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WASHINGTON, DC 20268-0001

Annual Compliance Report, 2011 | Docket No. ACR2011

PUBLIC REPRESENTATIVE COMMENTS
(February 3, 2012)

Pursuant to the Commission's Notice in this proceeding,[1] the Public Representative hereby comments on the Postal Service's Annual Compliance Report (ACR) filed for fiscal year 2011 as prescribed by 39 U.S.C. 3652.[2]

The Postal Service's ACR is "to demonstrate that all products during the year complied with all applicable requirements of [title 39]." 39 U.S.C. 3652(a)(1). These comments address several matters including the Postal Service's (1) financial condition, (2) CRA report for rate compliance, (3) worksharing, (4) performance plans and strategic initiatives required by 39 U.S.C. 2803 and 2804, and (5) reports on customer access to postal services.

I. FINANCIAL CONDITION

A. Introduction.

The financial position of the Postal Service is an important segment of the Commission's annual review of the Postal Service for compliance with Title 39 and other applicable law. A fundamental postal policy expressed in Title 39 is the Postal Service's obligation to provide postal service "to bind the Nation together through the …correspondence of the people [and] shall provide prompt, reliable, and efficient services to patrons in all areas and shall render postal services to all communities." 39 U.S.C. 101(a). The Postal Service shall also provide a maximum degree of effective

[1] Notice of Postal Service's Filing of Annual Compliance Report and Request for Public Comments, January 3, 2012.

[2] United States Postal Service FY 2011 Annual Compliance Report (FY 2011 ACR), December 29, 2011.

and regular service to rural areas, communities, and small towns where post offices are not self-sustaining. 39 U.S.C. 101(b). Its mandate requires that the Postal Service provide “adequate and efficient postal services at fair and reasonable rates and fees.” 39 U.S.C. 403(a). In turn, Title 39 provides that the modern system of rate regulation implemented by the Commission was to be designed, among other things, “To assure adequate revenues, including retained earnings, to maintain financial stability “ 39 U.S.C. 3622(5).

The Commission’s responsibilities include review of the Postal Service’s compliance with Title 39 in general and Chapter 36 in particular. If the Commission finds that the Postal Service failed to comply with Title 39 during the year under review, the Postal Accountability and Enforcement Act (PAEA), grants the Commission authority to exercise its discretion to remedy that noncompliance through the provisions of 39 U.S.C. 3662. The Commission may also request supporting matter from the Postal Service and the Postal Service’s Inspector General as necessary. 39 U.S.C. 3652(2)(d). The Commission may also institute proceedings to obtain data necessitated by the public interest. 39 U.S.C. 3652(e)(2). For these reasons, the Postal Service’s presentations and compliance with the financial provisions of Title 39 must be weighed by the Commission in this proceeding.

B. Working Capital Shortage.

1. *Working capital shortage in FY 2011*. The Postal Service has sustained net income losses for several years,[3] but not until FY 2011 was working capital so low as to require the Postal Service to take the unusual emergency action to defer, without authorization, payment of its obligation to contribute to the FERS retirement system. In FY 2011, due to “the critically low liquidity level projected for the end of FY 2011 and all of FY 2012,” the Postal Service deferred payments amounting to $900 million in order “to ensure sufficient short-term liquidity.”[4] This deferral allowed the

[3] Recent losses have been (in billions): FY 2010--$5.505; FY 2009--$3.794; FY 2008--$2.806; FY 2007--$5.142. Section 701 Report, Analysis of the Postal Accountability and Enhancement Act of 2006, Postal Regulatory Commission, September 22, 3011 at 22.

[4] Form 10-K Report at 33; United States Postal Service, Integrated Financial Plan FY 2012 (IFP), filed November 23, 2011 at 5.

Postal Service to end the fiscal year with $1.3 billion of cash.[5] Upon audit of the Postal Service's financial activities, the Postal Service's OIG ruled this action was an instance of noncompliance with accounting standards.[6] However, after of the Postal Service's action by the Office of Legal Counsel at the U.S. Department of Justice, the Postal Service plans to repay the withheld amounts and resume regular biweekly payments. Id. at 2, IFP at 6.

