 3652(g) of title 39 requires the Postal Service to submit, together with this Report, a copy of its most recent Comprehensive Statement. A copy of the Postal Service's FY 2012 Comprehensive Statement appears at USPS-FY12-17. Similarly, a copy of the Postal Service's annual report to the Secretary of the Treasury regarding the Competitive Products Fund, required by section 2012(i) of title 39, appears at USPS-FY12-39, along with the other Competitive Products Fund materials required by Commission Rules 3060.20 through 3060.23.

B. Roadmap

A separate roadmap document is included at USPS-FY12-9. The roadmap is a technical document that consolidates brief descriptions of each of the appended folders and of the flow of inputs and outputs among them. It also discusses any changes between the methodologies used to prepare this Report and the methodologies applied by the Commission in the FY 2011 Annual Compliance Determination (ACD). In addition, it includes the listing of special studies and the discussion of obsolescence required by Commission Rule 3050.12.

C. Methodology

In preparing this ACR, the Postal Service has adhered to the methodologies applied by the Commission in the FY 2011 ACD, except in instances where the Commission approved methodology changes subsequent to the FY 2011 ACD. Such changes are identified in the prefaces accompanying the appended folders. Listed in the table below are all of the proposals to change methodologies filed with the Commission in the past year. The table includes proposals that were still under review by the Commission when the FY 2011 ACD was issued.

PROPOSAL	TOPIC	FILING DATE	DOCKET	NOTICE ORDER	NOTICE DATE	FINAL ORDER	FINAL ORDER DATE
Sixteen	Productivity Measurement for Flats Sequencing System	11/30/2011	RM2012-2	1053	12/16/2011	1383	06/26/2012
Seventeen	Consolidated MODS Operation Groups to Letter Automation Productivities	11/30/2011	RM2012-2	1053	12/16/2011	1383	06/26/2012
Eighteen	Modifications to the Flats Cost Models	11/30/2011	RM2012-2	1053	12/16/2011	1383	06/26/2012
Nineteen	Modification of the First-Class Mail Presort Letters Mail Processing Cost Model	11/30/2011	RM2012-2	1053	12/16/2011	1383	06/26/2012
Twenty	Modification of the BRM Cost Model	11/30/2011	RM2012-2	1053	12/16/2011	1383	06/26/2012
One	Elimination of Separate Delivery Costs for Carrier Route Letters, Flats, and Parcels	06/26/2012	RM2012-5	1388	06/29/2012	1462	09/10/2012
Two	Calculation of Scanning Costs for All Non-	06/26/2012	RM2012-5	1388	06/29/2012	1462	09/10/2012

	Accountable Delivery Scans						
Three	Changes in IOCS Encirclement Rules	06/26/2012	RM2012-5	1388	06/29/2012	1462	09/10/2012
Four	Changes to IOCS Reporting Codes	06/26/2012	RM2012-5	1388	06/29/2012	1462	09/10/2012
Five	Change to Methodology of Distributing Costs Incurred by Vehicle Service Drivers	06/26/2012	RM2012-5	1388	06/29/2012	1462	09/10/2012
Six	Use of Foreign Postal Settlement System Data for Reporting of Inbound International Revenue, Pieces, and Weights in the ICRA	09/04/2012	RM2012-7	1459	09/05/12	1516	10/24/2012
Seven	TRACS Change to Parcel Density Process	09/04/2012	RM2012-7	1459	09/05/2012	1516	10/24/2012
Eight	Incorporation of the Lightweight Parcel Select Price Categories into the Parcel Select / Parcel Return Service Mail Processing Cost Model	09/28/2012	RM2012-8	1488	10/02/2012	1567	12/06/2012
Nine	Modifications to First-Class Mail, Standard Mail, and Periodicals Flats Cost Models	09/28/2012	RM2012-8	1488	10/02/2012	Pending	Pending

As noted above, the Commission’s ruling on Proposal 9 is still pending. Therefore, where Proposal 9 affects materials filed in this Report, the Postal Service has generally prepared two versions of the materials, one incorporating the proposal and one not incorporating it.

To facilitate its preparation of future ACRs, it would be helpful to the Postal Service to have more timely rulings on proposals to change methodologies. To that end, because the current review process appears to be unsuited to that goal, the Postal Service intends to file with the Commission a petition to amend the rule governing proposals to change methodologies.[4] In addition, the Postal Service requests that the Commission file, alongside its FY 2012 ACD, all of the models that the Commission has applied in preparing the ACD, so that the Postal Service can ascertain that it has the most up-to-date models when it prepares the FY 2013 ACR.[5]

[4] In its FY 2011 ACD, the Commission stated that it "expects the Postal Service to file future proposals to change analytical principles in sufficient time so that the proposals are approved before the Postal Service files its upcoming ACR." The Postal Service filed Proposal 9 a full two months before it began preparing the ACR and a full three months prior to the ACR filing date. Nonetheless, as of today, a ruling on Proposal 9 remains pending. Past precedent is even more troubling – the Commission ruled on the five Docket No. RM2012-2 proposals 209 days after they were filed.

[5] In the past, the Postal Service has found that the Commission sometimes mistakenly reverts to prior models, when more up-to-date models have already been approved. A central repository of the most up-to-date models would help prevent such occurrences.

II. MARKET DOMINANT PRODUCTS

Below, the Postal Service discusses, for each market dominant mail class, FY 2012 costs, revenues, and volumes by product, as well as intra-product workshare discounts and passthroughs.[6] Comprehensive cost, revenue, and volume data are contained in the CRA, at USPS-FY12-1, and in the ICRA, at USPS-FY12-NP2. Full data regarding workshare discounts and passthroughs are contained in USPS-FY12-3.

With respect to passthroughs generally, the Postal Service reiterates its longstanding position that section 3622(e) applies over the long term, as a principle guiding pricing over a series of price adjustments. This approach is consistent with subsections (B) and (D) of section 3622(e)(2) – the efficient operation of the Postal Service and the need to mitigate rate shock necessitate a measured approach to adjusting passthroughs. It should go without saying that it would be inefficient and unduly disruptive to the Postal Service and to its customers to immediately adjust prices to correct passthroughs that exceed 100 percent. The Postal Service will look to correct passthroughs that exceed 100 percent in its next price adjustment, which will then be reviewed by the Commission.[7]

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[6] The Postal Service maintains its position that the workshare provisions of title 39 apply only to intra-product relationships, and not to inter-product relationships. This issue is presently pending review before the United States Court of Appeals for the District of Columbia. *See* United States Postal Service v. Postal Regulatory Commission, *appeal docketed*, No. 12-1221 (D.C. Cir. 2012). Nonetheless, the Postal Service has applied the methodology set forth by the Commission in May 2012 in Docket No. RM2010-13 to the calculation of the First-Class Mail Presort Letters workshare discount cost avoidances. *See* the Commission's Notice of Errata, Docket No. RM2010-13 (May 9, 2012).

[7] In the past, parties have complained that the Postal Service's filing of its annual price adjustment before the filing of the ACR dilutes the efficacy of the Commission's ACD, as any pricing recommendations made by the Commission in the ACD must wait nine months before they can be implemented. The Postal Service is sympathetic to this concern – it would be ideal for the Postal Service's price adjustment filings to have the benefit of a recently issued ACD. However, the Postal Service notes that the timings of the ACR and ACD are set by statute at 90 days and 180 days, respectively, after the end of the fiscal year. This cannot be changed absent new legislation. While the Postal Service could theoretically change the timing of its annual price adjustments, it presently views January as the most efficient time of the year to

A. First-Class Mail

1. Cost, Revenues, and Volumes

Costs, revenues, and volumes for First-Class Mail products appear below.

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	23,913	$10,902	$6,573	$4,328	$0.456	$0.275	$0.181	165.85%
Presorted Letters/Cards	42,519	$15,079	$5,164	$9,915	$0.355	$0.121	$0.233	292.00%
Flats	2,049	$2,668	$1,791	$877	$1.302	$0.874	$0.428	148.99%
Parcels	293	$649	$659	-$10	$2.211	$2.246	-$0.035	98.42%
Domestic NSA First-Class mail	215	$79	$28	$51	$0.366	$0.128	$0.238	285.33%
First-Class Mail Fees		$139.7						
Total First-Class Domestic Mail (incl. fees)	68,990	$29,516	$14,215	$15,301	$0.428	$0.206	$0.222	207.6%
Outbound Single-Piece First-Class Mail Int'l	264	$665	$439	$226	$2.523	$1.664	$0.859	151.6%
Inbound Single-Piece First-Class Mail Int'l	202	$127	$193	-$66	$0.628	$0.955	-$0.327	65.8%
Total First-Class Mail	69,455	$30,308	$14,846	$15,462	$0.436	$0.214	$0.223	204.1%

adjust prices, both for itself and for most of its customers. For the Postal Service to forgo that efficiency merely to convenience a regulatory process would be to put the cart before the horse, and indeed would undermine the pricing flexibility accorded to the Postal Service by the PAEA.

As shown above, with the exception of First-Class Mail Parcels and Inbound Single-Piece First-Class Mail International, all First-Class Mail products covered their attributable costs in FY 2012, with most of them contributing significantly to institutional costs. This comports with the historical role of First-Class Mail as providing the highest contribution to institutional costs of all mail classes. Unfortunately, First-Class Mail volumes continued to decline at a significant pace in FY 2012. After declining 6.6 percent from FY 2009 to FY 2010, and 6.4 percent from FY 2010 to FY 2011, First-Class Mail volume declined 5.6 percent (or 4.0 billion pieces) from FY 2011 to FY 2012.

The cost coverage of First-Class Mail Parcels fell from 110.0 percent in FY 2011 to 98.4 percent in FY 2012. This likely stemmed from the transfer of commercial First-Class Mail Parcels to the competitive product list; only the retail portion of the product remains on the market dominant product list. On January 27, 2013, prices for First-Class Mail Parcels will increase by an average of 5 percent, almost double the class average increase of 2.57 percent. This should improve the product's cost coverage.

