Postal Regulatory Commission
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UNITED STATES
POSTAL REGULATORY COMMISSION
Washington, D.C. 20268-0001

FORM 10-Q

(Mark One)

☑ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2010 OR**

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM __________ TO**

Commission File Number: N/A

UNITED STATES POSTAL SERVICE

(Exact name of registrant as specified in its charter)

Washington, D.C. (State or other jurisdiction of incorporation or organization)	41-0760000 (I.R.S. Employer Identification No.)
475 L'Enfant Plaza, S.W. Washington, D.C. (Address of principal executive offices)	20260 (ZIP Code)

(202) 268-2000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☐ No ☐ Not Applicable ☑

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐ Not Applicable ☑

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐	Accelerated filer ☐
Non-accelerated filer ☐ (Do not check if a smaller reporting company)	Smaller reporting company ☐
Not Applicable ☑	

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock	Outstanding Shares as of May 10, 2010
No Common Stock	N/A

United States Postal Service
Quarterly Financial Report Index

Part I

Part II

Part I

Item 1 – Financial Statements

United States Postal Service
Statements of Operations
(Unaudited)

	Three Months Ended March 31,		Six Months Ended March 31,	
(Dollars in millions)	2010	2009	2010	2009
Operating revenue	$ 16,697	$ 16,938	$ 35,052	$ 36,033
Operating expenses				
Compensation and benefits	12,611	13,203	25,589	26,860
Retiree health benefits	1,929	1,846	3,826	3,660
Transportation	1,438	1,473	2,951	3,223
Other	2,272	2,318	4,502	4,572
Total operating expenses	18,250	18,840	36,868	38,315
Loss from operations	**(1,553)**	**(1,902)**	**(1,816)**	**(2,282)**
Interest and investment income	7	7	13	13
Interest expense	(38)	(10)	(78)	(20)
Net loss	**$ (1,584)**	**$ (1,905)**	**$ (1,881)**	**$ (2,289)**

See accompanying notes to the financial statements. (unaudited)

United States Postal Service
Balance Sheets - Assets

(Dollars in millions)		March 31, 2010		September 30, 2009
		(unaudited)		
Current Assets				
Cash and cash equivalents	$	1,029	$	4,089
Receivables:				
Foreign countries		610		526
U.S. government		85		150
Other		232		177
Receivables before allowances		927		853
Less allowances		32		29
Total receivables, net		895		824
Supplies, advances and prepayments		135		138
Total Current Assets		**2,059**		**5,051**
Noncurrent Assets				
Property and equipment, at cost:				
Buildings		23,672		23,189
Equipment		20,981		20,970
Land		2,981		2,995
Leasehold improvements		975		968
		48,609		48,122
Less allowances for depreciation and amortization		27,675		26,889
		20,934		21,233
Construction in progress		1,235		1,447
Total property and equipment, net		22,169		22,680
Other assets - principally revenue forgone receivable		**356**		**387**
Total Noncurrent Assets		**22,525**		**23,067**
Total Assets	$	**24,584**	$	**28,118**

See accompanying notes to the financial statements. (unaudited)

United States Postal Service
Balance Sheets - Liabilities and Net (Deficiency) Capital

(Dollars in millions)	March 31, 2010	September 30, 2009
	(unaudited)	
Current Liabilities		
Compensation and benefits	$ 3,974	$ 3,802
Retiree health benefits	2,750	-
Payables and accrued expenses:		
Trade payables and accrued expenses	994	1,203
Foreign countries	507	470
U.S. government	227	207
Total payables and accrued expenses	1,728	1,880
Deferred revenue - prepaid postage	2,329	2,445
Customer deposit accounts	1,344	1,347
Outstanding postal money orders	673	640
Prepaid box rent and other deferred revenue	451	461
Current portion of debt	2,030	3,675
Total Current Liabilities	**15,279**	**14,250**
Noncurrent Liabilities		
Workers' compensation costs	8,542	9,064
Employees' accumulated leave	1,977	2,096
Deferred appropriation and other revenue	424	457
Long-term portion capital lease obligations	535	544
Deferred gains on sales of property	304	305
Contingent liabilities and other	272	290
Long-term debt	4,500	6,525
Total Noncurrent Liabilities	**16,554**	**19,281**
Total Liabilities	**31,833**	**33,531**
Net (Deficiency) Capital		
Capital contributions of the U.S. government	3,132	3,087
Deficit since 1971 reorganization	**(10,381)**	**(8,500)**
Total Net (Deficiency) Capital	**(7,249)**	**(5,413)**
Total Liabilities and Net (Deficiency) Capital	**$ 24,584**	**$ 28,118**

See accompanying notes to the financial statements. (unaudited)

United States Postal Service
Changes in Net (Deficiency) Capital
(Unaudited)

(Dollars in millions)	Capital Contributions of U.S. Government	Deficit Since Reorganization	Total Net (Deficiency) Capital
Balance, September 30, 2008	$ 3,034	$ (4,706)	$ (1,672)
Net Loss	-	(2,289)	(2,289)
Balance, March 31, 2009	$ 3,034	$ (6,995)	$ (3,961)
Balance, September 30, 2009	$ 3,087	$ (8,500)	$ (5,413)
Additional Capital Contribution	45	-	45
Net Loss	-	(1,881)	(1,881)
Balance, March 31, 2010	$ 3,132	$ (10,381)	$ (7,249)

See accompanying notes to the financial statements. (unaudited)

United States Postal Service
Statements of Cash Flows
(Unaudited)

(Dollars in millions)	Six Months Ended March 31, 2010	2009
Cash flows from operating activities:		
Net loss	$ (1,881)	$ (2,289)
Adjustments to reconcile net loss to cash provided by operating activities:		
Depreciation and amortization	1,224	1,135
(Gain) loss on disposals of property and equipment and impairments, net	(21)	25
Decrease in appropriations receivable revenue forgone	31	26
(Decrease) increase in noncurrent workers' compensation liability	(522)	602
Decrease in noncurrent employees accumulated leave	(119)	(29)
Decrease in noncurrent deferred appropriations and other revenue	-	(2)
Increase in other noncurrent liabilities	13	7
Changes in current assets and liabilities:		
Receivables, net	(71)	(85)
Supplies, advances and prepayments	3	32
Compensation and benefits	172	188
Retiree health benefits	2,750	2,700
Payables and accrued expenses	(186)	(226)
Customer deposit accounts	(3)	(97)
Deferred revenue-prepaid postage	(116)	43
Outstanding postal money orders	33	19
Prepaid box rent and other deferred revenue	5	-
Net cash provided by operating activities	1,312	2,049
Cash flows from investing activities:		
Purchases of property and equipment	(683)	(984)
Proceeds from deferred building sale	-	4
Proceeds from sales of property and equipment	38	2
Net cash used in investing activities	(645)	(978)
Cash flows from financing activities:		
Issuance of notes payable	-	2,500
Payments on notes payable	(2,500)	(4,500)
Net change in revolving credit line	(1,170)	603
Payments on capital lease obligations	(25)	(23)
U.S. government appropriations - expensed	(32)	(33)
Net cash used in financing activities	(3,727)	(1,453)
Net (decrease) increase in cash and cash equivalents	(3,060)	(382)
Cash and cash equivalents at beginning of year	4,089	1,432
Cash and cash equivalents at end of period	$ 1,029	$ 1,050
Supplemental cash flow information:		
Interest paid	$ 73	$ 12

See accompanying notes to the financial statements. (unaudited)

Notes to Financial Statements (Unaudited)

Note 1 – Basis of Presentation

These interim financial statements reflect the unaudited results of operations of the United States Postal Service ("Postal Service") for the three and six month periods ended March 31, 2010 and 2009, the cash flows for the six month periods then ended, and the financial position as of March 31, 2010 (unaudited) and September 30, 2009. The interim financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial statements and, accordingly, do not include all the information and footnotes required by GAAP for complete financial statements. These interim financial statements should be read in conjunction with the significant accounting policies and other disclosures in the Annual Report on Form 10-K for the year ended September 30, 2009. As in that Annual Report on Form 10-K, all references to years refer to the fiscal year beginning October 1 and ending September 30, unless otherwise stated. All references to quarters, unless otherwise indicated, refer to quarters within fiscal years 2010 and 2009.

In the opinion of management, the accompanying unaudited interim financial statements reflect all adjustments (including normal recurring adjustments) necessary to fairly present the financial position of the Postal Service as of March 31, 2010, the results of operations for the three and six month periods then ended, and the cash flows for the six months ended March 31, 2010 and 2009. Operating results for the three and six month periods ended March 31, 2010, are not necessarily indicative of the results that may be expected for 2010. We have evaluated all subsequent events through May 10, 2010, the date we filed with the Postal Regulatory Commission (PRC).

Certain comparative prior year amounts related to fixed assets, leases and employees' leave have been reclassified to conform to the current year's presentation. These reclassifications had no effect on previously reported operating or net losses.

Note 2 – Liquidity Matters

As reported in the Annual Report on Form 10-K for the year ended September 30, 2009, the Postal Service had net losses of $3,794 million, $2,806 million, and $5,142 million for the three years ended September 30, 2009, 2008 and 2007, respectively. These losses have placed unprecedented demands on operating liquidity. The losses have continued into 2010, as losses of $1,584 million and $1,881 million were incurred for the three and six months ended March 31, 2010, respectively. The Postal Service also experienced negative cash flow from operations for two of the past three years, with 2009 being the exception. To alleviate pressure on liquidity, in September 2009 Congress enacted legislation (P.L. 111-68) which restructured the required $5.4 billion payment to the Postal Service Retiree Health Benefits Fund (PSRHBF) that was due on September 30, 2009, reducing it to $1.4 billion. Had this legislation not been enacted, cash flow from operations would have been negative for 2009 as well. This legislation did not, however, address future payments into the PSRHBF, including the $5.5 billion payment due in September 2010.

By statute, the Postal Service is limited to an annual net increase in debt of $3 billion, and a total outstanding debt of $15 billion. The Postal Service projects debt outstanding at year-end to increase over the September 30, 2009 balance by the maximum allowable $3 billion, to $13.2 billion. The $15 billion debt ceiling will become insufficient in 2011.

The recent losses are primarily attributable to unprecedented declines in mail volumes that began in 2008. The declines in mail volumes are primarily a result of the recent widespread economic recession and the long-term trend of hard copy correspondence and transactions migrating to electronic media. This migration trend accelerated during the recession and is expected to continue. Since peaking at 213 billion pieces in 2006, mail volumes dropped 904 million pieces in 2007, 9.5 billion pieces in 2008, and 25.6 billion pieces, to 177.1 billion pieces, in 2009. Mailing Services volume for the first six months of 2010 is already down an additional 5.9 billion pieces compared to the first six months of 2009 and is expected to decrease by a total of approximately 8 billion pieces in 2010. It is possible that volumes and related revenues could decrease at rates that differ significantly from these projections. Because of declining volumes, revenues are also expected to continue to decrease in 2010 and, even with substantial cost reductions, the Postal Service projects a potential cash shortfall in 2011.

In addition to normal recurring costs, the Postal Service has two substantial cash payments scheduled for September and October 2010: the $5.5 billion due to the PSRHBF on September 30, 2010; and approximately $1.1 billion due in

October 2010 to the Department of Labor (DOL) for the Postal Service workers' compensation liability. Based on the current Postal Service borrowing capacity and projections of cash available from operations, there will likely be sufficient cash available for ongoing operations in 2010. However, there is substantial uncertainty as to whether the Postal Service will have sufficient cash available to fund the $5.5 billion PSRHBF payment and the October DOL obligations while maintaining sufficient liquidity to meet its financial obligations in 2011. The legal and/or regulatory consequences to the Postal Service if the PSRHBF or the workers' compensation payments are not funded are unknown. Even if there is sufficient cash to fund the ongoing operations and PSRHBF payment on September 30, 2010, the Postal Service will likely experience a cash shortfall in 2011.