The failure of Inbound Single-Piece First-Class Mail International to cover its attributable costs stems from the product's unique pricing regime. The Postal Service does not independently determine the prices for delivering foreign origin mail. Rather, these prices are set according to a Universal Postal Union (UPU) terminal dues formula established in the Universal Postal Convention; the formula is based on a percentage of the one-ounce retail Single-Piece First-Class Mail price, instead of on actual costs.[8] The Postal Service will continue its strategy of negotiating bilateral agreements with some of its larger exchange partners to improve total inbound cost coverage.

[8] It is notable that the formula resulted in a positive net contribution to the Postal Service, because the Postal Service is a net exporter and generated significant revenue from its outbound flows.

2. Workshare Discounts and Passthroughs

i. Single-Piece Letters and Cards

The First-Class Mail Single-Piece Letters and Cards product has one worksharing discount, which is applicable to both Qualified Business Reply Mail (QBRM) Letters and QBRM Cards. The calculated passthrough for this discount decreased from 287.5 percent in FY 2011 to 129.4 percent in FY 2012. This reduction stems from a significant increase in the avoided costs, from 0.8 cents to 1.7 cents, and a reduction in the QBRM discount, from 2.3 cents to 2.2 cents. On January 27, 2013, the discount will reduce further to 1.7 cents, matching the FY 2012 avoided costs. The Postal Service therefore justifies the passthrough pursuant to section 3622(e)(2)(B), as it has moved to phase out the portion of the discount above avoided costs.

ii. Presorted Letters and Cards

Out of the nine First-Class Mail Presorted Letters and Cards workshare discounts, the passthroughs for four exceed 100 percent: Mixed AADC Automation Letters, Automation AADC Letters, Mixed AADC Automation Cards, and Automation 5-Digit Cards.

The passthrough for Mixed AADC Automation Letters is 102.2 percent. On January 27, 2013, the discount will become 5.5 cents, which is close to the 5.9 cents cost avoidance calculation current at the time of the filing of the Docket No. R2013-1 price adjustment. In the calculations presented in the instant docket, the cost avoidance has fallen to 4.5 cents, meaning that the new 5.5 cent discount will likely still lead to a passthrough above 100 percent for FY 2013. The Postal Service justifies the present Mixed AADC Automation Letters passthrough pursuant to section 3622(e)(2)(D). Given the large swings in the measured costs – the cost avoidance was 3.4 cents in FY 2011, rose to 5.9 cents at time of the filing of the Docket No. R2013-1 price adjustment, and has now fallen to 4.5 cents – it would be inefficient to the Postal Service to make significant changes to the discount while the measured costs are so unsettled. Indeed, the impact of the discount is not limited to Mixed AADC Automation Letters alone; it extends to the prices of AADC, 3-Digit, and 5-Digit Automation Letters.[9] Moreover, in terms of contribution, First-Class Mail Presort Letters is a critically important product, and the Postal Service must move cautiously in adjusting prices for categories within the product. Nevertheless, the Postal Service will endeavor to meet the section 3622(e)(2) standard through future price adjustments, as the measured cost differentials stabilize.

The passthrough for Automation AADC Letters is 115.4 percent. On January 27, 2013, the discount will fall to 2.1 cents, which is lower than the FY 2012 cost avoidance of 2.6 cents. The Postal Service therefore justifies this passthrough pursuant to section 3622(e)(2)(B), as it has moved to phase out the portion of the discount above avoided costs.

The passthrough for Mixed AADC Automation Cards is 227.3 percent. The Postal Service justifies this discount pursuant to section 3622(e)(2)(B). The cost avoidance associated with the discount has fallen quickly in the recent past – from 2.7 cents in FY 2010, to 1.9 cents in FY 2011, to 1.1 cents in FY 2012. Changing the discount rapidly enough to match these reductions in the cost avoidance would lead to

[9] As indicated in footnote 6 above, the Postal Service maintains its position that there is no worksharing relationship, as defined in the law, between Single-Piece Letters and Mixed AADC Automation Letters, but it nonetheless uses the term “discount” herein for simplicity.

rate shock. Instead, the Postal Service intends to phase out over time the portion of the discount above avoided costs, while taking into consideration other business needs.

The passthrough for Automation 5-Digit Cards is 116.9 percent. On January 27, 2013, the discount will be reduced to 1.2 cents, matching the FY 2012 cost avoidance. The Postal Service therefore justifies this passthrough pursuant to section 3622(e)(2)(B), as it has moved to phase out the portion of the discount above avoided costs.

iii. Flats

Two of the First-Class Mail Flats passthroughs exceed 100 percent: Automation ADC Flats and 5-Digit Automation Flats. The Automation ADC Flats passthrough is 158.7 percent. The Postal Service justifies this discount pursuant to section 3622(e)(2)(B). The Postal Service has been steadily bringing this passthrough toward 100 percent – from 277.3 percent in FY 2010, to 214.3 percent in FY 2011, to 158.7 percent in FY 2012 – and intends to continue to do so until it eliminates the portion of the discount above avoided costs, while forgoing any drastic changes in the discount that could lead to rate shock, and taking into account relevant business considerations.

The 5-Digit Automation Flats passthrough is 131.5 percent. The cost avoidance was 17.4 cents in FY 2010, grew to 18.8 cents in FY 2011, and then unexpectedly shrank to 14.3 cents in FY 2012. In Docket No. R2013-1, the Postal Service set the discount at 18.8 cents, matching the FY 2011 cost avoidance. Unfortunately, given the significantly smaller cost avoidance in FY 2012, the new discount will likely lead to a passthrough above 100 percent again in FY 2013. Reducing the discount more than 4 cents immediately would lead to rate shock; instead, the Postal Service intends to reduce the discount to match the cost avoidance over time, while taking into consideration other business needs. The Postal Service therefore justifies the passthrough pursuant to section 3622(e)(2)(B). More generally, the Postal Service must move slowly when cost avoidances swing back and forth; chasing the cost avoidance with significant changes to the discount would impede the efficient operation of the Postal Service. The passthrough is therefore also justified pursuant to section 3622(e)(2)(D).

3. First-Class Mail Incentive Programs

There was one First-Class Mail incentive program in effect in FY 2012: the 2012 Mobile Commerce and Personalization Program. The program started on July 1, 2012 and ended on August 31, 2012. Its primary intent was to generate awareness of specific ways in which mobile technology can be integrated into mail campaigns. The program provided a discount on the eligible postage for commercial First-Class Mail and Standard Mail letters, postcards and flats sent using a permit imprint, meter or precancelled stamp payment method, that included a two-dimensional mobile barcode inside or on the mailpiece. The mobile barcode was required to point to a mobile-optimized website that either facilitated mobile commerce or was personalized to the recipient. Over the course of the two month program period, the Postal Service issued over $1.7 million in rebates for 229 million First-Class Mail pieces.

B. Standard Mail

1. Cost, Revenues, and Volumes

Costs, revenues, and volumes for Standard Mail products appear below.

Table 2: Standard Mail Volume, Revenue, and Cost by Product								
Product	Volume (million)	Revenue ($million)	Attributable Costs	Contribution	Revenue/ Piece	Cost/ Piece	Unit Contribution	Cost Coverage
HD/Sat Letters	5,564	$ 767	$ 347	$ 420	$ 0.138	$ 0.062	$ 0.075	221.0%
HD/Sat Flats & Parcels	11,770	$ 1,951	$ 900	$ 1,051	$ 0.166	$ 0.076	$ 0.089	216.8%
Carrier Route	9,120	$ 2,244	$ 1,721	$ 524	$ 0.246	$ 0.189	$ 0.057	130.4%
Letters	46,147	$ 8,977	$ 5,046	$ 3,931	$ 0.195	$ 0.109	$ 0.085	177.9%
Flats	5,940	$ 2,230	$ 2,762	$ (532)	$ 0.375	$ 0.465	$ (0.090)	80.7%
Parcels & NFMs	304	$ 285	$ 338	$ (53)	$ 0.938	$ 1.113	$ (0.175)	84.3%
Standard Mail NSAs	956	$ 197	$ 104	$ 93	$ 0.206	$ 0.109	$ 0.098	189.7%
Standard Mail Fees	0	$ 62						
Total Standard Mail (incl. fees)	79,800	$ 16,713	$ 11,217	$ 5,496	$ 0.209	$ 0.141	$ 0.069	149.0%
Former Regular & Nonprofit Regular*	52,393	11,494			$ 0.219			
Former ECR & Nonprofit ECR*	26,454	4,962			$ 0.188			

*These are included to allow comparison with former subclass-level data.

As shown above, all Standard Mail products other than Standard Mail Parcels and Standard Mail Flats covered their attributable costs in FY 2012. As a class, Standard Mail covered its attributable costs and contributed significantly to institutional costs.

Under section 3626(a)(6), when the Postal Service adjusts Standard Mail prices, the estimated average revenue per piece for Standard Mail sent by nonprofit mailers must equal, as nearly as practicable, 60 percent of the estimated average revenue per piece for Standard Mail sent by commercial customers. For FY 2012, the ratio was 59.3 percent.

Standard Mail Parcels had a cost coverage of 84.3 percent in FY 2012. While the Postal Service increased the product's prices by 2.864 percent in January 2012, the increase could not counteract cost increases enough to raise the cost coverage from FY

2011, when the product's cost coverage was 85.4 percent. Nonetheless, the cost coverage is still significantly higher than the FY 2010 cost coverage of 77.9 percent. On January 22, 2012, a large portion of the product – specifically, commercial Standard Mail machinable and irregular parcels generally used for fulfillment purposes – transferred to the competitive product list, and the portion of the product formerly titled Not Flat-Machinables became Marketing Parcels, with different mailing standards. Because a higher proportion of the product is now Nonprofit, the product is likely to continue to have a cost coverage below attributable costs in FY 2013. However, the Postal Service intends to continue attempting to increase the product's cost coverage over the long term through price increases.

Standard Mail Flats had a cost coverage of 80.7 percent in FY 2012, an increase of 1.4 percentage points over FY 2011 that reverses three consecutive years of declining cost coverage. This increase materialized notwithstanding a 12.4 percent decline in volume in FY 2012. As the Postal Service has stated repeatedly in the past, it agrees with the Commission that having products cover their costs is an appropriate long-term goal. This improvement in cost coverage takes a step in that direction.

In Order No. 1472, the Commission directed the Postal Service, as part of its FY 2012 Annual Compliance Report (ACR), to "respond to the specific remedy adopted by the 2010 ACD by presenting a schedule of future price adjustments for Standard Mail Flats."[10] In the FY 2010 ACD, the Commission ordered the Postal Service to take both general and specific remedial actions designed to increase the cost coverage of the

[10] Order No. 1472, Docket No. ACR2010 (Sept. 21, 2012), at 3.

Standard Mail Flats product (ACD Order).[11] With respect to the specific remedial action, the Commission required the Postal Service to present “a schedule of future above-CPI price increases for Standard Mail Flats.”[12] Table 3, below, complies with Order No. 1472 by presenting a three-year schedule of above-CPI increases for the Flats product.

When discussing any schedule involving future prices, it is important to consider two factors. First, any proposed rate schedule is speculative, because it relies on numerous assumptions (*i.e.*, anticipated market conditions) that may or may not materialize. Second, only the Postal Service’s Governors have the authority to change prices of postal products.[13] Pricing decisions are based upon the application of statutory and regulatory requirements, taking into consideration the Governors’ independent evaluation of market and business strategy concerns. These decisions can only be made within the context of the circumstances that exist at the time a specific price change is approved.

Though the Postal Service is presenting a schedule of above-CPI price increases for Standard Mail Flats, it continues to have significant reservations about the assumptions embodied in the Commission’s directives. As the Postal Service explained in Docket No. R2013-1, it believes that continued above-CPI price increases for the

[11] FY 2010 Annual Compliance Determination, Docket No. ACR2010 (Mar. 29, 2011), at 106.
[12] *Id*.
[13] *See* 39 U.S.C. § 404(b).

Flats product could impair the Postal Service's ability to enhance its revenue and contribution in the long run.[14]

Assuming that the systemic decline in Standard Mail Flats volume continues, the rest of Standard Mail will be increasingly called upon to cover a larger portion of network costs. By keeping the price of other Standard Mail products low (that is, by "spending" more of the Postal Service's limited cap-based pricing authority on higher than average increases for Flats), the Commission's strategy could weaken these products' ability to bear this burden. The financial risk inherent in the Commission's pricing directives is illustrated in the models presented in USPS-FY12-43.[15] Quite simply, the mechanics of market dominant price change calculations (which rely on historic volume proportions) make it risky to use more of the Postal Service's limited pricing authority on mail volume that may not be around to pay those prices in the future. This risk is one of many factors (statutory, market-related, strategic, etc.) that the Postal Service believes should be considered in the pricing decision. Consideration of all of these factors is best done on a case-by-case, or year-by-year, basis, depending in part on the market outlook obtaining at the time.

The Commission's strategy is complicated by two additional factors. First, volume-variable total product cost may not actually fall in concert with declining volume. The "prospective" model in USPS-FY12-43 allows the user to test the sensitivity to such

[14] Notice of Market Dominant Price Adjustment, Docket No. R2013-1 (Oct. 11, 2012), at 21-24. It is also important to note that, since FY 2008, Flats volume has declined by a little over 40 percent. This decline stands in stark contrast to the modest 6 percent cumulative price increase over the same period. While the continued weakness in the general economy has undoubtedly played some role in depressing Flats volume, a significant portion of the decline is likely being driven by systemic changes in the industry that reduce the prevalence of hard-copy alternatives.

[15] These models were produced by Christensen Associates. A detailed explanation from Christensen Associates regarding the models is also included in USPS-FY12-43.

an effect. By using this feature of the model, it can be seen that the risk to contribution from directing more of the price cap authority to the product in relative volume decline (in this instance, Standard Mail Flats) is increased. Further, the resulting upward pressure on unit cost could jeopardize the goal of improving Flats cost coverage. Even with above-CPI price increases, the Postal Service may struggle to reach a Flats cost coverage of 100 percent.

Second, strict adherence to above-CPI price increases also impairs the pricing flexibility the Postal Service is guaranteed under the PAEA. Indeed, as Commissioner Taub noted in his dissent to Order No. 1541, “the Postal Service is responsible for selecting the set of rates which, in its judgment, is most consistent with its statutory mission.”[16] An unquestioning implementation of above-CPI price increases would also significantly restrict the Postal Service’s ability to react to changing market and strategy considerations.[17] In short, forcing the Postal Service to use more of its limited pricing authority on Standard Mail Flats (irrespective of the judgment of the Governors and Postal Service management) is inconsistent with the balance of authorities embodied in title 39.

Despite the above referenced reservations, the Postal Service presents below a three-year schedule of above-CPI price increases for Standard Mail Flats.[18]

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[16] Order No. 1541, Docket No. R2013-1, at Dissent of Commissioner Taub, at 4 (Nov. 16, 2012).

[17] For example, the Postal Service needs to consider the most up-to-date rates of growth or decline of each Standard Mail product before deciding how to allocate its cap authority.

[18] A three-year time horizon was chosen because of the Commission’s responsibility, pursuant to 39 U.S.C. § 3622(d)(3), to review the system for regulating rates and classes of market dominant products in 2016.

Table 3 – Planned Standard Mail Flats Price Increases

Year	Planned Flats Price Increases
2014	CPI * 1.05
2015	CPI * 1.05
2016	CPI * 1.05

In developing this schedule, the Postal Service was mindful to balance its need to maintain pricing flexibility with the Commission's directive that higher prices are necessary for this product. As seen in Table 3, the Postal Service contemplates above-CPI increases that are larger than the above-CPI increases approved for Standard Mail Flats in Docket Nos. R2012-3 and R2013-1. The schedule also adopts a multiplier consistent with the Postal Service's view that the additional absolute price increase above CPI, if appropriate at all, should vary with the size of CPI. The Postal Service expects that any above-CPI price increases will be complemented by cost savings from initiatives such as Network Rationalization.

All else equal, larger price increases could improve the cost coverage of Standard Mail Flats. Of course, as discussed above, not all else is equal, and pricing decisions under the CPI cap involve complexities that make the rallying call of "raise the price" a potentially counter-productive reaction. The PAEA contemplates that many factors and considerations must be balanced, and it places that thoughtful balancing in the hands of the Governors. While the Postal Service may choose to implement the schedule in Table 3 without further revision, changes in market conditions and other strategic concerns may require subsequent adjustments.

2. Workshare Discounts and Passthroughs

i. Letters

Three workshare passthroughs for Standard Mail Letters exceed 100 percent: Nonautomation ADC Nonmachinable Letters, Nonautomation 3-Digit Nonmachinable Letters, and Nonautomation 5-Digit Nonmachinable Letters.

The Nonautomation ADC Nonmachinable Letters passthrough is 121.3 percent. The cost avoidance increased from 7.9 cents in FY 2011 to 8.0 cents in FY 2012. On January 27, 2013, the discount will be reduced from 9.7 cents to 9.5 cents, somewhat reducing the passthrough. The Postal Service intends to continue moving the discount toward the avoided costs, until the passthrough reaches 100 percent, while avoiding any drastic reductions that could lead to rate shock. The Postal Service therefore justifies this passthrough pursuant to section 3622(e)(2)(B).

The Nonautomation 3-Digit Nonmachinable Letters passthrough is 144.4 percent, down from 152 percent in FY 2011. The cost avoidance increased from 2.5 cents in FY 2011 to 2.7 cents in FY 2012. On January 27, 2013, the discount will be reduced from 3.9 cents to 3.4 cents, reducing the passthrough further. The Postal Service intends to continue reducing the passthrough, through adjustments to the discount, until the passthrough reaches 100 percent, while avoiding any drastic reductions that could lead to rate shock. The Postal Service therefore justifies this passthrough pursuant to section 3622(e)(2)(B).

The Nonautomation 5-Digit Nonmachinable Letters passthrough is 120.8 percent, down from 122.4 percent in FY 2011. The cost avoidance increased from 7.6 cents in FY 2011 to 7.7 cents in FY 2012. On January 27, 2013, the discount will increase from

9.3 cents to 9.5 cents. For context, the Postal Service notes that the cost avoidance was 10.5 cents in FY 2010. The Postal Service did not decrease the discount in its Docket No. R2013-1 price adjustment because, given the increase in the Mixed AADC price, reducing the 5-Digit discount would increase the 5-Digit price beyond what the Postal Service believes the industry would presently be able to bear. The inability of customers to rely on stability in annual price adjustments would significantly undermine the ability of the Postal Service to use prices to signal efficient behavior. It is the Postal Service's goal to phase out over time the portion of the discount above avoided costs – as avoided costs appear to be increasing once again, successive modest reductions in the discount should bring it in line with avoided costs over time. The Postal Service therefore justifies this passthrough pursuant to section 3622(e)(2)(B).