To meet this financial challenge, the Postal Service has, as previously reported, reduced work hours by 50 million in 2008 and an additional 115 million hours in 2009. Work hours during the first six months of 2010 were 49 million hours or 7.5% less than the comparable period of 2009. Work hours in Quarter II, 2010 were 20 million hours or 6.5% less than the comparable quarter of last year. The Postal Service continues to target work hour reductions of up to 90 million in 2010. The ultimate number of work hour savings achieved is also dependent on mail volumes. The Postal Service continues its efforts to increase operational efficiencies, reduce costs by renegotiating contracts with major suppliers, and has halted construction of new facilities. Although each of these efforts is expected to positively impact cash flow, they are not, individually or in the aggregate, sufficient to offset a possible cash shortfall in 2011.

The ability to generate sufficient cash flows to meet financial obligations in 2010 and beyond is substantially dependent on the strength of the economic recovery, the rate at which mail continues to migrate to electronic alternatives, and the ability of the Postal Service to execute strategies to increase efficiency, reduce costs and retain and grow revenue. Legislative changes including restructuring the PSRHBF payment schedule are also necessary. However, no assurance can be given that the Postal Service efforts will be successful, or that Congress will enact restructuring legislation in time to impact 2010, or at all. Further, it should be noted that the $15 billion debt ceiling will become insufficient in 2011.

Even with legislative action to address these shorter-term liquidity matters, the Postal Service would still face longer-term financial viability concerns. To begin the process of addressing these issues, in March 2010, the Postal Service issued its action plan for the next decade, *Ensuring a Viable Postal Service for America*. In this plan, the Postal Service estimates that during the next decade, there would be cumulative financial losses of approximately $238 billion, absent significant operational and legislative changes. The Postal Service estimates that approximately $123 billion of the projected losses could be addressed and resolved by aggressive management actions and within the existing regulatory structure, assuming the full cooperation of all Postal Service stakeholders. To address the remaining unsustainably large projected deficit of at least $115 billion, a balanced set of actions has been proposed. These actions will require legislation and cooperation from a range of stakeholders, and include changes in the following areas: retiree health benefits prefunding; delivery frequency; access to postal services; workforce flexibility; product and pricing flexibility; expansion of products and services; and regulatory oversight issues. In addition, on January 20, 2010, the Office of Inspector General issued a report in which it evaluated the current system of funding the Postal Service's Civil Service Retirement System responsibility, concluding that the Postal Service had been overcharged by $75 billion. The PRC has initiated a study on this issue and will be issuing a report at a later date.

The Postal Service filed a request for an advisory opinion with the PRC on March 30, 2010, regarding whether the elimination of Saturday mail delivery to street addresses and other associated changes conform to the policies in Title 39, United States Code. Furthermore, Congressional action would be required to reduce the number of legally-required delivery days. No savings would occur in 2010 from the ability to adjust the six day delivery requirement, even if the request is granted in 2010, as numerous operational, contractual and customer issues would need to be resolved prior to implementation of a new delivery schedule. However, such new flexibility could provide cost savings beginning no earlier than mid-2011.

The Postal Service continues to inform the Administration, Congress, and other stakeholders of the immediate and longer-term financial issues it faces and the legislative changes that would help insure both the availability of sufficient liquidity at September 30, 2010, and beyond. There can be no assurance that the requested adjustments to the PSRHBF payment schedule, or any other legislative changes, will be made by September 30, 2010, or at all.

Note 3 – Debt and Related Interest

As of March 31, 2010, debt payable to the Federal Financing Bank (FFB), a government-owned corporation under the general supervision of the Secretary of the Treasury, was $6,530 million compared to $10,200 million at September 30, 2009. Fixed-rate debt can be repaid at any time at a price determined by the Secretary of the Treasury based on rates prevailing in the Treasury Security market at the time of repayment. During the six months ended March 31, 2010, the Postal Service repaid four floating rate notes. The interest rates on the credit line debt are determined by the U.S. Treasury each business day.

Debt as of March 31, 2010 and September 30, 2009, all of which is unsecured and not subject to sinking fund requirements, is as follows:

Indebtedness to Federal Financing Bank
(Dollars in millions)

		March 31, 2010		September 30, 2009	
Maturity	Debt Type	Balance	Rate	Balance	Rate
January 31, 2014	Fixed rate-payable at maturity	$ 300	2.035%	$ 300	2.035%
May 2, 2016	Fixed rate-payable at maturity	300	2.844	300	2.844
November 15, 2018	Fixed rate-payable at maturity	500	3.048	500	3.048
February 15, 2019	Fixed rate-payable at maturity	700	3.296	700	3.296
May 15, 2019	Fixed rate-payable at maturity	1,000	3.704	1,000	3.704
May 15, 2019	Fixed rate-payable at maturity	500	3.513	500	3.513
May 17, 2038	Fixed rate-payable at maturity	200	3.770	200	3.770
February 15, 2039	Fixed rate-payable at maturity	1,000	3.790	1,000	3.790
November 15, 2042	Floating rate	-	-	500	0.184
June 15, 2043	Floating rate	-	-	500	0.271
December 15, 2042	Floating rate	-	-	1,025	0.216
October 15, 2009	Floating rate	-	-	475	0.155
[1]	Overnight revolving credit line	355	0.277	-	-
[1]	Short-term revolving credit line	1,675	0.237	3,200	0.145
Total debt		$ 6,530		$ 10,200	
Less: Current portion of debt		2,030		3,675	
Long-term portion of debt		$ 4,500		$ 6,525	

[1] Credit lines matured on April 30, 2010, and were renewed to May 3, 2011.

The Postal Service has two credit facilities with the FFB, which matured on April 30, 2010, and were renewed to May 3, 2011. One, a short-term credit line, enables the Postal Service to draw up to $3,400 million with two days prior notice. Borrowings under this credit line can have a maximum maturity of one year. The second credit facility, which allows borrowing on an overnight basis, enables the Postal Service to draw up to $600 million on the same business day that funds are requested. In addition, the Postal Service can use a series of other notes with varying provisions to draw upon with two days prior notice. These credit facilities and note arrangements provide the Postal Service the flexibility to borrow short-term or long-term, using fixed- or floating-rate notes. Fixed-rate notes can be either callable or non-callable.

By statute, the Postal Service is limited to a net annual debt increase of $3 billion and total debt outstanding cannot exceed $15 billion. For 2010, it is subject to an absolute debt ceiling of $13.2 billion, a $3 billion increase from the September 30, 2009 debt of $10.2 billion.

Scheduled principal repayments, exclusive of capital leases, subsequent to March 31, 2010, are as follows:

Scheduled Principal Repayments (Dollars in millions)		March 31, 2010
2010	$	2,030
2011		-
2012		-
2013		-
2014		300
After 2014		4,200
Total Debt	$	6,530

Note 4 – Property and Equipment

Continuing a program that began in Quarter III of 2009 under the provisions of the American Reinvestment and Recovery Act of 2009 (P.L. 111-5), during the first six months of 2010, the Postal Service received from the General Services Administration approximately 3,100 new fuel-efficient vehicles in exchange for approximately the same number of vehicles then in its fleet. The $45 million excess of the fair value of the vehicles received over the vehicles traded-in was recorded as an additional non-cash capital contribution by the U.S. government. There was no comparable capital contribution in the first six months of 2009.

Note 5 – Leases and Other Commitments

COMMITMENTS

Each year, the Postal Service incurs new capital commitments which consist of lease obligations, and contracts for the acquisition of equipment, vehicles, and building construction and improvements. Since these capital commitments are not normally fully funded within one year, the total of committed resources is tracked. At March 31, 2010, commitments for capital items were $1,352 million, compared to $1,809 million at September 30, 2009. The table summarizes capital commitments at March 31, 2010:

Capital Commitments (Dollars in millions)		March 31, 2010
Mail Processing Equipment	$	847
Postal Support Equipment		128
Building Improvements		296
Construction and Building Purchase		43
Retail Equipment		33
Vehicles		5
Total Capital Commitments	$	1,352

LEASES

At March 31, 2010, future minimum payments on non-cancelable operating and capital leases were as follows:

Lease Obligations (Dollars in millions)	Operating	Capital
2010	$ 407	$ 52
2011	767	101
2012	717	103
2013	662	96
2014	598	91
After 2014	4,838	450
Total Lease Obligations	$ 7,989	$ 893
Less: Interest		306
Total Capital Lease Obligations		$ 587
Less: Short-term portion of capital lease obligations		52
Long-term portion of capital lease obligations		$ 535

Rent expense for the quarter and six months ended March 31, 2010 and 2009 was as follows:

Rental Expense	Three Months Ended March 31,		Six Months Ended March 31,	
(Dollars in millions)	2010	2009	2010	2009
Non-cancelable real estate leases including related taxes	$ 251	$ 250	$ 491	$ 497
Facilities leased from GSA* subject to 120-day cancellation	11	11	22	21
Equipment and other short-term rentals	68	68	122	137
Total Rental Expense	$ 330	$ 329	$ 635	$ 655

*General Services Administration

Note 6 – Contingent Liabilities

Contingent liabilities consist mainly of claims and lawsuits resulting from labor and equal employment opportunity disputes, environmental matters, property damage claims, injuries on postal properties, issues arising from postal contracts, personal claims and traffic accidents. Each quarter, significant new claims and litigation are evaluated for the probability of an adverse outcome. If the claim is deemed probable of an unfavorable outcome and the amount of potential resolution is estimable, a liability for the loss is recorded. Each quarter, any prior claims and litigation are reviewed and adjusted for resolutions or revisions to prior estimates. No individual claim currently assessed as probable of an unfavorable outcome is material to the interim financial statements taken as a whole. The table summarizes contingent liabilities provided for in the interim financial statements.

Accrued Contingent Liabilities (Dollars in millions)	March 31, 2010	September 30, 2009
Labor Cases	$ 194	$ 174
Equal Employment Opportunity	58	52
Environmental	40	40
Tort	36	35
Total Accrued Contingent Liabilities	$ 328	$ 301

Based on currently available information, adequate provision has been made for probable losses arising from claims and suits. The current portion of this liability of $100 million at March 31, 2010, and $86 million at September 30, 2009, is included on the Balance Sheets in “Trade payables and accrued expenses”. The long-term portion of this liability at March 31, 2010, was $228 million and $215 million at September 30, 2009. These amounts are accrued in “Contingent liabilities and other” on the Balance Sheets.

We also have other claims and lawsuits which we deem reasonably possible of an unfavorable outcome which range from $1.4 billion to $1.6 billion. No provisions for these are accrued or included in the results of operations for the three and six months ended March 31, 2010.

Note 7 – Health Benefits Programs

CURRENT EMPLOYEES

Substantially all career employees are covered by the Federal Employees Health Benefits Program (FEHBP). The Office of Personnel Management (OPM) administers the program and allocates the cost of the program to the participating government agency employers. The Postal Service portion of the cost is based on the weighted-average premium cost of the various employee coverage choices and the specific coverage choices made by current employees. Employees paid approximately 21% of the premium costs in Quarter II, 2010, compared to 19% in Quarter II, 2009. For the six months ended March 31, 2010 and 2009, employees paid approximately 20% and 19% of premium costs, respectively. The Postal Service paid the remaining employee health care expense which was $1,286 million and $1,331 million in Quarter II, 2010 and 2009, respectively, and $2,570 million and $2,661 million for the six months ended March 31, 2010 and 2009, respectively. These expenses are included in "Compensation and benefits" in the Statements of Operations.