The Postal Service notes that the FY 2012 cost avoidance for Standard Mail Automation Mixed AADC Letters is calculated at negative 0.3 cents, compared to positive 1.8 cents in FY 2011. Intuitively, this does not make sense – pre-barcoding a mailpiece should result in lower processing costs than not pre-barcoding the mailpiece, all else equal. The Postal Service will therefore refrain, for the time being, from making any pricing decisions based on this change in the cost avoidance.[19]

ii. Flats

Two passthroughs for Standard Mail Flats exceeds 100 percent: the presorting Nonautomation 5-Digit Flats passthrough and the pre-barcoding Automation Mixed ADC Flats passthrough. The presorting Nonautomation 5-Digit Flats passthrough is 141.4

[19] It appears that, as a result of Proposal 19, Docket No. RM2012-2, ISS productivities increased by 112 percent, thereby reducing the cost of applying a barcode to a Mixed ADC Nonautomation Machinable piece, while at the same time Outgoing BCS secondary productivity dropped 30 percent, thereby increasing the cost of sorting Automation Mixed AADC pieces.

percent. On January 27, 2013, the discount will fall from 8.2 cents to 7.8 cents, matching the FY 2011 cost avoidance of 7.8 cents. In FY 2012, the cost avoidance fell significantly, to 5.8 cents, meaning that the passthrough will likely remain above 100 percent in FY 2013. The Postal Service intends to continue moving the discount in line with the cost avoidance; if the cost avoidance stabilizes, this should occur over time. Moving the discount in line with the cost avoidance immediately could lead to rate shock, and would further be inadvisable given that the significant one-year reduction in the cost avoidance could be short-lived. The Postal Service therefore justifies this passthrough pursuant to section 3622(e)(2)(B).

The pre-barcoding Automation Mixed ADC Flats passthrough is 126.7 percent, down from 247.8 percent in FY 2011. The Postal Service justifies this passthrough pursuant to section 3622(e)(2)(D). As FSS machines were being deployed over the past few years, a pre-barcoding discount was necessary for the efficient operation of the Postal Service. With the deployment of FSS machines only just completed, there continues to be a need for a pre-barcoding incentive, although the incentive can gradually be reduced. In FY 2010, the discount was 6.2 cents. In FY 2011, the discount was reduced to 5.7 cents. On January 27, 2013, the discount will be reduced further to 5.5 cents. The Postal Service intends to continue reducing the discount until it no longer exceeds avoided costs.

iii. Parcels and NFMs

Six Standard Mail Parcels passthroughs exceed 100 percent: the presorting NDC Irregular Parcels passthrough, the presorting NDC Marketing Parcels passthrough, the presorting SCF Marketing Parcels passthrough, the pre-barcoding

Mixed NDC Machinable Barcoded Parcels passthrough, the pre-barcoding Mixed NDC Irregular Barcoded Parcels passthrough, and the pre-barcoding NDC Marketing Barcoded Parcels passthrough.

The presorting passthrough for NDC Irregular Parcels is 242.8 percent, down from 300.8 percent in FY 2011. The passthrough fell because of both a decrease in the discount and an increase in the cost avoidance. On January 27, 2013, the discount will be reduced further, from 36.9 cents to 36.5 cents. The Postal Service intends to continue reducing the discount until it is line with the cost avoidance, while avoiding any drastic reductions that could lead to rate shock. The Postal Service therefore justifies this passthrough pursuant to section 3622(e)(2)(B).

The presorting passthrough for NDC Marketing Parcels is 134.7 percent, down from 180.4 percent in FY 2011. On January 27, 2013, the discount will be reduced from 41.5 cents to 41.4 cents. The Postal Service intends to continue moving the discount in line with the avoided costs, while avoiding any drastic changes that could lead to rate shock. The Postal Service also finds encouraging the recent increase in avoided costs, from 23.0 cents in FY 2011 to 30.8 cents in FY 2012. The Postal Service therefore justifies this passthrough pursuant to section 3622(e)(2)(B).

The presorting passthrough for SCF Marketing Parcels is 135.3 percent, down from 139.3 percent in FY 2011. The cost avoidance increased from 26.7 cents in FY 2011 to 27.5 cents in FY 2012, and the discount will be reduced from 37.2 cents to 31.2 cents on January 27, 2013, thereby bringing the passthrough close to 100 percent. The Postal Service intends to close the remaining gap by further reducing the discount over time. The Postal Service therefore justifies this passthrough pursuant to section 3622(e)(2)(B).

Furthermore, with respect to both the NDC Marketing Parcels and SCF Marketing Parcels presorting passthroughs, the Postal Services notes that the recent substantial changes in the definition of Standard Mail Parcels, with the reclassification in FY 2012 of the majority of the product to the competitive product list, introduce some uncertainty as to whether the Standard Mail Parcels cost avoidances will remain steady in FY 2013. This underscores the need to move deliberately and gradually with respect to the corresponding discounts.

The pre-barcoding passthroughs for Mixed NDC Machinable Barcoded Parcels, Mixed NDC Irregular Barcoded Parcels, and NDC Marketing Barcoded Parcels are all 164.1 percent. As discussed in previous price adjustment filings and ACRs, the Postal Service has been sending a strong signal to mailers through the parcels nonbarcoded surcharge to develop a fully barcoded parcels mailstream. The Postal Service has plans to soon require barcodes on all ground parcels. A fully barcoded mailstream would permit the elimination of keying stations on parcel sorters, thereby increasing the efficiency of postal operations. In light of the above, it makes sense, in the near term, to maintain the pre-barcoding discounts above 100 percent of avoided costs, in order to encourage a mailstream that will make postal operations more efficient. The Postal Service therefore justifies these passthroughs pursuant to section 3622(e)(2)(D).

iv. High Density and Saturation Letters, Flats, and Parcels

No workshare discount associated with Standard Mail High Density Saturation Letters, Flats, or Parcels exceeds 100 percent of avoided costs.

3. Standard Mail Incentive Programs

There were two Standard Mail incentive program in effect in FY 2012: the Saturation and High Density Mail Incentive Program, and the 2012 Mobile Commerce and Personalization Promotion Program.

i. Saturation and High Density Mail Incentive Program

The Saturation and High Density Mail Incentive Program began on January 1, 2011 and will end on December 31, 2012. The program encouraged increased mail usage from existing direct mail customers by providing a discount on incremental volume. There were a total of 919 certified participants in the program. Of these certified participants, 336 customers received rebates totaling $7.2 million. Rebate earners mailed 1.5 billion pieces of Saturation and High Density letter and flat mail pieces during the program period, which represented approximately 9 percent of total Saturation and High Density letter and flat volume over the same time period.

ii. 2012 Mobile Commerce and Personalization Program

The 2012 Mobile Commerce and Personalization Program is described as part of the First-Class Mail discussion in Section II.A.3 above. Over the course of the two month program period, the Postal Service issued $13.2 million in rebates for 3.17 billion Standard Mail pieces.

C. Periodicals

1. Cost, Revenues, and Volumes

Costs, revenues, and volumes for Periodicals products appear below.

Table 4: Periodicals 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	631	$66	$95	$(29)	$0.105	$0.151	$(0.046)	69.70
Outside County Periodicals	6,110	$1,657	$2,306	$(649)	$0.271	$0.377	$(0.106)	71.84
Fees		$8.3	-	-	-	-	-	-
Total Periodicals Mail (incl.fees)	6,741	$1,731	$2,402	$(670)	$0.257	$0.356	$(0.099)	72.10

As shown above, both Periodicals products failed to cover their attributable costs in FY 2012. The cost coverage of Within County Periodicals fell from 78.4 percent in FY 2011 to 69.7 percent in FY 2012, and the cost coverage of Outside County Periodicals fell from 74.8 percent in FY 2011 to 71.8 percent in FY 2012. Overall, the cost coverage of the class fell from 74.9 percent to 72.1 percent. These declines have occurred despite the Postal Service taking the steps outlined in the *Periodicals Mail Study*.[20]

When examining Periodicals cost coverage, it is important to remember that both cost and revenue play a role in the calculation. In this instance, the revenue per piece for Periodicals overall (25.7 cents) was the same in FY 2012 as it was in FY 2011, despite price increases that occurred in January 2012. Cost per piece increased from 34.3 cents to 35.6 cents, or 3.8 percent. The net effect was a lower calculated cost coverage.

Unit revenue is driven by many factors – including weight, editorial content percentage, and “mail mix” – only some of which affect handling costs. For instance, the percentage of a publication’s content that is editorial affects the revenue received for

[20] Periodicals Mail Study: Joint Report of the United States Postal Service and the Postal Regulatory Commission (Sept. 2011).

it but does not affect the cost of handling it. Likewise, the reported unit cost is the result of many drivers. In any event, the combination of all of these factors led to a lower calculated cost coverage in FY 2012.

The Postal Service shares the Commission's concern about Periodicals cost coverage, and, as stated in the *Periodicals Mail Study*, "the Postal Service and the Commission will continue to work together to identify and address challenges related to Periodicals."[21] That Study outlined the continuing steps that the Postal Service is taking to reduce costs. While the Postal Service believes that some of the savings from those steps began to accrue in FY 2012, it is clear that they did not impact the cost coverage appreciably. Of course, some of the initiatives are longer-term than one year, and in some instances costs from the changes associated with those initiatives have been incurred while the associated savings may take longer to realize.

More generally, while the Postal Service will pursue whatever efficiency enhancements are possible, it is extremely doubtful that, in the context of price increases limited to the CPI cap, the Periodicals class can achieve 100 percent cost coverage.

2. Workshare Discounts and Passthroughs

All workshare discounts associated with Within County Periodicals are below 100 percent of avoided costs, with the exception of the High Density presorting discount, which is at exactly 100 percent of avoided costs. Ten workshare discounts associated with Outside County Periodicals exceed 100 percent of avoided costs: the presorting discounts for Machinable Nonautomation 5-Digit Flats, High Density, Machinable

[21] *Id*. at 3.

Automation 5-Digit Flats, Nonmachinable Nonautomation 3-Digit / SCF Flats, Nonmachinable Automation 3-Digit / SCF Flats, ADC Automation Letters, 3-Digit Automation Letters, and 5-Digit Automation Letters; and the pre-barcoding discounts for Machinable Automation MADC Flats and Nonmachinable Automation MADC Flats.

As a general matter, the Postal Service justifies all of these discounts pursuant to section 3622(e)(2)(C), which permits discounts provided in connection with mail matter of educational, cultural, scientific, or informational value to exceed 100 percent of avoided costs. Nonetheless, of particular note is the pre-barcoding passthrough for Nonmachinable Automation MADC Flats. It is calculated to be 4500 percent in FY 2012, compared to 750 percent in FY 2011. The passthrough is high because the pre-barcoding cost avoidance for nonmachinable pieces is approaching zero. This has resulted from the reduction in the number of UFSM1000 machines, which has led to manual processing of AFSM100 nonmachinable pieces. In manual processing, the presence of a barcode does not add any value.

D. Package Services

1. Cost, Revenues, and Volumes

Costs, revenues, and volumes for Package Services products appear below.

Table 5: 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 (%)
Parcel Post	71	774	840	(66)	10.907	11.841	(0.934)	92.1
Bound Printed Matter Flats	231	186	138	47	0.806	0.600	0.206	134.3
Bound Printed Matter Parcels	243	305	281	24	1.256	1.156	0.100	108.7
Media Mail/Library Mail	100	321	377	(56)	3.193	3.752	(0.559)	85.1
Fees		3						
Inbound Surface Parcel Post	1	20	12	9	18.598	10.509	8.089	177.0
Total Package Services Mail (incl. fees)[22]	646	1,610	1,648	(38)	2.491	2.550	(0.060)	97.7

Two Package Services products failed to cover their attributable costs. Parcel Post had a cost coverage of 92.1 percent, and Media Mail / Library Mail had a cost coverage of 85.1 percent. Overall, the class had a cost coverage just under attributable costs, at 97.7 percent. With the recently approved transfer of Parcel Post to the competitive product list, the Package Services class's cost coverage should increase above 100 percent of attributable costs. The Postal Service intends to attempt to improve the cost coverage of Media Mail / Library Mail over time through price increases, though such increases are limited by the CPI cap system.

2. Workshare Discounts and Passthroughs

i. Media Mail / Library Mail

Two passthroughs associated with Media Mail / Library Mail exceeded 100 percent in FY 2012: the presorting Media Mail Basic passthrough and the presorting Library Mail Basic passthrough. The former is 133.3 percent, and the latter is 126.7

[22] Totals are calculated from unrounded numbers and then rounded. This is why the rounded totals do not always equal the sum of the rounded subtotals in Table 5.

percent, compared to 83.0 percent and 78.7 percent, respectively, in FY 2012. The significant change occurred as a result of the new cost avoidance calculation methodology approved by the Commission in Order No. 1153, Docket No. RM2012-1 (Proposal 20). The Postal Service justifies these passthroughs pursuant to section 3622(e)(2)(C), as Media Mail and Library Mail transport matter of educational, cultural, scientific, and informational value. Nonetheless, the Postal Service plans to move the discounts toward the new cost avoidances over time, while avoiding any drastic changes that could cause rate shock. The passthroughs would therefore also be justified pursuant to section 3622(e)(2)(B).

ii. BPM Flats and BPM Parcels

Two passthroughs for BPM Flats and BPM Parcels exceed 100 percent. The passthroughs for the BPM Flats and BPM Parcels DNDC drop ship discounts are both 123.4 percent. On January 27, 2013, the discounts will be reduced from 17.4 cents to 17.0 cents, in line with the FY 2011 cost avoidance of 17.0 cents but still above the newly calculated FY 2012 cost avoidance of 14.1 cents. The Postal Service intends to further reduce the discounts in the next price adjustment, and over time return the passthrough to 100 percent or below, while avoiding any drastic changes that could cause rate shock. The Postal Service therefore justifies these passthroughs pursuant to section 3622(e)(2)(B).

E. Special Services

1. Cost, Revenues, and Volumes

Costs, revenues, and volumes for Special Services products appear below.

Table 6: Special Services Volume, Revenue and Cost by Product								
Product	Volume (Million)	Revenue ($Million)	Attributable Costs ($Million)	Contribution ($Million)	Revenue / Piece ($)	Cost / Piece ($)	Unit Contribution ($)	Cost Coverage
Certified Mail	227.1	662.8	601.9	60.9	2.92	2.65	0.27	110.12%
COD	0.7	5.9	3.6	2.3	8.44	5.13	3.31	164.45%
Insurance	30.1	108.5	97.0	11.5	3.60	3.22	0.38	111.90%
Registered Mail	2.4	39.5	30.2	9.3	16.35	12.52	3.83	130.61%
Stamped Envelopes	N/A	16.6	6.4	10.2	N/A	N/A	N/A	259.59%
Stamped Cards	70.6	2.1	0.7	1.4	0.03	0.01	0.02	289.60%
Other Ancillary Services	N/A	696.7	547.9	148.9	0.35	0.27	0.07	127.17%
Total Ancillary Services	N/A	1,532.1	1,287.6	244.5	N/A	N/A	N/A	118.99%
Int'l Ancillary Services	2.4	30.0	22.6	7.4	N/A	N/A	N/A	132.53
Caller Service	N/A	92.5	27.0	65.4	N/A	N/A	N/A	341.98%
Address Management Services	N/A	15.9	7.7	8.2	N/A	N/A	N/A	206.49%
Change of Address Credit Card Authentication*	13.1	13.5	1.4	12.1	N/A	N/A	N/A	N/A
Confirm	N/A	0.8	0.3	0.5	N/A	N/A	N/A	266.67%
Customized Postage	3	0.9	0.1	0.8	N/A	N/A	N/A	900.00%
Int'l Reply Coupon Service	N/A	0.2	N/A	N/A	N/A	N/A	N/A	N/A
Int'l Business Reply Mail Service	0.2	0.2	N/A	N/A	1.45	N/A	N/A	N/A
Money Orders	115.5	166.3	110.5	55.8	1.53	1.02	0.51	150.50%
Post Office Box Services	N/A	481.6	377.1	104.5	N/A	N/A	N/A	127.71%
Stamp Fulfillment Services	2.7	3.3	5.6	-2.3	1.27	2.15	-0.88	59.25%
Total Special Services Mail**	N/A	2,336.9	1840.0	496.9	N/A	N/A	N/A	127.01%

* See USPS-FY12-NP26 for cost after revenue-sharing with third-party partners.

One Special Services product failed to cover its attributable costs in FY 2012: Stamp Fulfillment Services. The product had attributable costs of $5.6 million in FY 2012, but listed revenues of only $2.7 million, resulting in a cost coverage of 59.3 percent. SFS prices increased 25 to 75 percent in January 2012, but the new prices were in effect for less than three quarters. The Postal Service believes that, had the new prices been in effect for the full year, the cost coverage would have improved relative to FY 2011. The Postal Service will continue to attempt to move the cost coverage toward 100 percent through price adjustments.

F. Negotiated Service Agreements

There were two market dominant Negotiated Service Agreements (NSAs) in effect in FY 2012: Discover Financial Services and Valassis. Full information regarding the Discover Financial Services NSA appears in USPS-FY12-30. The Valassis NSA was approved by the Commission on August 23, 2012, in Order No. 1448, but no mailings were made under the NSA in FY 2012, and therefore there is no data to report.

From a fiscal year perspective, the Discover Financial Services NSA had a volume of 1.171 billion pieces, revenue of $275.6 million, and attributable costs of $131.4 million, resulting in an attributable cost coverage of 209.8 percent. The Commission reviews NSAs from a contract year perspective, and it focuses on the net benefit of an NSA to the Postal Service.[23] As shown in USPS-FY12-30, the net benefit of the Discover Financial Services NSA for the contract year of April 2011 to March 2012 is estimated to be between $23.568 million and $25.513 million.

[23] 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, regardless of whether it is deemed “incremental.”

It is clear, then, that the NSA improved the net financial position of the Postal Service. Furthermore, the Postal Service has no reason to believe that the NSA caused unreasonable harm in the marketplace. The scale of the agreement was sufficiently small to make market effects unlikely, and similar functionally-equivalent NSAs could have been made available to similarly-situated mailers. The Discover Financial Services NSA therefore satisfies section 3622(c)(10)(A) and the Commission's rules.

III. SERVICE PERFORMANCE, CUSTOMER SATISFACTION, AND CONSUMER ACCESS

A. 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.[24] 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, however, is not required where the Commission has granted a semi-permanent exception or a temporary waiver.[25] The Postal Service's report, including information responsive to the criteria listed in Rule 3055.2(b)-(k), is included as USPS-FY12-29.

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. The Postal Service's targets are intended to guide longer-term improvement and are based on the continued evolution of Intelligent Mail barcode systems and on customers' participation in data collection, which enables performance measurement at the necessary levels. The specific reasons why national scores have not been met are discussed in USPS-FY12-29.

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[24] 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.

[25] *Id.* at 21-23.

B. Customer Satisfaction with Market Dominant Products

1. Overview

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. In FY 2010, the Postal Service transitioned from its prior Customer Satisfaction Measurement system to its Customer Experience Measurement (CEM) system. The CEM system divides customers into three groups – Residential, Small/Medium Business, and Large Business. The Postal Service surveyed randomly selected customers in all three groups in FY 2012.

Residential and Small/Medium Business customers 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 the corresponding product. Large business customers were asked which market dominant products they used, and then instructed to rate their satisfaction with their experience with those products. The satisfaction results reported below reflect only those customers who selected *Very Satisfied* or *Mostly Satisfied*; they exclude customers who selected *Somewhat Satisfied.*

2. Survey Results and Comparison with FY 2011

The CEM survey results appear below. The survey instruments and full results are contained in USPS-FY12-38.

Customer Satisfaction with Market Dominant Products - FY 2012

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	*94.73*	*93.35*	*91.16*
Single-Piece International	*87.54*	*84.93*	*87.37*
Standard Mail	*84.84*	*87.92*	*85.68*
Periodicals	*87.96*	*86.14*	*84.88*
Single-Piece Parcel Post	*89.83*	*88.88*	*87.14*
Media Mail	*89.10*	*88.17*	*85.89*
Bound Printed Matter	*87.17*	*85.89*	*83.53*
Library Mail	*87.89*	*87.06*	*87.04*

Among Residential and Small/Medium Business customers, satisfaction ratings increased, FY 2012 over FY 2011, for all products covered in the survey. Periodicals, Bound Printed Matter, and International Mail saw the greatest increases in satisfaction among Residential customers, with increases of .99 percent, .95 percent, and .91 percent, respectively. Library Mail, International Mail, and Periodicals saw the greatest increases in satisfaction among Small/Medium Business customers, with increases of 1.16 percent for Library Mail, and 1.07 percent for both International Mail and Periodicals.