RETIREES

Employees who participate in the FEHBP for at least the five years immediately prior to retirement may participate in the plan during retirement. The Postal Service is required by statute to fund the employer's share of health insurance premiums for retired postal employees and their survivors who have met the participation requirements and retired on or after July 1, 1971. Because the Postal Service cannot direct the costs, benefits or funding requirements of this federally-sponsored plan, plan costs are accounted for using multiemployer accounting rules and, accordingly, expense is recorded when payments are due to OPM.

In addition to these payments to OPM for the Postal Service share of FEHBP retiree premiums, P.L. 109-435 established the PSRHBF, which requires prefunding of its retiree premiums. The fund will be used, commencing in 2017, to pay the Postal Service share of the health insurance premiums for current and future Postal Service retirees. The schedule of payments into the PSRHBF, which began in 2007, originally required us to pay into the fund, on average, $5.6 billion per year for ten years. At March 31, 2010, remaining payments to the PSRHBF are as follows:

Postal Service Retiree Health Benefit Fund Commitment (Dollars in millions)	P.L. 109-435 Requirement
2010	$ 5,500
2011	5,500
2012	5,600
2013	5,600
2014	5,700
After 2014	11,500
Total Postal Service Retiree Health Benefit Fund Commitment	$ 39,400

P.L. 109-435 specifies PSRHBF funding requirements through 2016. The timing of and amounts to be funded can be changed, however, with the passage of a new law or amendment of the existing law. With the enactment of P.L. 111-68, the 2009 payment was decreased from $5.4 billion to $1.4 billion. On September 30, 2010, a $5.5 billion payment is due to the PSRHBF. However, the Postal Service has asked Congress to restructure the payment schedule for 2010 and future years. There can be no assurance that Congress will restructure any of the scheduled payments.

After the scheduled payments into the PSRHBF are completed in 2016, OPM will perform an actuarial valuation to determine if additional payments into the PSRHBF are required. If additional payments are required, OPM will design an amortization schedule to fully fund the remaining liability, if any, by September 30, 2056.

Retiree health benefit expenses in Quarter II, 2010 and 2009 were $1,929 million and $1,846 million, respectively, a 4.5% increase. For the six months ended March 31, 2010 and 2009, retiree health benefit expenses were $3,826 million and $3,660 million, respectively, also a 4.5% increase. The components of these expenses are as follows:

Retiree Health Benefits	Three Months Ended March 31,		Six Months Ended March 31,	
(Dollars in millions)	2010	2009	2010	2009
Retiree Health Benefits	$ 554	$ 496	$ 1,076	$ 960
P.L. 109-435 Scheduled Payments to PSRHBF	1,375	1,350	2,750	2,700
Total Retiree Health Benefit Expense	$ 1,929	$ 1,846	$ 3,826	$ 3,660

Note 8 – Retirement Programs

Employees participate in one of three pension programs based upon the starting date of their employment with the federal government. Employee contributions are made to the Civil Service Retirement System (CSRS), the Dual CSRS/Social Security (Dual/CSRS) or the Federal Employees Retirement System (FERS), all of which are administered by OPM. Employees may also participate in the Thrift Savings Plan (TSP), which is a defined contribution retirement savings and investment plan administered by the Federal Retirement Thrift Investment Board.

P.L. 109-435 suspends until 2017 the employer contribution to CSRS that would otherwise have been required under Title 5, Section 8334(a)(1) of the United States Code. At that time OPM will determine whether additional funding is required for the benefit of postal retirees. The Postal Service makes employer contributions of 11.2% of base salary for current FERS employees. Retirement expense for Quarter II, 2010 was $1,445 million compared to $1,477 million for the same period last year. Year-to-date retirement expense was $2,914 million compared to $2,989 million in the same period last year. Retirement expense is recorded in “Compensation and benefits” in the Statements of Operations.

Note 9 – Workers’ Compensation

The Postal Service pays for workers’ compensation costs under a program administered by DOL. These costs, recorded as an operating expense, include employees’ medical expenses, compensation for wage losses and DOL administrative fees. The program also provides for payment of benefits to dependents of employees who die from work-related injuries or diseases.

Workers’ compensation expense was $390 million and $376 million for the three months ended March 31, 2010 and 2009, respectively, and $576 million and $729 million for the six months then ended.

The workers’ compensation liability at March 31, 2010, represents the present value of the estimated future payments to current and former employees, or their qualified survivors, who have been injured or who have died because of work-related injuries or diseases incurred through the quarter-end. The estimated total cost of a claim is based on the date of injury, pattern of historical payments, frequency and severity of the claim-related injury or injuries, and the expected trend in future costs. The payout of this liability will, in some instances, be for the rest of the lives of the claimants.

Taking into account a payment of $1.1 billion in Quarter I, the estimated liability for future workers’ compensation payments was $9,613 million at March 31, 2010, compared to $10,133 million at September 30, 2009. The current portion of this liability was $1,071 million at March 31, 2010 and $1,069 million at September 30, 2009. These amounts are accrued under “Compensation and benefits” on the Balance Sheets.

Inflation and discount rates used to determine the present value of estimated future workers’ compensation payments are reviewed and, if necessary, adjusted on a quarterly basis. Separate analyses of the inflation rates for the medical and compensation portions of the liability are performed utilizing forecasts of medical inflation and inflation in the general economy and the forecasted rates of return on a basket of Treasury securities of varying durations.

The assumptions used to calculate the workers' compensation liability are as follows for the periods indicated:

Workers' Compensation Liability Inflation and Discount Rates	March 31, 2010	Quarter Ended December 31, 2009	September 30, 2009
Compensation Claims Liability:			
Discount Rate	5.1%	5.0%	4.9%
Wage inflation	2.9%	2.9%	3.2%
Medical Claims Liability:			
Discount Rate	4.5%	4.5%	4.4%
Medical Inflation	4.4%	4.4%	3.8%

The impact of changes in the discount and inflation rates decreased the Quarter II, 2010 estimated liability and expense by $47 million from Quarter I, 2010. Changes in these rates during the first six months of 2010 resulted in a decrease to the estimated liability and expense of $252 million. The impact of quarterly changes in the discount and inflation rates is accounted for as a change in accounting estimate and included in the quarter's compensation and benefits expense.

Note 10 – Fair Value Measurements

The Postal Service assumes that the carrying value of current assets and current liabilities approximate fair values. The Postal Service also has non-current financial instruments, such as the long-term portion of debt (see Note 3-Debt and Related Interest) and long-term receivables (see Note 11-Revenue Forgone), that must be measured for disclosure purposes on a recurring basis under authoritative accounting literature as promulgated by the Financial Accounting Standards Board. The Postal Service also applies these requirements to various non-recurring measurements of financial and non-financial assets and liabilities, such as the impairment of property and equipment. Measurement of assets and liabilities at fair value is performed using inputs from the following three levels of the fair value hierarchy as defined in the authoritative literature:

- Level 1 inputs include unadjusted quoted prices in active markets for identical assets or liabilities as of the balance sheet date.
- Level 2 inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, observable data, other than quoted market prices, for the asset or liability (i.e., interest rates, yield curves, etc.) and inputs that are derived from, or corroborated by, observable market data.
- Level 3 inputs include unobservable data that reflect current assumptions about the judgments and estimates that market participants would use when pricing the asset or liability. These inputs are based on the best information available, including internal data.

Because no active market exists for the debt with the FFB, the fair value of the long-term portion of these notes has been estimated using prices provided by the FFB, a level 3 input.

The fair value of revenue forgone has been estimated using the income method and discount rates on similar assets, such as long-term U.S. Treasury securities that have a similar maturity, a level 2 input.

The carrying values and the fair values of non-current assets and liabilities that qualify as financial instruments in accordance with the accounting literature are as indicated in the table below:

Fair Value of Long-Term Financial Assets and Liabilities	March 31, 2010		September 30, 2009	
(Dollars in millions)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Revenue Forgone	$ 334	$ 421	$ 360	$ 462
Total Long-Term Financial Assets	334	421	360	462
Long-Term Portion of Debt	4,500	4,251	6,525	6,519
Total Long-Term Financial Liabilities	$ 4,500	$ 4,251	$ 6,525	$ 6,519

The above table is presented for disclosure purposes only. The Postal Service has not recorded a charge or credit to its operations for the differences between carrying and fair values of the above assets and liabilities.

The reconciliation of the fair values of the long-term portion of debt calculated using level 3 inputs is shown below:

Reconciliation of Fair Value of Level 3 Instruments (Dollars in millions)	
Debt	
Balance at September 30, 2009	$ 6,519
Repayment of Debt	(2,025)
Unrecognized Gain	(243)
Balance at March 31, 2010	$ 4,251

Non-financial assets, such as property and equipment, are measured at fair value when there is an indicator of impairment or when a decision is made to dispose of a property, and recorded at fair value only when impairment is recognized. Impairment analyses of property and equipment were performed in Quarter I and II of 2010 and, based on those analyses, immaterial impairment charges were recorded for the three and six months ended March 31, 2010; there were no impairment charges recorded in the first six months of 2009. Independent appraisals, adjusted for estimated selling costs, are used to determine the fair value of non-financial assets deemed impaired or being held for sale. Independent third party appraisals are deemed level 2 inputs as defined above.

Note 11 – Revenue Forgone

Revenue forgone is a legislative appropriation which reimburses the Postal Service for the cost of statutorily required free and reduced rate mailing services to groups designated by Congress. During Quarter II, 2010, we recognized revenue of $22 million, including $6 million of imputed interest income from these appropriations, compared to $23 million, including $6 million of imputed interest, during the same period last year. For the first half of 2010, we recognized $43 million of such revenue, including $12 million of imputed interest, compared to $45 million of revenue, including $12 million of imputed interest, for the same period in 2009. The related amount of the receivable was $392 million at March 31, 2010 and $448 million at September 30, 2009. The current portion of this receivable was $58 million at March 31, 2010 and $88 million at September 30, 2009. These amounts are recorded under “Receivables – U.S. government” on the Balance Sheets.

Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Statements

Management's Discussion and Analysis of Financial Condition and Results of Operations and other parts of this report include statements representing expectations about the United States Postal Service business and financial results. These may be affected by risks and uncertainties discussed here and in the Annual Report on Form 10-K for the year ended September 30, 2009, such as, but not limited to, economic conditions, regulatory and legislative changes, changes in actuarial assumptions, and known and anticipated trends believed relevant to future operations. Some of these and other factors, many of which we cannot control or influence, may cause actual results to differ materially from those currently contemplated. Operating results for the three and six month periods ended March 31, 2010 are not necessarily indicative of the results to be expected for the year ending September 30, 2010. This report should be read in conjunction with the United States Postal Service Annual Report on Form 10-K for the year ended September 30, 2009. As in that report, all references to years, unless otherwise stated, refer to our fiscal year beginning October 1 and ending September 30. All references to quarters, unless otherwise noted, refer to quarters within fiscal years 2010 and 2009.

Introduction

The United States Postal Service ("Postal Service" or "we") commenced operations on July 1, 1971, as an "independent establishment of the executive branch of the Government of the United States" and is governed by an eleven member Board of Governors. Nine independent Governors are appointed by the President of the United States with the advice and consent of the Senate. The Postmaster General and the Deputy Postmaster General, who are appointed by the independent Governors, are also members of the Board of Governors. Under the Postal Reorganization Act, and its successor, the Postal Accountability and Enhancement Act, Public Law 109-435 (P.L. 109-435), we have a legal mandate to offer a "fundamental service" to the American people "at fair and reasonable rates." We fulfill this legal mandate by offering a variety of classes of mail services without undue discrimination among our many customers. This means that, within each class of mail service, prices do not unreasonably vary by customer for the levels of service provided. However, P.L. 109-435 does provide some flexibility in the pricing of our Shipping Services.

We have a very diverse customer base and are not dependent upon a single customer or small group of customers. No single customer represents more than 3% of operating revenue. The financial services sector, which includes the real estate sector, represents approximately 11% of operating revenue.

We serve individual and commercial customers throughout the nation and compete for business in the communications, distribution and delivery, advertising and retail markets. The prices and fees for our services are subject to a regulatory review process by the independent Postal Regulatory Commission (PRC).

P.L. 109-435 divides postal services into two broad categories: market-dominant and competitive. Market-dominant services include, but are not limited to, First-Class Mail, Standard Mail, Periodicals and certain Package Services. Price increases for these services are generally subject to a price cap which is based on changes in the Consumer Price Index–All Urban Consumers (CPI-U). Competitive services, such as Priority Mail, Express Mail, Bulk Parcel Post and Bulk International Mail have greater pricing flexibility. Throughout this document and in the day-to-day operation of the organization, we refer to market-dominant services as "Mailing Services" and competitive services as "Shipping Services".

Mailing and Shipping Services are sold and processed through over 36,000 Post Offices, stations, branches, contract postal units, a large network of consignees and on-line at *www.usps.com*. Mail is delivered to over 150 million city, rural, Post Office box, and highway contract delivery points. We conduct operations primarily in the domestic market, with international mail representing approximately 3% of operating revenue.

We operate and manage a very extensive and integrated retail, distribution, transportation and delivery network. Therefore, our physical infrastructure and labor force are not, with limited exceptions, dedicated to individual business lines. Expenses are incurred and managed by functional groupings that align with the integrated network structure.

Reporting of expenses on a functional basis in this report comports with the management and structure of expense incurrence within the organization.

The labor force is primarily represented by the American Postal Workers Union (APWU), National Association of Letter Carriers (NALC), National Postal Mail Handlers Union (NPMHU), and National Rural Letter Carriers Association (NRLCA). More than 85% of career employees are covered by collective bargaining agreements. The APWU and NRLCA labor contracts expire in November 2010, and the NPMHU and NALC contracts expire in November 2011.

By law, we consult with management organizations representing most of the employees not covered by collective bargaining agreements. We participate in federal employee benefit programs for retirement, health and workers' compensation benefits.

We are not a reporting company under the Securities Exchange Act of 1934, as amended, and not subject to regulation by the Securities and Exchange Commission (SEC). However, we are required by P.L.109-435 to file with the PRC certain financial reports containing information prescribed by the SEC under Section 13 of the Securities Exchange Act of 1934. These reports include annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, which are available on our website at *www.usps.com*.

Additional disclosures about our organization and finances, including Cost and Revenue Analysis reports, Revenue, Pieces, and Weight reports, financial and strategic plans and the Comprehensive Statement on Postal Operations may also be found on the above website. Information on this website is not incorporated by reference in this document.

Critical Accounting Policies

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make significant judgments and estimates to develop certain amounts reflected and disclosed in the financial statements. In many cases, there are alternative policies or estimation techniques that could be used. We maintain a thorough process to review the application of our accounting policies and to evaluate the appropriateness of the many estimates that are required to prepare the financial statements of a large organization. However, even under optimal circumstances, estimates routinely require adjustment based on changing circumstances and new or better information.

The three critical accounting policies that we believe are either the most judgmental or involve the selection or application of alternative accounting policies, and are material to our interim financial statements, are those relating to workers' compensation costs, deferred revenue for prepaid postage, and contingent liabilities. Management discusses the development and selection of these accounting policies and estimates with the Audit and Finance Committee of the Board of Governors.

For additional information, see *Critical Accounting Policies* in Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 3, *Summary of Significant Accounting Policies*, in the Notes to the Financial Statements contained in the Annual Report on Form 10-K for the year ended September 30, 2009.

Results of Operations

Operating losses were $1,553 million and $1,902 million in Quarter II, 2010 and 2009, respectively. For the six months ended March 31, 2010, we had an operating loss of $1,816 million, compared to an operating loss of $2,282 million for the comparable period of 2009. As in the prior year, we were unable to fully offset the current year's decrease in both mail volumes and the related revenues despite making significant cost reductions. In 2010, we are accruing $1,375 million each quarter for the scheduled September 30, 2010 $5.5 billion payment to the PSRHBF, compared to $1,350 million each quarter in 2009. Without the impact of the Congressionally-mandated accruals of $1,375 million and $1,350 million, the Quarter II operating loss would have been $178 million in 2010 and $552 million in 2009. For the six months ended March 31, 2010, we would have had an operating income of $934 million, compared to an operating income of $418 million for the comparable period of 2009, if the accrual of $2,750 million for 2010 and $2,700 million were not included.

Key Operating Statistics		Three Months Ended March 31,				Six Months Ended March 31,		
(Dollars and volume per day in millions)		2010		2009		2010		2009
Operating Revenue	$	16,697	$	16,938	$	35,052	$	36,033
Operating Loss	$	(1,553)	$	(1,902)	$	(1,816)	$	(2,282)
Net Loss	$	(1,584)	$	(1,905)	$	(1,881)	$	(2,289)
Operating Margin		-9.3%		-11.2%		-5.2%		-6.3%
Average Volume per day		572		590		591		630

We have experienced negative operating results in thirteen of the last fifteen quarters. As explained more fully in the "Revenue and Volume" section of this report, the recession that began in December 2007, coupled with the continued electronic diversion of mail caused a significant decrease in operating revenue in recent years, including the current quarter and the first six months of 2010. For the three months ended March 31, 2010, operating revenue was $16,697 million, compared to $16,938 million for the same period last year, a decrease of $241 million or 1.4%, in spite of a 3.8% average price increase for Mailing Services in May 2009. Only our Standard Mail category within Mailing Services had a volume increase for the quarter ended March 31, 2010.

For the six months ended March 31, 2010, operating revenue was $35,052 million, a decrease of $981 million, or 2.7%, from the same period of 2009. All categories of Mailing Services experienced volume declines in the six month periods ended March 31, 2010, compared to the same periods last year. However, Shipping Services, which represent approximately 12% of our revenues, increased 5.7% on volume increases of 1.5% for the three months ended March 31, 2010 compared to the same period of 2009.

Quarter II, 2010, operating expenses were $18,250 million compared to $18,840 million in the corresponding quarter of last year, a decrease of $590 million, or 3.1%. Compensation and benefits expenses decreased by $592 million, or 4.5%, as work hour decreases of 20 million hours, or 6.5%, from the comparable quarter of the prior year resulted in significant savings. Transportation expenses decreased by $35 million, or 2.4%, in the quarter ended March 31, 2010 compared to same quarter of 2009. Other expenses decreased by $46 million, or 2.0%, as the Postal Service continued to limit spending for discretionary items. Quarterly retiree health benefits expense increased from $1,846 million in Quarter II, 2009 to $1,929 million in the current year, an increase of $83 million, or 4.5%, reflecting a larger number of retirees, higher premiums and a larger scheduled PSRHBF payment.

Total operating expenses were $36,868 million for the first six months of 2010, a decline of $1,447 million, or 3.8%, from the first six months of 2009. For the first six months of 2010, compensation and benefits expenses of $25,589 million were $1,271 million, or 4.7%, less than the first six months of 2009, primarily attributable to a 49 million decrease in work hours, or 7.5%. Transportation expenses and other expenses decreased by $272 million and $70 million, or 8.4% and 1.5%, respectively, from the six month period ended March 31, 2009.

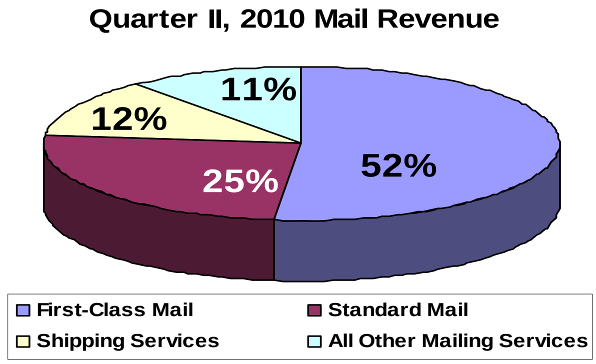
Revenue and Volume

Revenue		Three Months Ended March 31,				Six Months Ended March 31,		
(Dollars in millions)		2010		2009		2010		2009
First-Class Mail	$	8,614	$	9,023	$	17,929	$	18,677
Standard Mail		4,197		4,122		8,860		9,249
Periodicals		468		497		960		1,062
Package Services		394		436		803		936
Other Mailing Services*		977		923		1,955		1,832
Total Mailing Services	$	14,650	$	15,001	$	30,507	$	31,756
Total Shipping Services		2,047		1,937		4,545		4,277
Total Operating Revenue	$	16,697	$	16,938	$	35,052	$	36,033

* Includes Certified Mail, Return Receipts, PO Boxes, Insurance, Congressional Appropriations, Other Ancilliary Fees & Non-Mailing Income.

Prices for most Mailing Services increased by an average of 3.8% on May 11, 2009, while prices for Shipping Services increased on January 18, 2009, and January 4, 2010, by an average of 5.0% and 3.3%, respectively. While the economic recession may have ended, the adverse effects on our results continue. The rate of decline in mail volume has slowed, but we do not anticipate improvements for several quarters. Quarter II, 2010 total mail volume was 3.3% less than the same period of 2009, with an accompanying revenue decline of 1.4%. For the first six months of 2010, total Mailing Services and Shipping Services volume decreased by 6.3%.

The decline in revenues and volumes for both the quarter and six months ended March 31, 2010, can largely be attributed to the recent recession, its impact on electronic diversion rates and continuing electronic diversion. Compared to the equivalent periods of 2009, four of our five major categories of Mailing Services had volume declines in Quarter II. Standard Mail volume was up a modest 0.6% in Quarter II compared to the same quarter of the prior year. For the six months ended March 31, 2010, all categories of Mailing Services experienced volume declines.



Bill payments continue to move away from paper-based payments by mail toward electronic payments using the internet. Electronic presentment of bills and statements, while currently less advanced than bill payments, is a substantial threat to future mail revenue.

MAILING SERVICES

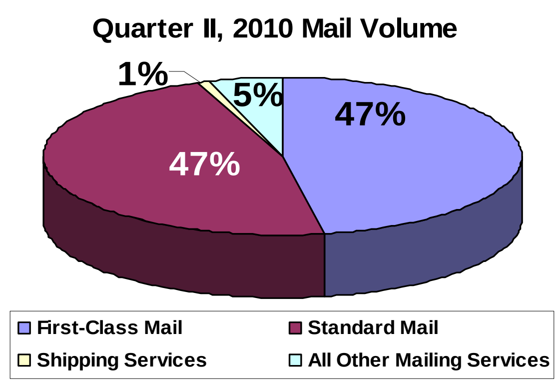
For the quarter ended March 31, 2010, combined First-Class Mail and Standard Mail, which were 94% of our volume, decreased almost 1,281 million pieces, or 3.1%, compared to the same period last year, with an associated drop in revenue of $334 million, or 2.5%.