Results from Large Business customers were mixed, with increased satisfaction ratings for three products (Library Mail, Periodicals and Standard Mail), and decreased satisfaction ratings for five products (International, First Class, Parcel Post, Media Mail, and Bound Printed Matter). Satisfaction with International Mail rating decreased 1.78 percent, and satisfaction with First Class decreased .94 percent, while the satisfaction ratings for Library Mail and Periodicals increased to a smaller degree (.75 percent and .62 percent, respectively).

C. Customer Access to Postal Services

Information regarding post offices, collection boxes, wait time in line, and delivery points is contained in USPS-FY12-33. The Postal Service closed 180 post offices and 57 stations and branches in FY 2012. At the end of FY 2012, there were 26,700 post offices, 4,905 stations and branches, and 647 carrier annexes. Also at the end of FY 2012, there were 100 suspensions of post offices in effect and 24 suspensions of stations and branches. To help mitigate the effect of closures of post offices and stations and branches, the Postal Service opened 55 Village Post Offices in FY 2012. Thus far in FY 2013, the Postal Service has opened an additional 50 Village Post Offices, and it hopes to open a total of 400 Village Post Offices in FY 2013.

Nationally, there were 164,099 collection boxes available at the end of FY 2012, compared to 166,461 at the beginning of FY 2012. Average wait time in line improved at the national level from 2 minutes 45 seconds in FY 2011 to 2 minutes 34 seconds in FY 2012. Average wait time in line also improved in six of the seven Areas from FY 2011 to FY 2012.

IV. COMPETITIVE PRODUCTS

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

For FY 2012, cost, revenues, and volumes for competitive products of general applicability are shown directly in the FY 2012 CRA and ICRA. In the CRA, competitive products are disaggregated into six groups – Total Express Mail, Total Priority Mail, Total First-Class Package Service, Total Ground, Total International Competitive, and Total Domestic 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-FY12-NP11). For competitive products not of general applicability, available data on international customized mailing agreements (ICMs) for FY 2012 are presented in the ICRA materials within USPS-FY12-NP2. For domestic competitive products not of general applicability, information is provided in USPS-FY12-NP27.

B. 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 2012 data with reference to those standards.

i. Subsection 3633(a)(1)

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.[26] 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.

As in past ACRs, the Postal Service is presenting what can be termed a "hybrid" estimate of incremental costs, in which an estimate of the aggregate incremental costs of domestic competitive products (including group specific costs) is added to an estimate of the attributable costs of 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. As demonstrated in Proposal 22, Docket No. RM2010-4, the hybrid estimate is an improvement over the full proxy of attributable costs for both domestic and international competitive products, plus group specific costs, used before FY 2009.[27] The hybrid approach provides stronger protection against cross-subsidy than the previous 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.

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[26] *See* 39 C.F.R. § 3015.7(a).

[27] Proposal 22 was approved by the Commission in Order No. 399, Docket No. RM2010-4 (Jan. 27, 2010).

INCREMENTAL COST CALCULATION FOR TOTAL COMPETITIVE PRODUCTS

	Attributable Cost (000s)	Group Specific (000s)	Incremental Cost (000s)	Hybrid Incremental Cost (000s)
Domestic Competitive	$ 7,158,171	$25,869	$7,296,749	$7,296,749
International Competitive	$ 1,225,131	-	N/A	$ 1,225,131
Total Competitive	$ 8,383,302	$25,869	N/A	$ 8,521,880

The total competitive hybrid incremental cost is $8,521,880 thousand, which is the sum of the hybrid incremental costs for domestic competitive mail and the hybrid incremental costs for international competitive. In the past, the Commission used attributable cost plus group specific cost for the cross-subsidy test. That proxy would provide a cost floor of $8,409,171 thousand ($8,383,302 + $25,869). 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.[28]

The hybrid incremental costs of $8.522 billion are well below total competitive products revenue of $11.425 billion (shown on page 3 of USPS-FY12-1). Therefore, based on these estimates, it is clear that competitive products in FY 2012 were not cross-subsidized by market dominant products, and thus were in compliance with subsection 3633(a)(1).

ii. Subsection 3633(a)(2)

Subsection 3633(a)(2) requires that each competitive product cover its attributable costs. As shown in the Nonpublic CRA (USPS-FY12-NP11) and the ICRA

[28] As demonstrated in Proposal 22, 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.

(USPS-FY12-NP2), every competitive product covered its attributable costs, with the exception of the Inbound Air Parcel Post (at non-UPU Rates) NSA. The booked and imputed versions of the ICRA report a negative contribution of $912,000 for Inbound Air Parcel Post (at non-UPU rates). This category consists of the Royal Mail air parcel post bilateral,[29] and agreements for inbound rates with several other European postal operators that are parties to Sub-Agreement B to the Agreement for the Delivery of Day-Certain Cross-Border Parcels (effective October 17, 2006), (hereinafter "eParcels" or "EPG" agreement) and that have executed and implemented bilateral inbound parcel rate agreements as provided in Annex B2 of the EPG agreement. The Postal Service has furnished information about these instruments in various filings.[30] Several of these inbound parcel bilateral rate agreements (*i.e.*, those with postal operators of Belgium, Denmark, Germany, Finland, Sweden, Switzerland, Slovakia, and Slovenia) derive from instruments executed prior to the implementation of the new rate structure under the

[29] See Request of the United States Postal Service to Add Royal Mail Inbound Air Parcel Post Agreement to the Competitive Products List, and Notice of Filing (Under Seal) Contract and Enabling Governors' Decision (Docket Nos. CP2009-28, MC2009-24).

[30] See United States Postal Service Response to Order No. 84 and Notice of Filing Ongoing International Expedited Services Agreements (Docket No. CP2008-7); (http://www.prc.gov/Docs/60/60574/CP08-7InboundEMS.pdf); see also Response of the United States Postal Service to Chairman's Information Request No. 1, Question 6 (Docket Nos. MC2009-10, CP 2009-12) (http://www.prc.gov/Docs/61/61592/MC2009-10%20CIR1%20Response.pdf); Letter from Anthony Alverno, Chief Counsel, Global Business, to Shoshana Grove, PRC Secretary, May 21, 2010 (LaPoste/Geopost) (http://prc.gov/Docs/68/68145/Groupe%20La%20Poste%20407%20d%202%20Filing.pdf); Letter from Anthony Alverno, USPS Chief Counsel, Global Business, to Honorable Shoshana Grove, PRC Secretary, May 10, 2010 (Slovenská Pošta) (http://prc.gov/Docs/68/68000/Slovenska%20Posta%20407%20d%202%20Filing.pdf); Letter from Anthony Alverno, USPS Chief Counsel, Global Business, to Honorable Shoshana Grove, PRC Secretary, March 26, 2010 (Post Danmark) (http://prc.gov/Docs/67/67315/Denmark%20407%20d%202%20Filing.pdf); Letter from Giselle Valera, Executive Director, Global Finance and Business Analysis, to Honorable Shoshana Grove, PRC Secretary, March 30, 2009 (Slovenská Pošta); Letter from Giselle Valera, Executive Director, Global Finance and Business Analysis, to Honorable Steven Williams, PRC Secretary, March 11, 2009 (Poste Italiane).

PAEA, and thus have not yet been classified since the inbound rates for EPG air parcels tendered by these posts have not been changed. The rates with postal operators of Netherlands[31] and Norway[32] have, however, been changed since the implementation of the PAEA rate review structure and are reported with the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators grouping. The Postal Service is reviewing its obligations under the inbound bilateral EPG agreements to determine if they continue to be in the best interests of the Postal Service, in consideration of the fact that the Postal Service also benefits from the rates and service for traffic dispatched to EPG participating countries.

iii. Subsection 3633(a)(3)

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.[33] Page 3 of USPS-FY12-1 shows total institutional costs of $40.625 billion.[34] Applying the 5.5 percent to that figure yields a target contribution of $2.234 billion. Page 3 of USPS-FY12-1 shows

[31] See Notice of United States Postal Service of Filing Functionally Equivalent Inbound Competitive Multi-Service Agreement with a Foreign Postal Operator (Docket Nos. CP2013-24, MC2010-34); Request of United States Postal Service to Add Inbound Competitive Multi-Service Agreements With Foreign Postal Operators to the Competitive Product List, and Notice of Filing (Under Seal) of Enabling Governors' Decision and Negotiated Service Agreement (Docket Nos. CP2010-95; MC2010-34).

[32] Notice of United States Postal Service of Filing Additional Functionally Equivalent Agreement (Docket No. CP2011-69); Notice of United States Postal Service of Filing Additional Functionally Equivalent Agreement (Docket Nos. CP2012-60, MC2010-34).

[33] *See* 39 C.F.R. § 3015.7(c). The Commission recently affirmed 5.5 percent as an appropriate minimum share of total institutional costs to be borne by competitive products. Order No. 1449, Docket No. RM2012-3 (Aug. 23, 2012).

[34] Institutional costs are significantly higher in FY 2012 compared to FY 2011 because the $5.5 billion Retiree Health Benefits Fund prefunding payment due in FY 2011 was deferred to FY 2012, and an additional $5.6 billion Retiree Health Benefits Fund Prefunding payment was already due in FY 2012, resulting in a total $11.1 billion of additional Retiree costs in FY 2012 compared to FY 2011.

total competitive attributable costs of $8.383 billion and total competitive product revenue of $11.425 billion. Subtracting the former from the latter results in total competitive contribution of $3.042 billion, greater than the $2.234 billion target. Thus, the subsection 3633(a)(3) requirement was met in FY 2012.