Mail Volume	Three Months Ended March 31,		Six Months Ended March 31,	
(Pieces in millions)	2010	2009	2010	2009
First-Class Mail	19,999	21,401	41,217	44,110
Standard Mail	19,875	19,754	41,791	44,362
Periodicals	1,845	1,990	3,735	4,115
Package Services	172	186	350	401
Other Mailing Services*	111	122	246	268
Total Mailing Services	42,002	43,453	87,339	93,256
Total Shipping Services	339	334	750	735
Total Mail Volume	42,341	43,787	88,089	93,991

*Includes Certified Mail, Return Receipts, Delivery Confirmation, Money Orders & Insurance

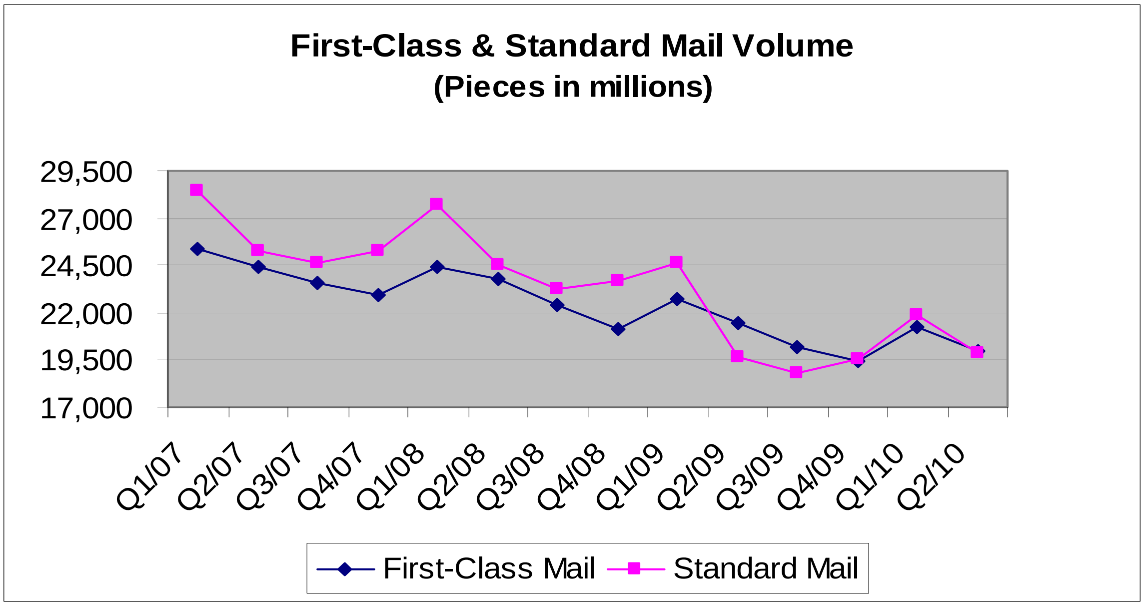
Despite a favorable boost in revenue as a result of the 2010 U.S. Census of approximately $180 million, First-Class Mail revenue of $8,614 million decreased $409 million, or 4.5%, in Quarter II on a volume decline of 1,402 million pieces, or 6.6%, compared to the same period last year. Single-piece First-Class letter revenue declined $312 million, or 9.2%, for the quarter compared to Quarter II, 2009. For the six months ended March 31, 2010, First-Class Mail revenue of $17,929 million was $748 million, or 4.0%, less than the comparable period of 2009 and year-to-date First-Class mail volume decreased by 2,893 million pieces from 2009 to 2010. Year-to-date, single-piece First-Class letter revenue declined $467 million, or 6.4%, on a volume decline of 10.1%.

The volume of First-Class Mail, our highest margin product, which includes bills, bill payments, statements, confirmations, orders and rebates, has been in decline for nearly a decade. While price has some effect on First-Class Mail volume, in this environment the economy and electronic diversion are both major causes of the volume decline. The recent economic recession appears to have accelerated the rate of migration to electronic alternatives to First-Class Mail. We anticipate that any positive impacts of an economic recovery on single-piece First-Class Mail will be more than offset by the continuing technology-driven decline in single-piece First-Class Mail.



Standard Mail revenue of $4,197 million increased $75 million, or 1.8%, in Quarter II, 2010, as volume increased 121 million pieces, or 0.6% compared to the same period last year. For the six month period ended March 31, 2010, Standard Mail revenue of $8,860 million decreased $389 million, or 4.2%, compared to the first six months of 2009. Standard Mail volumes have been significantly impacted by the decline in advertising spending resulting from the recent recession. In addition to the impact of the troubled economy on Standard Mail revenues, advertisers continue to become more sophisticated in the targeting of their mailings, further reducing mail volume. We expect advertising mail to stabilize and slightly increase as the economy improves; however increased migration of advertising to the internet or other media will adversely impact volumes.

The following depicts First-Class and Standard Mail volume since 2007:



Revenue from Periodicals decreased $29 million, or 5.8%, in the second quarter of 2010 and year-to-date revenue decreased $102 million, or 9.6%, compared to the same period last year. Trends in hard copy reading behavior and shifts of advertising away from print have been depressing this segment for years. For the first half of 2010, average per piece weights for Periodicals decreased by 3.3%, reflecting the decline in the number of pages. Volume for Quarter II, 2010 and the first half of 2010 decreased 145 million and 380 million pieces, or 7.3% and 9.2%, respectively, compared to the same period last year.

Package Services revenue decreased $42 million, or 9.6%, in Quarter II compared to the second quarter of 2009, as volume decreased 14 million pieces, or 7.5%. Year-to-date 2010 Package Services revenue decreased $133 million, or 14.2%, as volume decreased 51 million pieces, or 12.7%, compared to the same period last year. The increase in Parcel Post rates in May 2009, and shifts to the more profitable Priority Mail Flat Box in the Shipping Services category adversely impacted Package Services.

SHIPPING SERVICES

Shipping Services revenue increased $110 million, or 5.7%, in Quarter II compared to the same period of 2009, as volume increased 5 million pieces, or 1.5%. Year-to-date volume increased 15 million pieces, or 2.0%, resulting in a revenue increase of $268 million, or 6.3%, from the first six months of 2009. The small volume increases in Shipping Services are indicative of the early signs of economic recovery and the impact of our advertising campaigns.

Additional discussion on volume and revenue projections can be found in the Outlook section of this report. Detailed data on Mailing Services product volume and revenue may be found in the Quarterly Revenue, Pieces and Weight reports on [www.usps.com/financials/rpw.](http://www.usps.com/financials/rpw)

Operating Expenses – Compensation and Benefits

COMPENSATION AND BENEFITS

Compensation and benefits expense in Quarter II, 2010 was $12,611 million. This was $592 million, or 4.5% less than the same period last year. Decreases in compensation and health benefits expenses were the result of fewer employees and work hours. Compensation expense decreased by $532 million, or 5.4%, in Quarter II compared to the same period last year. This was primarily due to a 6.5%, or 20 million hour decrease in work hours used. In addition, the Postal Service contributed approximately 2% less per employee for health benefit premiums compared to the prior year which resulted in a decrease to quarterly health benefit expense.

Compensation and Benefits Expenses (Dollars in millions)	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009	Six Months Ended March 31, 2010	Six Months Ended March 31, 2009
Compensation	$ 9,403	$ 9,935	$ 19,354	$ 20,294
Retirement	1,445	1,477	2,914	2,989
Health Benefits	1,286	1,331	2,570	2,661
Workers' Compensation	390	376	576	729
Other	87	84	175	187
Total	$ 12,611	$ 13,203	$ 25,589	$ 26,860

For the six months ended March 31, 2010, compensation and benefits expense decreased by $1,271 million, or 4.7%, compared to the first six months of 2009. Year-to-date compensation expense through March 31, 2010 decreased by $940 million, or 4.6%, from the same period of 2009, primarily as a result of a 49 million, or 7.5%, reduction in work hours. Offsetting a portion of the year-to-date savings generated by the decrease in work hours and lower health benefits contributions was $112 million of incentive accruals for approximately 7,400 APWU and NPMHU employees, who elected in fiscal year 2010 to retire or resign from the Postal Service in the first quarter of fiscal year 2010. This is in addition to the $197 million accrued in the fourth quarter of 2009, which was attributable to approximately 13,400 employees electing to retire or resign in fiscal 2009. These incentives have been, or will be, paid in two installments – the first in Quarter I, 2010 and the second in Quarter I, 2011. There was no comparable expense recorded in the first six months of 2009. The year-to-date decrease in compensation and benefits expense also reflects a decrease in workers' compensation expense of $153 million due to changes in discount and inflation rates.

WORK HOURS

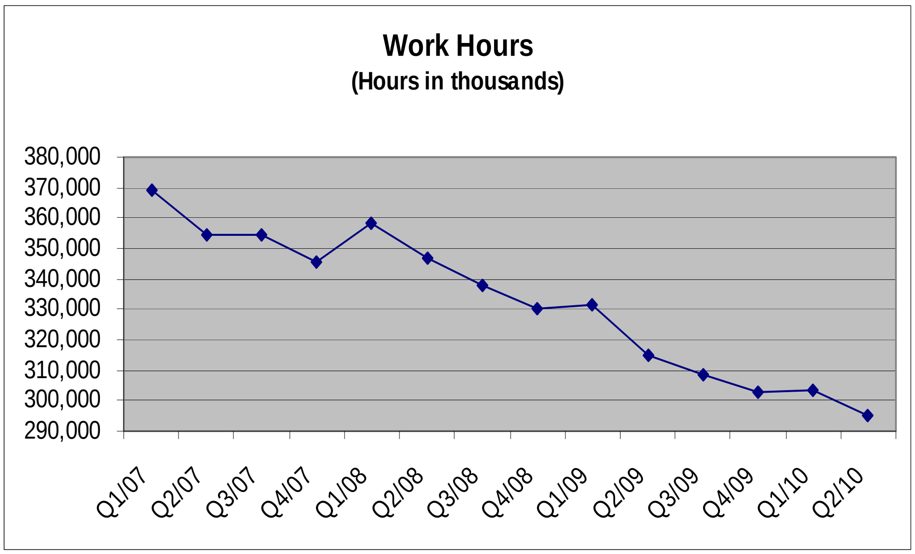
Due to ongoing savings from automation and operational improvements designed to match labor resources to a reduced mail volume workload, work hours in Quarter II, 2010 decreased by 20 million hours, or 6.5%, compared to the same quarter of 2009. Work hours for the first six months of 2010 were 49 million hours, or 7.5%, less than the first six months of 2009.

On a quarterly basis, Mail Processing achieved a reduction of almost 7 million hours. Customer Services Operations and City Delivery reduced work hours by approximately 5 million and 4 million hours, respectively. The work hour reduction was achieved even though the number of delivery points increased by approximately one million from March 31, 2009 to March 31, 2010.

Work Hours (Hours in thousands)	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009	Six Months Ended March 31, 2010	Six Months Ended March 31, 2009
City Delivery	101,440	105,413	205,784	216,223
Mail Processing	56,341	63,270	117,182	134,172
Customer Services & Retail	40,309	45,088	82,367	93,144
Rural Delivery	43,818	45,525	87,353	91,159
Postmasters	14,795	15,044	29,379	29,721
Other, including Plant, Vehicle Services, Operational Support, and Administration	38,092	40,867	76,252	82,553
Total Work Hours	294,795	315,207	598,317	646,972

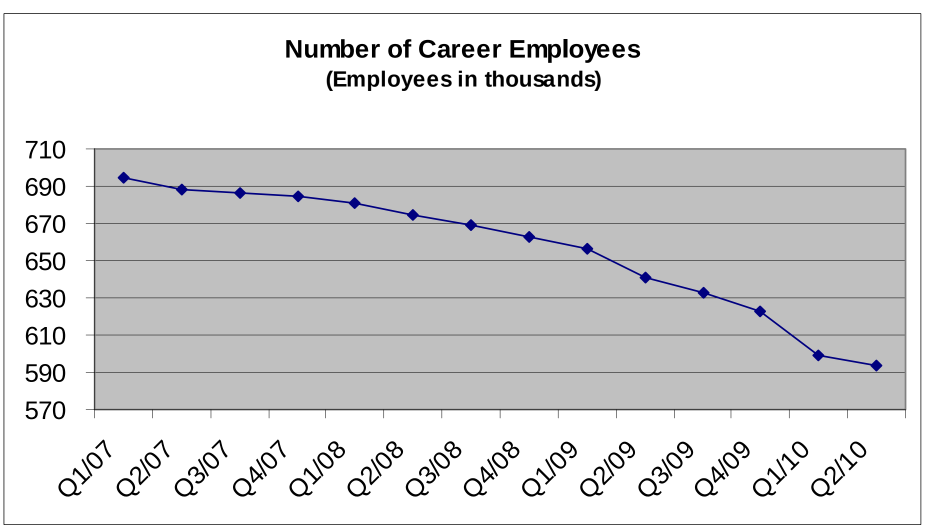
On a year-to-date basis, Mail Processing work hours decreased by approximately 17 million hours, or 12.7%, from the comparable period of 2009. City Delivery and Rural Delivery decreased work hours by approximately 14 million hours and Customer Services operations reduced work hours by approximately 11 million hours, or 11.6%. We continue to target the elimination of up to 90 million hours in 2010, or approximately 50,000 full-time equivalent employees, although the ultimate savings in work hours is also dependent upon mail volume. Inhibiting the Quarter II work hour reductions somewhat was a 2.6 million hour or 16.7% increase in overtime over Quarter II 2009. Much of this increase was incurred as a result of unprecedented winter storms that impacted operations throughout much of the country and higher than anticipated but still declining volumes.