V. MARKET TESTS AND NONPOSTAL SERVICES

A. Market Dominant Market Tests

Four market dominant market tests of experimental products were offered under the provisions of section 3641 in FY 2012: Alternate Payment Method for Greeting Cards, Every Door Direct Mail - Retail (EDDM-R), First-Class Tracer, and Mail Works Guarantee. Information for these market tests is provided below:

Market Test	Revenue	Cost	Volume
Alternate Payment Method for Greeting Cards	$ 1,739,274	$ 215,404	3,623,487
Every Door Direct Mail	$ 65,304,052	$ 31,861,054	450,322,769
First-Class Tracer	$ 3,692	$ 7,000	1,972
Mail Works Guarantee	0	0	0
Total Market Dominant	$ 67,047,018	$ 32,083, 458	

Given the dissimilarity of the four market dominant experimental products, the Postal Service has not calculated an aggregate volume. The Postal Service does not possess comprehensive cost information for the market tests. The cost listed above for Alternate Payment Method for Greeting Cards represents the information technology costs associated with the product, the cost listed above for EDDM-R represents processing and delivery costs, and the cost listed above for First-Class Tracer represents the product development costs. The Postal Service has not yet received any volume for Mail Works Guarantee.

The Postal Service does not have a method for estimating the quality of service of its market dominant experimental products. Nonetheless, for Alternate Payment Method for Greeting Cards, the quality of service associated with First-Class Mail would apply, and for EDDM, the quality of service associated with Standard Mail would apply.

The Postal Service does not believe that the offering of any of the four market dominant experimental products created an inappropriate competitive advantage for the Postal Service or any mailer.

B. Competitive Market Tests

Gift Cards was the only competitive market test of an experimental product offered under the provisions of section 3641 in FY 2012. Information for this market test is provided below:

Market Test	Revenue	Cost	Volume
Gift Cards	$ 1,080,020	$ 278,645	208,409
Total Competitive	$ 1,080,020	$ 278,645	208,409

While the information listed above would ordinarily be filed in the nonpublic annex, the Postal Service has provided it here publicly because it already exists in public form in the Postal Service's data collection reports filed with the Commission.

The Postal Service does not have a method for estimating the quality of service of its competitive experimental products. The Postal Service does not believe that the offering of this competitive experimental product created an inappropriate competitive advantage for the Postal Service or any mailer.

C. Nonpostal Services

On December 11, 2012, the Commission issued an order approving Mail Classification Schedule (MCS) descriptions and prices for nonpostal service products.[35] The approved MCS includes 11 nonpostal service products, two of which are market dominant and nine of which are competitive. Revenue, cost, and volume data for the two market dominant products are provided below.

[35] Order No. 1575, Docket No. MC2010-24 (Dec. 11, 2012).

Alliances with the Private Sector to Defray Costs of Key Postal Functions

Revenue	$44,956,099
Expense	$4,678,334
Net Income (Loss)	$40,277,765
Volume	NA

Philatelic Sales*

Revenue	$10,647,495
Expense	$6,523,854
Net Income (Loss)	$10,600,000
Volume	NA

*Revenue and expense are for fulfillment only, through the Stamp Fulfillment Services center in Kansas City.

Comparable data for the nine competitive nonpostal services in effect in FY 2012 are provided in USPS-FY12-NP27.

VI. 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." Accordingly, such information is contained in this Report's nonpublic annex.

A complete listing of the contents of the nonpublic annex appears at Attachment One. In general, the nonpublic annex contains the same types of materials that were included in the nonpublic annex in Docket No. ACR2011. Thus, its primary contents are:

(1) versions of the CRA and Cost Segments and Components reports that provide disaggregated information for competitive products, and supporting materials underlying the CRA (such as the CRA "B" workpapers, the CRA model, and files relating to the various costing data systems);

(2) the ICRA, supporting materials underlying the ICRA, and data for international customized agreements with customers;

(3) billing determinants for domestic and international competitive products; and

(4) information on individual domestic competitive product NSAs.

An Application for Nonpublic Treatment of Materials regarding the nonpublic annex appears at Attachment Two.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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Attachment One

LIST OF APPENDED MATERIALS

Public Annex:

USPS-FY12-1	FY 2012 Public Cost and Revenue Analysis Report
USPS-FY12-2	FY 2012 Public Cost Segments and Components Report
USPS-FY12-3	FY 2012 Discounts and Passthroughs of Workshare Items
USPS-FY12-4	FY 2012 Market Dominant Billing Determinants
USPS-FY12-5	Cost Segment and Components Reconciliation to Financial Statements and Account Reallocations (Reallocated Trial Balances)
USPS-FY12-6	General Classification of Accounts
USPS-FY12-7	Cost Segment 3 Cost Pools & Other Related Information (Public Portion)
USPS-FY12-8	Equipment and Facility Related Costs
USPS-FY12-9	FY 2012 ACR Roadmap Document
USPS-FY12-10	FY 2012 Special Cost Studies Workpapers - Letter Cost Models (First and Standard)
USPS-FY12-11	FY 2012 Special Cost Studies Workpapers - Flat Cost Models (First and Standard) & Periodicals Cost Model
USPS-FY12-12	Standard Mail Hybrid/Parcel Cost Study
USPS-FY12-13	FY 2012 Special Cost Studies Workpapers - Drop Ship Cost Avoidances for Periodicals and Standard Mail
USPS-FY12-14	Mail Characteristics Study (Public Portion)
USPS-FY12-15	FY 2012 Special Cost Studies Workpapers – Bound Printed Matter Mail Processing Cost Model / Media Mail – Library Mail Mail Processing Cost Model
USPS-FY12-16	FY 2012 Special Cost Studies Workpapers - Bound Printed Matter Transportation Costs / Bulk Parcel Return Service Cost Model

USPS-FY12-17	FY 2012 Comprehensive Statement of Postal Operations
USPS-FY12-18	FY 2012 ECR Mail Processing Unit Costs
USPS-FY12-19	FY 2012 Delivery Costs By Shape
USPS-FY12-20	FY 2012 Window Service Cost by Shape
USPS-FY12-21	FY 2012 QBRM and BRM Costs
USPS-FY12-22	FY 2012 Bound Printed Matter Mail Processing Costs
USPS-FY12-23	MODS Productivity Data
USPS-FY12-24	FY 2012 Non-Operation Specific Piggyback Factors (Public Portion)
USPS-FY12-25	FY 2012 Mail Processing Piggyback Factors (Operation Specific)
USPS-FY12-26	FY 2012 Mail Processing Costs by Shape (Public Portion)
USPS-FY12-27	FY 2012 Nonprofit Mail Cost Approximations
USPS-FY12-28	FY 2012 Special Cost Studies Workpapers – Special Services (Public Portion)
USPS-FY12-29	Annual Report on Service Performance for Market Dominant Products
USPS-FY12-30	FY 2012 Market Dominant NSA Materials
USPS-FY12-31	FY 2012 CRA Model (Model Files, Cost Matrices, and Reports) (Public Version)
USPS-FY12-32	FY 2012 CRA “B” Workpapers (Public Version)
USPS-FY12-33	Consumer Access to Postal Services
USPS-FY12-34	City Carrier Cost System (CCCS) Documentation (Public Version)
USPS-FY12-35	Rural Carrier Cost System (RCCS) Documentation (Public Version)
USPS-FY12-36	Transportation Cost Systems (TRACS) Documentation (Public Version)

USPS-FY12-37	In-Office Cost System (IOCS) Documentation (Public Version)
USPS-FY12-38	USPS Market Dominant Product Customer Experience Measurement Survey Instruments and Results
USPS-FY12-39	FY 2012 Competitive Products Fund Reporting Materials
USPS-FY12-40	2012 Rural Mail Count Data and Analysis
USPS-FY12-41	International Market Dominant Billing Determinants
USPS-FY12-42	FY 2012 Revenue, Pieces, and Weight Report
USPS-FY12-43	Christensen Associates Scenario Analysis for Standard Mail Contribution

Nonpublic Annex:

USPS-FY12-NP1	FY 2012 Domestic Competitive Product Billing Determinants
USPS-FY12-NP2	FY 2012 International Cost and Revenue Analysis Report
USPS-FY12-NP3	FY 2012 International Cost Segments and Components Report
USPS-FY12-NP4	FY 2012 ICRA Domestic Processing Model (Cost Matrices, Reports, Control File, & Changes)
USPS-FY12-NP5	FY 2012 ICRA Overview/Technical Description
USPS-FY12-NP6	FY 2012 International Cost Segment Spreadsheets
USPS-FY12-NP7	Cost Segment 3 International Subclass Costs by Cost Pools (Volume Variable Cost Pools)
USPS-FY12-NP8	FY 2012 International Billing Determinants
USPS-FY12-NP9	FY 2012 Miscellaneous International Data
USPS-FY12-NP10	FY 2012 Competitive Product Incremental and Group Specific Costs
USPS-FY12-NP11	FY 2012 Nonpublic Cost and Revenue Analysis Report
USPS-FY12-NP12	FY 2012 Nonpublic Cost Segments and Components Report