The following illustrates our quarterly work hour usage since 2007:



EMPLOYEE WORKFORCE

The number of career employees at March 31, 2010 was approximately 594,000, a reduction of 5,000 employees during Quarter II, 2010 and 47,000 employees since March 31, 2009. This reduction has been accomplished primarily through attrition and retirement incentives. The following graph depicts the number of career employees in the Postal Service since 2007:



In addition, at March 31, 2010 the Postal Service had approximately 90,000 Non-Career Employees, a reduction of 5,000 Non-Career employees during Quarter II, 2010 and 7,000 Non-Career employees since March 31, 2009.

RETIREMENT EXPENSE – CURRENT EMPLOYEES

During the second quarter of 2010, retirement expense was $1,445 million compared to $1,477 million for the same period last year, a decrease of $32 million, or 2.2%. For the six months ended March 31, 2010, retirement expense was $2,914 million compared to $2,989 million for the first six months of 2009, a decline of $75 million, or 2.5%. The declines were principally due to the reduction in the number of employees.

WORKERS' COMPENSATION

Postal employees are covered by the Federal Employees' Compensation Act, administered by the Department of Labor (DOL) Office of Workers' Compensation Programs (OWCP), which makes all decisions regarding injured workers eligibility for benefits. However, we reimburse the DOL from postal funds for all workers' compensation benefits paid to postal employees on our behalf, and, in addition, pay an administrative fee to the DOL.

We record a liability for the present value of the estimated future workers' compensation payments. After making our annual payment of $1.1 billion to the DOL in Quarter I, the present value of our liability for future workers' compensation payments was $9,613 million at March 31, 2010, compared to $10,133 million at September 30, 2009. The current portion of this liability was $1,071 million at March 31, 2010 and $1,069 million at September 30, 2009. These amounts are accrued under "Compensation and benefits" on the balance sheets.

Workers' compensation expense was $390 million in the second quarter of 2010 compared to $376 million in same quarter of 2009, an increase of $14 million, or 3.7%, for the six months ended March 31, 2010 and 2009, workers' compensation expense was $576 million and $729 million, respectively, a decrease $153 million or 21%. The increase in the three month period ended March 31, 2010 compared to the same period last year was driven in part, by increased medical payments incurred as part of a program to evaluate whether all employees in modified work assignments are performing work that is both suitable to their medical restrictions and necessary to the Postal Service's mission. This increase in the number of medical payments was partially offset by the impact of the change in discount and inflation rates. We anticipate that the short term increase in medical payments may result in lower expenses in future years. The decrease in workers' compensation expense for the six month period ended March 31, 2010 from the comparable period in 2009 was driven by changes in the discount and inflation rate assumptions used to calculate the workers' compensation liability, which are updated quarterly. The impact of the rate changes more than offset the increase in medical payments for the period. The rates for the periods are as indicated:

Workers' Compensation Liability Inflation and Discount Rates	Quarter Ended March 31, 2010	December 31, 2009	September 30, 2009
Compensation Claims Liability:			
Discount Rate	5.1%	5.0%	4.9%
Wage inflation	2.9%	2.9%	3.2%
Medical Claims Liability:			
Discount Rate	4.5%	4.5%	4.4%
Medical Inflation	4.4%	4.4%	3.8%

The increase in the compensation discount rate in Quarter II, 2010 decreased our estimated liability and expense by $47 million from Quarter I, 2010. Changes in both the medical and compensation inflation and discount rates during the first six months of 2010 resulted in a decrease to our estimated liability and expense of $252 million. The impact of the quarterly changes in the discount and inflation rates is accounted for as a change in accounting estimate and included in the quarter's compensation and benefits expense. Changes in our workers' compensation liability not attributable to changes in the discount and inflation rates are attributable to other routine changes in the actuarial estimation, new compensation and medical cases and the development of existing cases.

For the six months ended March 31, 2010, we experienced a 4.7% increase in the number of compensation claims receiving payments from the comparable period of the prior year. For the first six months of 2010, the dollar amount of claim payments disbursed by DOL on our behalf, including compensation and medical claim payments, increased $15 million, or 2.8%, from the comparable period of 2009. The increase from the prior year is attributable to increased medical claim payments. Year-to-date compensation claim payments declined slightly from 2009.

On a quarterly basis, changes in the number of claims and amounts paid are highly volatile and depend on a number of factors including, but not limited to: the number, timing and severity of injuries; the number of new and closed claims in the period; and the amount and timing of payments made by the OWCP on our behalf. Medical and compensation claims payments fluctuate significantly from quarter to quarter, so the change in the number of paid medical and compensation claims for any quarter compared to the same period last year may not necessarily be representative of the results to be expected for the full year.

Operating Expenses – Retiree Health Benefits

P.L. 109-435 included a 10 year, $55,800 million payment schedule that requires payment of $5,500 million into the PSRHBF on September 30, 2010. We are expensing the $5,500 million at a rate of $1,375 million per quarter and, accordingly, have recorded $2,750 million of expense for the six months ended March 31, 2010. In 2009, we expensed the scheduled annual payment of $5,400 million at the rate of $1,350 million per quarter for the first three quarters of the year and in Quarter IV, 2009, adjusted our accrual for retiree health benefits to reflect the passage of P.L. 111-68, which reduced our required 2009 contribution from $5.4 billion to $1.4 billion. For the first six months of 2009, we recognized $2,700 million of expense. Although P.L. 109-435 specifies the funding requirements through 2016, the amounts to be funded and the timing of funding can be changed at any time with the passage of new laws, or amendment of existing laws. In 2010, the Postal Service continues to seek legislative restructuring of both the 2010 and future years' payments due to the PSRHBF. There can be no assurance that the restructuring of any of these payments will occur.

In addition to our funding of the PSRHBF, the Office of Personnel Management charges us for the cost of our retirees currently participating in the Federal Employee Health Benefits Program (FEHBP). See Note 7, *Health Benefits Programs,* and Note 8, *Retirement Programs* in the Notes to the Financial Statements.

Retiree health benefits expense for the second quarter of 2010 and 2009 was $1,929 million and $1,846 million, respectively, an $83 million, or 4.5% increase. For the six months ended March 31, 2010 and 2009, we recorded $3,826 million and $3,660 million of retiree health benefit expense, respectively, a $166 million, or 4.5% increase. The components of these expenses are as follows:

Retiree Health Benefits	Three Months Ended March 31,		Six Months Ended March 31,	
(Dollars in millions)	2010	2009	2010	2009
Retiree Health Benefits	$ 554	$ 496	$ 1,076	$ 960
P.L. 109-435 Scheduled Payment to PSRHBF	1,375	1,350	2,750	2,700
Total Retiree Health Benefit Expenses	$ 1,929	$ 1,846	$ 3,826	$ 3,660

Quarterly expenses for current retirees increased $58 million in 2010, or 11.7%, from the same period last year. Year-to-date these expenses increased by $116 million, or 12.1%, from the first six months of 2009. The major drivers of current retiree health benefits expense are the number of retirees participating in the health benefits program and the premium costs of the plans they select. As of March 31, 2010, there were approximately 467,000 retired participants, an increase of about 12,000 compared to the same period last year. The large increase in the number of participants and the 8.8% increase in premiums explain the substantial rise in current retiree health benefit expenses.

Operating Expenses – Transportation

Transportation Expenses		Three Months Ended March 31,				Six Months Ended March 31,		
(Dollars in millions)		2010		2009		2010		2009
Highway Transportation	$	803	$	732	$	1,624	$	1,599
Air Transportation		597		646		1,232		1,423
Other Transportation		38		95		95		201
Total Transportation Expenses	$	1,438	$	1,473	$	2,951	$	3,223

Transportation expenses are largely made up of highway and air transportation costs. Transportation expenses were $1,438 million, a decrease of $35 million, or 2.4%, for Quarter II, 2010, compared to $1,473 million in the same period last year. For the six months ended March 31, 2010, transportation expenses were $2,951 million, a decrease of $272 million, or 8.4%, from the first six months of 2009.

Highway transportation expenses were $803 million in the second quarter of 2010, an increase of $71 million, or 9.7%, from the second quarter of 2009. Highway transportation expenses for the first half of 2010 were $1,624 million, an increase of $25 million, or 1.6%, compared to the same period last year. The quarterly and year-to-date increases in highway transportation expenses are attributable to increases in the cost of diesel fuel and highway contractual mileage.

Diesel fuel, which makes up approximately 93% of fuel purchased for highway contracts, cost an average of $2.85 per gallon during Quarter II, 2010 compared to $2.19 per gallon during second quarter of 2009, an increase of 30.1%. For the first six months of the year, the average cost of a gallon of diesel fuel was $2.80, compared to $2.56 in 2009, a 9.4% increase. Gasoline prices increased 42.6% compared to the same quarter last year, with the cost of a gallon of gasoline averaging $2.71 during Quarter II, 2010 compared to $1.90 during Quarter II, 2009. The cost of a gallon of gasoline averaged $2.66 during the first six months of 2010 compared to $2.07 during the first half of 2009, a 28.5% increase.

Highway contracted mileage increased by 32 million miles, or 2.0%, for the first half of 2010 compared to the first half of 2009. These mileage increases were attributed primarily to the initiation of the Network Distribution Center (NDC) project. This project is transforming existing Bulk Mail Centers into NDCs. This has improved the flow of mail into the network, consolidated package distribution and improved transportation utilization. The impact of the increases in contracted mileage was partially offset by decreased rail transportation expense, which is included in "Other Transportation", as a result of the NDC project. Although initiation of NDCs is initially increasing miles driven, we expect that contracted mileage will decrease as the implementation process continues during the second half of 2010.

An additional driver of increased highway mileage is the ongoing effort to shift from high cost air transportation to lower cost highway transportation in areas where service will not be affected.

Air transportation expenses of $597 million in the quarter ended March 31, 2010 decreased by $49 million, or 7.6%, from the same quarter last year and, on a year-to-date basis, decreased by $191 million, or 13.4%, from the six months ended March 31, 2009. On a year-to-date basis, domestic air transportation decreased $83 million or 7.5 % due to lower shipping volume throughout the six month period compared to the same period in 2009. Our second quarter, 2010 domestic air transportation expenses increased $4 million, or 0.8% due to increases in fuel offset by the lower volumes.

For the second quarter, 2010, international air transportation expenses decreased $53 million, or 32.3%, and on a year to date basis, decreased $108 million, or 33.8%. These decreases were due to a one time benefit for the recapture of foreign postal payments required under the Universal Postal Union regulations.

The quarterly and year-to-date decreases in other transportation expenses of $57 million and $106 million, or 60.0% and 52.7%, respectively, from the comparable periods of the prior year, are due to lower settlements for foreign postal transactions related to mail transported via surface transportation due to lower international mail volume. Lower rail transportation expenses also contributed to these decreases, as we shifted business to other modes of transportation.

Operating Expenses – Other Operating Expense

Other Operating Expenses (Dollars in millions)	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009	Six Months Ended March 31, 2010	Six Months Ended March 31, 2009
Supplies and Services	$ 557	$ 596	$ 1,106	$ 1,141
Depreciation and Amortization	597	565	1,224	1,135
Rent and Utilities	448	462	862	902
Vehicle Maintenance Service	209	181	408	377
Information Technology and Communications	161	181	288	318
Rural Carrier Equipment Maintenance Allowance	129	134	261	264
Other	171	199	353	435
Total Other Operating Expenses	$ 2,272	$ 2,318	$ 4,502	$ 4,572

Other operating expenses of $2,272 million for the second quarter of 2010 were $46 million, or 2.0%, less than last year's comparable quarter. For the six months ended March 31, 2010, other operating expenses of $4,502 million were $70 million, or 1.5%, less than the first half of 2009. Supplies and Services, which include our advertising costs, decreased by $39 million and $35 million for the three and six months ended March 31, 2010 from the comparable periods of the prior year, primarily due to stringent controls over discretionary expenses and decreases in professional fees and other miscellaneous services. Advertising expenses, however, increased by $10 million and $44 million for the three and six months ended March 31, 2010, respectively, compared to the comparable periods of 2009 due primarily to increased promotion of our Priority Mail Flat Rate products. Information Technology and Communications decreased $20 million and $30 million for the quarter and six months ended March 31, 2010, respectively, primarily as a result of decreases in commercial software and independent contractor fees.

Partially offsetting these decreases were the $32 million and the $89 million increase in Depreciation and Amortization for the three and six months ended March 31, 2010 primarily as a result of the adjustment of the useful lives of certain properties and the reclassification of certain leases from operating to capital leases. As a result of this reclassification, depreciation has increased and rent expense has decreased which explains most of the decrease in rent and utilities expense of $14 million and $40 million for the three and six month periods ending March 31, 2010.

Cash Flows and Liquidity

Cash Flow Activity

Net cash provided by operating activities in the six month period ended March 31, 2010 was $1,312 million, or $737 million lower than the net cash generated from operations in the first half of 2009. This decrease was primarily due to a change in the timing of the annual workers compensation payment to DOL. In 2010, we began making the annual reimbursement to the DOL on the statutorily-required deadline of October 15, rather than on September 15, the date on which we had made such payments in previous years. This had the effect of shifting approximately $1,051 million of cash outflow from 2009 into 2010. We also had a $154 million decrease in the change in deferred revenue-prepaid postage and prepaid box rent and other deferred revenue compared with the prior year, indicating that services were provided in 2010 for cash collected in prior years, and an $89 million increase in depreciation and amortization expense compared to the comparable six months of 2009.

Net cash used in investing activities decreased by $333 million for the six months ended March 31, 2010, compared to the same period last year, due principally to a $301 million decrease in property and equipment purchases. The reduction in purchases reflects our on-going efforts to conserve cash.

Net cash used in financing activities increased $2,274 million for the six months ended March 31, 2010 from the comparable period of 2009 due to repayments on our debt.

At March 31, 2010, cash and cash equivalents were $1,029 million, a $3,060 million decrease from September 30, 2009, and a $21 million decrease from March 31, 2009.

The following table illustrates our scheduled cash flow obligations in 2010 and future years:

Contractual Obligations (Dollars in millions)	Total	Less than 1 Year	1-3 Years	3-5 Years	After 5 Years
	Payments Due by Year				
Debt (1)	$ 6,530	$ 2,030	$ -	$ 300	$ 4,200
Interest on debt (1)	2,337	155	306	303	1,573
PSHRBF	39,400	5,500	11,100	11,300	11,500
Capital lease obligations	893	52	204	187	450
Operating leases	7,989	407	1,484	1,260	4,838
Capital commitment (2)	1,352	384	716	165	87
Purchase obligations (2)	4,905	751	2,769	1,383	2
Workers' compensation (3)	16,847	1,356	2,995	3,401	9,095
Employees' leave	2,277	276	361	214	1,426
Total Contractual Obligations	$ 82,530	$ 10,911	$ 19,935	$ 18,513	$ 33,171

(1) For overnight and short-term debt, the table assumes the balance as of period end remains outstanding for all periods presented.

(2) Legally binding obligations to purchase goods or services. Capital commitments pertain to purchases of equipment, building improvements and vehicles. Purchase obligations generally pertain to items that are expensed when received or amortized over a short period of time. Capital commitments and purchase obligations are not reflected on the Balance Sheet.

(3) Assuming no new cases in future years. This amount represents the undiscounted expected workers' compensation payments. The discounted amount of $9,613 million is reflected in our Balance Sheet at March 31, 2010.

Liquidity

As reported in the Annual Report on Form 10-K for the year ended September 30, 2009, the Postal Service had net losses of $3,794 million, $2,806 million, and $5,142 million for the three years ended September 30, 2009, 2008 and 2007, respectively. These losses have placed unprecedented demands on operating liquidity. The losses have continued into 2010, as losses of $1,584 million and $1,881 million were incurred for the three and six months ended March 31, 2010, respectively. The Postal Service also experienced negative cash flow from operations for two of the past three years, with 2009 being the exception. To alleviate pressure on liquidity, in September 2009 Congress enacted legislation (P.L. 111-68) which restructured the required $5.4 billion payment to the Postal Service Retiree Health Benefits Fund (PSRHBF) that was due on September 30, 2009, reducing it to $1.4 billion. Had this legislation not been enacted, cash flow from operations would have been negative for 2009 as well. This legislation did not, however, address future payments into the PSRHBF, including the $5.5 billion payment due in September 2010.

By statute, the Postal Service is limited to an annual net increase in debt of $3 billion, and a total outstanding debt of $15 billion. The Postal Service projects debt outstanding at year-end to increase over the September 30, 2009 balance by the maximum allowable $3 billion, to $13.2 billion. The $15 billion debt ceiling will become insufficient in 2011.

The recent losses are primarily attributable to unprecedented declines in mail volumes that began in 2008. The declines in mail volumes are primarily a result of the recent widespread economic recession and the long-term trend of hard copy correspondence and transactions migrating to electronic media. This migration trend accelerated during the recession and is expected to continue. Since peaking at 213 billion pieces in 2006, mail volumes dropped 904 million pieces in 2007, 9.5 billion pieces in 2008, and 25.6 billion pieces, to 177.1 billion pieces, in 2009. Mailing Services volume for the first six months of 2010 is already down an additional 5.9 billion pieces compared to the first six months of 2009 and is expected to decrease by a total of approximately 8 billion pieces in 2010. It is possible that volumes and related revenues could decrease at rates that differ significantly from these projections. Because of declining volumes, revenues are also expected to continue to decrease in 2010 and, even with substantial cost reductions, the Postal Service projects a potential cash shortfall in 2011.

In addition to normal recurring costs, the Postal Service has two substantial cash payments scheduled for September and October 2010: the $5.5 billion due to the PSRHBF on September 30, 2010; and approximately $1.1 billion due in October 2010 to the Department of Labor (DOL) for the Postal Service workers' compensation liability. Based on the current Postal Service borrowing capacity and projections of cash available from operations, there will likely be sufficient cash available for ongoing operations in 2010. However, there is substantial uncertainty as to whether the Postal Service will have sufficient cash available to fund the $5.5 billion PSRHBF payment and the October DOL obligations while maintaining sufficient liquidity to meet its financial obligations in 2011. The legal and/or regulatory consequences to the Postal Service if the PSRHBF or the workers' compensation payments are not funded are unknown. Even if there is sufficient cash to fund ongoing operations and the PSRHBF payment on September 30, 2010, the Postal Service will likely experience a cash shortfall in 2011.

ACTIONS TAKEN

To meet this financial challenge, we are continuing efforts to increase efficiency, reduce costs, and generate new revenue.

In 2010, liquidity management actions include targeting a work hour reduction of up to 90 million hours, although the ultimate number of work hour savings is somewhat dependent upon mail volumes. We will continue maximizing operational efficiencies, renegotiating contracts with major suppliers, halting construction of new facilities and continuing revenue generation efforts. We have targeted $3.8 billion in total cost reductions in 2010 and for the six months ended March 31, 2010, we have used 49 million fewer work hours than the same period last year. In 2009, we achieved $6.1 billion of cost reductions, mostly from a reduction of 115 million work hours.

PROJECTED CASH SHORTFALL – SHORT AND LONG-TERM

The actions discussed above are intended to conserve cash and generate revenue. However, the full effect of these actions may not be realized until 2011 and beyond. We are committed to exploring all of the initiatives discussed above because there is no assurance that economic conditions will improve substantially during the second half of 2010 or that mail volumes will return to previous levels once the economy does improve. We have taken these actions with the goal of maximizing liquidity in spite of declining revenues while not adversely impacting customer service. Although each of the actions discussed above is expected to positively impact cash flow, they may not, either individually or in the aggregate, be sufficient to offset a potential cash shortfall at September 30, 2010 and beyond.

Even with legislative action to address these shorter-term liquidity matters, we would still face longer-term financial viability concerns. To begin the process of addressing these issues, in March 2010, we issued our action plan for the next decade, *Ensuring a Viable Postal Service for America*. In this plan, we estimate that during the next decade, there would be cumulative financial losses of approximately $238 billion, absent significant operational and legislative changes.

We estimate that approximately $123 billion of the projected losses could be addressed and resolved by aggressive management actions and within the existing regulatory structure, assuming full cooperation from all Postal Service stakeholders. To address the remaining unsustainably large projected deficit of at least $115 billion, a balanced set of actions has been proposed. These actions will require legislation and cooperation from a range of stakeholders, and include changes in the following areas: retiree health benefits prefunding; delivery frequency; access to postal services; workforce flexibility; product and pricing flexibility; expansion of products and services; and regulatory oversight issues. In addition, on January 20, 2010, the Office of Inspector General issued a report in which it evaluated the current system of funding the Postal Service's Civil Service Retirement System responsibility, concluding that the Postal Service had been overcharged by $75 billion. The Postal Regulatory Commission has initiated a study on this issue and will be issuing a report at a later date. *Ensuring a Viable Postal Service for America* and related documents can be found online at *www.usps.com/strategicplanning/futurepostalservice.htm.*

The Postal Service filed a request for an advisory opinion with the PRC on March 30, 2010, regarding whether the elimination of Saturday mail delivery to street addresses and other associated changes conform to the policies in Title 39, United States Code. Furthermore, Congressional action would be required to reduce the number of legally-required delivery days. No savings will occur in 2010 from the ability to adjust the six day delivery requirement, even if granted in 2010, as numerous operational, contractual and customer issues would need to be resolved prior to implementation of a new delivery schedule. However, such important new flexibility could provide direct cost savings beginning no earlier than mid-2011.

In April 2010, the GAO issued its report *U.S. Postal Service-Strategies and Options to Facilitate Progress toward Financial Viability* which urges quick action by Congress and the Postal Service to (1) reach agreement as to the actions necessary to achieve financial viability, (2) provide financial relief by revising our retiree health funding schedule and (3) require that any binding arbitration resulting from collective bargaining take our financial condition into account. The GAO recommends that we pursue the following three strategies: reduce compensation and benefits costs; reduce other operations and network costs and improve efficiency; and generate additional revenues through product and pricing flexibility. In addition, the report also recommends that Congress could set up a mechanism, such as one similar to the military Base Realignment and Closure Commission, where independent experts could recommend a package of actions with time frames. Although we agree with almost all the recommendations, we do have concern with the creation of a new commission. We believe that such a commission would only add a layer of bureaucracy and delay to problems that require immediate attention. The GAO report notes that if no actions are taken, the risks of larger Postal Service losses, rate increases and taxpayer subsidies will increase.