USPS-FY12-NP13	FY 2012 CRA Model (Model Files, Cost Matrices, and Reports)
USPS-FY12-NP14	FY 2012 CRA "B" Workpapers (Nonpublic Version)
USPS-FY12-NP15	FY 2012 Special Cost Studies Workpapers - Parcels Cost Models (Nonpublic Portion)
USPS-FY12-NP16	FY 2012 Special Cost Studies Workpapers - Bound Printed Matter and Parcel Post Transportation Costs / Bulk Parcel Return Service Cost Study (Nonpublic Portion)
USPS-FY12-NP17	FY 2012 Special Cost Studies Workpapers - Parcel Post Regression Analysis (Nonpublic Portion)
USPS-FY12-NP18	Cost Segment 3 Cost Pools & Other Related Information (Nonpublic Portion)
USPS-FY12-NP19	FY 2012 Non-Operation Specific Piggyback Factors (Nonpublic Portion)
USPS-FY12-NP20	FY 2012 Mail Processing Costs by Shape for Select Competitive Products
USPS-FY12-NP21	In-Office Cost System (IOCS) Documentation (Nonpublic Version)
USPS-FY12-NP22	City Carrier Cost System (CCCS) Documentation (Nonpublic Version)
USPS-FY12-NP23	Rural Carrier Cost System (RCCS) Documentation (Nonpublic Version)
USPS-FY12-NP24	Transportation Cost Systems (TRACS) Documentation (Nonpublic Version)
USPS-FY12-NP25	Mail Characteristics Study (Nonpublic Portion)
USPS-FY12-NP26	FY 2012 Special Cost Studies Workpapers – Special Services (Nonpublic Portion)
USPS-FY12-NP27	2012 Competitive NSA & Nonpostals Materials
USPS-FY12-NP28	Rule 3050.14 Alternative Format Report (Non-Public)

USPS-FY12-NP29	Cost Segment and Components Reconciliation to Financial Statements and Account Reallocations (Reallocated Trial Balances) (Nonpublic Version)
USPS-FY12-NP30	FY 2012 Revenue, Pieces, and Weight Report (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 the thirty appended folders identified as nonpublic in Attachment One of the FY 2012 Annual Compliance Report (these are referred to collectively as the "Nonpublic Annex"). As is apparent from the Attachment One list, the majority of the folders in the Nonpublic Annex have a corresponding public folder.

In many instances, a set of material has been divided into one portion that relates to Market Dominant products and another 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, one that is public and contains aggregated information regarding Competitive products or large groups of Competitive products, and another that is nonpublic and contains information regarding Competitive products that is disaggregated to 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 Dominant products.[2] In general, except for the six groups of Competitive products for which cost data are shown in the Cost and Revenue Analysis (CRA), all disaggregated cost information

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

[2] For 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.

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 longstanding and deep familiarity with the postal and communications businesses 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).[3]

(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 2012 Annual Compliance

[3] 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 "likely commercial injury" should be construed broadly to encompass other types of injury, such as harms to privacy, deliberative process, or law enforcement interests. 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.

Report are (1) entities, including foreign postal operators, holding competitive negotiated service agreements (NSAs) in FY 2012 for which data are reported on a contract-specific basis, (2) Federal Express Corporation (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 2012 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 3, the Royal Mail Inbound Air Parcel Post Agreement, Direct Entry Parcels 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: Mr. Lindsay Welsh, Regional Business Director - Europe/North America, +64 4 496 4574, lindsay.welsh@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 68 855 592, zhulei@ems.com.cn;
- For the Inbound Direct Entry Contract with Hongkong Post: Sammy Cheng, Senior Manager, International Letters, +852 9304 3057, sammy_cw_cheng@hkpo.gov.hk, and Penny Hung, Manager, International Letters, +852 2921 2115, penny_hung@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: Tracy Hayward, Regional Director International, Royal Mail, +44 7802 864 132, david.breeze@parcelforce.co.uk;
- For the China Post Group Inbound International Expedited Services 3 Agreement terminated on December 31, 2011, the China Post Inbound Market-Dominant Multi-Service Agreement, and the China Post Inbound Competitive Multi-Service Agreement, Mr. Zhu Lei, Deputy Manager, International Operations, China Post EMS and Logistics Corporation (China Post Group), +86 10 68 855 592, zhulei@ems.com.cn;
- For the Hongkong Post Inbound Market-Dominant Multi-Service Agreement, Mr. Sammy Cheng, Senior Manager (International Letters), External Affairs Division, Hongkong Post, +852 2921 6026, Sammy_cw_cheng@hkpo.gov.hk;

- For the Singapore Post Limited – United States Postal Service Small Packet with Delivery Scanning Bilateral Agreement, S. Shankar, Business Manager (International Mail Business), Singapore Post Limited, +65 6845 6105, Shankar@singpost.com; and
- For the Strategic Bilateral Agreement Between United States Postal Service and Koninklijke TNT Post BV and TNT Post Pakketservice Benelux BV, Mr. Ben Pilgram, Consultant, International Distribution Agreements, PostNL, +31 (0)6 83 64 57 90, ben.pilgram@postnl.nl

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
- 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.[4] The Postal Service identifies James H. Ferguson, Corporate Vice President, Customer and Business Transactions, FedEx Corp. &

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

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 jhferguson1@fedex.com.

The International Cost and Revenue Analysis (ICRA) report contains data for various products that are 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 to CPC's negotiated bilateral agreement with the Postal Service. The Postal Service identifies Terry Dunn, General Manager, International Relations, Canada Post Corporation, as the appropriate contact on behalf of Canada Post. Mr. Dunn's telephone number is (613) 734-8894, and his email address is terry.dunn@canadapost.ca. Canada Post has requested that any communications regarding confidential treatment of these data be sent with a courtesy copy to Ewa Kowalski, Manager, International Mail Settlement, Canada Post Corporation. Ms. Kowalski's telephone number is (613) 734-6201, and her email address is ewa.kowalski@canadapost.ca.[5]

The ICRA report also contains inbound and outbound international mail data specific to Correos de México, the public postal operator for Mexico, and in which Correos de México might be deemed to have a proprietary interest. Due to language

[5] In the event of a request for early termination of non-public treatment under 39 C.F.R. § 3007.31, a preliminary determination of non-public status under 39 C.F.R. § 3007.32, or a request for access to non-public materials under 39 C.F.R. § 3007.40, the Postal Service notes, on Canada Post's behalf, that differences in the official observation of national holidays might adversely and unduly affect Canada Post's ability to avail itself of the times allowed for response under the Commission's rules. In such cases, Canada Post has requested that the Postal Service convey its preemptive request that the Commission account for such holidays when accepting submissions on matters that affect Canada Post's interests. A listing of Canada's official holidays can be found at http://www.pch.gc.ca/eng/1266366005340/1268235063611.

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.[6] The Postal Service identifies as an appropriate contact person Guadalupe Contreras, 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 Franca Davis, Executive Director, International Strategy and Business Development Support. Ms. Davis's phone number is (202) 268-5459, and her email address is franca.s.davis@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

[6] 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 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.

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. § 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-FY12-NP11, USPS-FY12-NP12, USPS-FY12-NP13, USPS-FY12-NP14, USPS-FY12-NP18, USPS-FY12-NP19, USPS-FY12-NP20, USPS-FY12-NP21, USPS-FY12-NP22, USPS-FY12-NP23, USPS-FY12-NP24, USPS-FY12-NP25, USPS-FY12-NP27, and USPS-FY12-NP28. Descriptions of the contents of these folders can be found in the roadmap document, filed at USPS-FY12-9. The roadmap indicates the corresponding public folder which contains information similar to that in each 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-FY12-NP15, USPS-FY12-NP16, USPS-FY12-NP17, and USPS-FY12-NP26. Again, descriptions of the contents of these folders can be found in the roadmap document, filed at USPS-FY12-9. 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-FY12-NP2 through USPS-FY12-NP7 and USPS-FY12-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-FY12-9. There are no corresponding public folders.

A fourth category is the Competitive product billing determinants. These are found in USPS-FY12-NP1 for domestic Competitive products, and USPS-FY12-NP8 for International products. They are comparable in format to the Market Dominant billing determinants presented in USPS-FY12-4, 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-FY12-NP10, which presents the application of the incremental cost methodology set forth in the Petition for Proposal Twenty-two (filed on Oct. 23, 2009, and considered as part of Docket No. RM2010-4) to Competitive products. The outputs of that application are shown in the text of the FY 2012 ACR itself, and USPS-FY12-NP10 merely provides the background materials supporting those outputs. The incremental cost model used in USPS-FY12-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-FY12-NP10 are described in the roadmap document, USPS-FY12-9.

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 CRA. The CRA (USPS-FY12-1) 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-FY12-NP11). Instead, in the CRA, the Postal Service is aggregates data for Competitive products into six product groups. Those groups are Total Express, Total First-Class Package Service, Total Priority, Total Ground, Total Competitive International, and Total Domestic Competitive Services. (The product rows in the Nonpublic CRA that are rolled up into each of the six Competitive product group rows in the 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 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.

Category in Public Version CRA	Categories Rolled in from Nonpublic Version CRA
Total Express Mail	Domestic Express Mail Domestic Express Mail NSAs
Total First-Class Package Service	First-Class Package Service
Total Priority Mail	Domestic Priority Mail Domestic Priority Mail NSAs Priority Mail Fees
Total Ground	Parcel Select Mail Parcel Select NSAs Parcel Return Service Mail Parcel Return Service NSAs

Total Competitive International	Outbound International Expedited Services Inbound International Expedited Services Outbound Priority Mail International Inbound Air Parcel Post International Priority Airmail (IPA) International Surface Airlift (ISAL) International Direct Sacks M-Bags Outbound Intl Negotiated Serv. Agreement Mail Inbound Intl Negotiated Serv. Agreement Mail International Money Transfer Service International Ancillary Services
Total Domestic Competitive Services	Premium Forwarding Service Address Enhancement Services Greeting Cards Shipping and Mailing Supplies Post Office Box Service Other Ancillary Services

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

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

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

As explained below, the data and information considered to be non-public 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 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.

<u>Volume and Revenue Information</u>

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.

<u>Billing Determinants</u>

Billing determinants present a special category of volume and revenue information that would enable highly refined understanding of individual products aligned specifically to their individual 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 the 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 that have been cultivated through the Postal Service's efforts and resources. The Postal Service considers it 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, and 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 in some instances are not required 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 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. The public disclosure of this 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 make 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 becomes 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 becomes 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 become 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 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 (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 bilaterals with other foreign postal operators (*e.g.*, letter post, air and surface parcels, and 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 Postal Service 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) to 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 2012 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.

Nabeel R. Cheema

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