We continue to inform the Administration, Congress, and other stakeholders of the immediate and longer-term financial issues we face and legislative changes that will help ensure both the availability of sufficient liquidity at September 30, 2010 and beyond. However, there can be no assurance that adjustments to the PSRHBF payment schedule, or any other legislative changes, will be made by September 30, 2010, or at all.

Outlook

The economic slowdown appears to be ending with uneven but encouraging signs of economic recovery. Year-over-year GDP growth stabilized after a first quarter surge of 5.6% growth. Real GDP growth was 3.2% in Quarter II, with a projection for the remainder of the year to be in the mid-two percent range. By historical standards, this is a weak recovery from a widespread recession. The precursors to the recent recession, housing price deflation and oil shocks, appear to have eased. However, the recovery in real estate values, a major component of many Americans' net worth, is expected to be very gradual.

Unfortunately, two important factors that have historically driven mail volume growth – employment and investment – appear to be lagging GDP growth by several quarters. According to the Bureau of Labor Statistics (BLS), the unemployment rate reached 10.0% in Quarter I. Although unemployment has started to decline, improvement in the unemployment rates is expected to be a very gradual process. Quarter II unemployment is expected to be 9.7% and little improvement is expected for the remainder of 2010. Gross private domestic investment improved in Quarter I, lead by an increase of 18.2% in business equipment and software spending. Another historical driver of mail volume growth, retail sales, is growing similarly to GDP. Retail sales grew 2.6% in Quarter II compared to 1.7% in the first quarter; housing sales, however, have dropped sharply, blunting the benefit of better consumer spending. Retail sales are projected to grow gradually for the balance of the year, reaching 3.4% in Quarter IV.

Revenue Outlook

Revenue continues to present significant forecasting challenges due to the tenuous nature of the economic recovery thus far and the accelerated migration of mail to electronic alternatives. Revenue for the first six months of the year decreased by 2.7% compared to the first six months of 2009. If this trend continues for the remainder of the year, revenues would decrease by $1,800 million for the year compared to 2009. Our economic forecasts anticipate that revenues will stabilize in the second half of the year. If this scenario materializes, our revenue will be down approximately $1.2 billion on a related volume decrease of approximately 8 billion pieces of mail.

Expense Outlook

We are continuing our cost reduction plans to mitigate the effects of the significant revenue shortfall from continuing declining mail volumes. Savings initiatives have been implemented across the entire organization, including all operations, administrative and non-personnel expenses. We are targeting approximately $3.8 billion in cost savings, including up to 90 million in work hour reductions in 2010, although the ultimate work hour savings are dependent on mail volume. In the first six months of 2010 we used 49 million, or 7.5%, fewer work hours than the same period last year. Total expenses, including interest expense, were $1,389 million, or 3.6%, less than the same period last year.

Our continued savings will be helped by the departure of approximately 20,800 employees who accepted retirement/termination incentives and left the organization in the first quarter of the year.

Bulk Mail Centers are being transformed into Network Distribution Centers (NDC). The core principle of the NDC concept is to fill containers and trucks as early in the network as possible and dispatch them as deep into the network as possible. It is anticipated that the majority of the expected savings from this initiative will be realized beginning in the latter part of 2010, continuing into 2011.

Plant staffing optimization will continue to contribute to operational savings in 2010 by aligning the plant workforce to meet changing workload levels. Route adjustments performed last year resulted in a reduction of 11,500 routes in 2009. Additional city delivery savings will be generated in 2010 from the adjustment process.

Fair Value Measurements

Certain fair value disclosures for the quarter and six months ended March 31, 2010 are included in our financial statements as required by authoritative accounting literature. We did not recognize gains as a result of valuation measurements during the three and six months ended March 31, 2010. All losses required to be recognized have been incorporated into our financial statements as of March 31, 2010, and for the three and six months then ended. See Note 10, *Fair Value Measurements,* in the Notes to the Financial Statements.

Legislation

P. L. 111-148, *the Patient Protection and Affordable Care Act,* was signed on March 23, 2010. We are currently analyzing the legislation to determine the future impact on our operations.

H.R. 4711, *Postal Service Electronic Motor Vehicle Act,* would require that our delivery vehicle fleet be replaced by electric motor vehicles. The measure does not include provisions for funding the effort. Based on a 2009 solicitation for electric vehicle research and development, we believe the cost of converting one diesel delivery vehicle to an electric drive train is approximately $30,000 to $50,000 per vehicle. Cost estimates for the purchase of a new electric truck could range from approximately $40,000 to $70,000. Major facility modifications would be required to provide 240V/30A recharging station for each vehicle. Under the provisions of the bill as currently drafted, initial infrastructure costs could exceed $1.5 billion. The bill was referred to a House committee.

H.R. 4612, would amend Title 39, *United States Code,* to provide that the procedures governing the closure or consolidation of our stations and branches be the same as those for Post Offices. The measure was referred to a House committee.

Item 3 – Quantitative and Qualitative Disclosures about Market Risk

In the normal course of business we are exposed to market risks from changes in commodity prices, certain foreign currency exchange rate fluctuations and interest rates. Our commodity price risk consists primarily of exposure to changes in prices for diesel fuel, unleaded gasoline and aircraft fuel for transportation of the mail, and fuel for heating facilities. We have foreign currency risk related to the settlement of terminal dues and transit fees with foreign postal administrations for international mail.

We have not used derivative commodity or financial instruments, such as hedging, to manage market risk related to commodities, foreign currency exchange or interest rate fluctuations for debt instruments. Additionally, we do not purchase or hold derivative financial instruments for speculative purposes.

See our 2009 10-K, Financial Section Part II, Item 7A-*Quantitative and Qualitative Disclosures about Market Risk*.

Item 4 – Controls and Procedures

Management is responsible for the preparation, integrity and fair presentation of the financial statements of the Postal Service.

Disclosure Controls

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports presented in accordance with the Securities Exchange Act is recorded, processed, summarized and reported within the time frames specified by P.L. 109-435 and that this information is accumulated and communicated to our management, including the Postmaster General and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures we recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and we were required to apply our judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We carried out an evaluation under the supervision and with the participation of management, including the Postmaster General and Chief Financial Officer, of the effectiveness of the design and operation of disclosure controls and procedures as of March 31, 2010. Based on the foregoing, the Postmaster General and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of March 31, 2010.

Internal Controls

There have been no changes during the period covered by this report in our internal control over financial reporting or in other factors that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

Part II

Item 1 – Legal Proceedings

The Environmental Protection Agency filed in April 2010 an administrative complaint against five New York area postal facilities seeking $350,000 in fines for alleged violations of federal laws concerning underground storage tanks. The complaint alleges deficiencies in record keeping, corrosion protection and testing. No releases to the environment from the tanks are alleged. We are reviewing the allegations to determine what, if any, liability exists. Although the applicable disclosure rules require that we disclose this matter, we do not consider the potential liability to be material.

Item 1A – Risk Factors

Except for the risk factor identified in the next paragraph, there were no changes in risk factors from those disclosed in our Annual Report on Form 10-K for the year ended September 30, 2009.

We may be adversely impacted by the legal or regulatory response to actual or perceived global climate change.

Concerns about climate change, particularly global warming, have resulted in significant discussions in the scientific community, domestic and international governments, and environmental organizations, about the effects of greenhouse gases on the environment. These discussions may result in new laws or regulations that regulate greenhouse gas emissions into the environment and, as a result, our operating costs may increase. The costs that we believe are likely to increase as a result of any new environmental laws or regulations could include: diesel fuel, unleaded gasoline, the cost of retrofitting our existing vehicles, and other petroleum-related products, such as tires. In addition, the utility costs associated with the operation of our facilities may increase as a result of new environmental laws and regulations. Finally, since we use contracted carriers to help transport the mail, we expect that increased operating costs to these independent carriers as a result of new laws or regulations may ultimately be passed through to us.

Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds

Not applicable to the United States Postal Service. As an "independent establishment of the executive branch of the United States government" we do not issue stock or other securities.

Item 3 – Defaults Upon Senior Securities

Not applicable to the United States Postal Service. As an "independent establishment of the executive branch of the United States government" we do not issue stock or other securities.

Item 4 – Other Information

None.

Item 5 – Exhibits

Exhibit Number	Description of Exhibit
31.1	Certification of Principal Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities and Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities and Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Signatures

Pursuant to the requirements of the Postal Accountability and Enhancement Act of 2006, the United States Postal Service has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

United States Postal Service

/s/ John E. Potter
John E. Potter
Postmaster General and Chief Executive Officer
Date: May 10, 2010

/s/ Joseph Corbett
Joseph Corbett
Chief Financial Officer and Executive Vice President
Date: May 10, 2010

Exhibit 31.1

CERTIFICATION PURSUANT TO
RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES AND EXCHANGE ACT OF 1934,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002.

I, John E. Potter, certify that:

1. I have reviewed this quarterly report on Form 10-Q of the United States Postal Service ("Postal Service");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Postal Service as of, and for, the periods presented in this report;

4. The Postal Service's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15e and 15d-15e) for the Postal Service and have:

    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Postal Service, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b. Evaluated the effectiveness of the Postal Service's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    c. Disclosed in this report any change in the Postal Service's internal control over financial reporting that occurred during the Postal Service's most recent fiscal quarter (the Postal Service's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Postal Service's internal control over financial reporting; and

5. The Postal Service's other certifying officer and I have disclosed based on our most recent evaluation of internal control over financial reporting, to the Postal Service's auditors and the audit committee of the Postal Service's Board of Governors (or persons performing the equivalent functions):

    a. All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the Postal Service's ability to record, process, summarize and report financial information; and

    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Postal Service's internal control over financial reporting.

Date: May 10, 2010

/s/ John E. Potter
John E. Potter
Postmaster General and Chief Executive Officer

Exhibit 31.2

CERTIFICATION PURSUANT TO
RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES AND EXCHANGE ACT OF 1934,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002.

I, Joseph Corbett, certify that:

1. I have reviewed this quarterly report on Form 10-Q of the United States Postal Service (“Postal Service”);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Postal Service as of, and for, the periods presented in this report;

4. The Postal Service’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15e and 15d-15e) for the Postal Service and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Postal Service, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Evaluated the effectiveness of the Postal Service’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c. Disclosed in this report any change in the Postal Service’s internal control over financial reporting that occurred during the Postal Service’s most recent fiscal quarter (the Postal Service’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Postal Service’s internal control over financial reporting; and

5. The Postal Service’s other certifying officer and I have disclosed based on our most recent evaluation of internal control over financial reporting, to the Postal Service’s auditors and the audit committee of the Postal Service’s Board of Governors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the Postal Service’s ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Postal Service’s internal control over financial reporting.

Date: May 10, 2010

/s/ Joseph Corbett
Joseph Corbett
Chief Financial Officer and Executive Vice President

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002.

In connection with the Quarterly Report of the United States Postal Service (Postal Service) on Form 10-Q for the period ended March 31, 2010, (the "Report"), I, John E. Potter, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Postal Service.

Dated: May 10, 2010

/s/ John E. Potter
John E. Potter
Postmaster General and Chief Executive Officer

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002.

In connection with the Quarterly Report of the United States Postal Service (Postal Service) on Form 10-Q for the period ended March 31, 2010 (the “Report”),I, Joseph Corbett, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Postal Service.

Dated: May 10, 2010

/s/ Joseph Corbett
Joseph Corbett
Chief Financial Officer and Executive Vice President