That deferral of payments is a portent of the future if the Postal Service's increasingly precarious fiscal situation is not relieved. Unless the Postal Service is able to maintain sufficient working capital to pay its employees and suppliers, it will not only be unable to provide universal services, but its ability to provide effective and regular postal services will be in jeopardy.

2. *Working capital shortage in FY 2012.* The Postal Service has dutifully reported in the last couple of years its inability to make payments in FY 2010 and FY 2011 on its retirement fund obligation that were due at the end of each fiscal year. The financial situation worsened in FY 2011. Even without retirement fund payments, the Postal Service will soon run out of cash. The Postal Service reported in its IFP filed November 24, 2011 that even if the $11.2 billion retirement pre-funding now due in FY 2012 is set aside, and if it borrows all of the remaining line of credit on its borrowing authority from the U.S. Treasury of $2 billion, by the end of September, 2012, (nine months away) it will have only $0.6 billion in cash. The IFP concludes,

> This [$0.6 billion] is a dangerously low level of liquidity as it is equivalent to only three days of operating costs. It also assumes we are able to achieve our operating plan with significant cost reductions and no unforeseen drops in revenue. *Id.* at 6.

Thus, even this gloomy forecast assumes the best. The Postal Service is not clear whether its operating plan to which it refers is the annual budget for FY 2012 or if it

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[5] *Id*. *But see*, United States Postal Service, Form 10-K, year ended September 30, 2011 (Form 10-K Report), filed November 16, 2011 at 36. The Form 10-K Report states cash and cash equivalents at the end of FY 2012 were $1.5 billion.

[6] Fiscal Year 2011 Postal Service Financial Statements Audit, Washington, D.C. Headquarters, Office of Inspector General, United States Postal Service, Audit Report No. FT-AR-12-005, December 12, 2011.

includes completion of the major cost savings initiatives such as the review and closing of as many of the 3,650 post offices under review as possible, realigning its network, and perhaps moving to 5 day delivery. Moreover, based on the Postal Service's response to the review by the Department of Justice' s Office of Legal Counsel, the option of deferring payments into the FERS retirement fund will not be available in FY 2012.

3. Cash shortage requires action. The current financial condition of the Postal Service dictates that the current level of services cannot continue and must be drastically reduced in a few months unless Congress takes at least one if not more of the following steps by changing laws to remove significant payments into retirement funds, increases the Postal Service's borrowing power, changes the labor laws applicable to the Postal Service, removes price cap limitations, or enables the Postal Service to undertake nonpostal businesses that generate billions in revenue in a short period of time (such as Postal Service operation of a national lottery using postal retail facilities) .

Unless there is significant Congressional relief from not only the $11.2 billion owed to the retirement fund in FY 2012, but also additional operating funds, the Postal Service's payments and services appear likely to be significantly curtailed within months. The impact on the public due to uncertainty of mail delivery and on suppliers such as truckers, box manufacturers, gasoline suppliers and utilities, as well as the hundreds of thousands of employees, is unknown. A delivery system with intertwined parts could, for all practical purposes, be reduced so substantially that if mail customers cannot rely upon mail delivery and thus flee the Postal Service in short order, most never to return, they would critically reduce the Postal Service's revenue stream.

C. FY 2011 – Another year of treading water.

Financially, for the Postal Service and its stakeholders, FY 2011 was, much like FY 2010, a year of treading financial waters awaiting Congressional action. However, the waters in FY 2011 deepened and by the end of FY 2011 became treacherous. During both FY 2010 and FY 2011, all stakeholders awaited Congressional resolution of the Postal Service's well-documented inability to meet its obligation to make its payment due into the Retiree Health Benefit Fund (RHBF) on September 30. Fortunately, Congress provided financial relief to the Postal Service at the end of FY 2010.[7]

At the end of FY 2011, the Postal Service again did not have the funds to meet its retirement fund payment obligation and, at the same time, maintain the funds necessary to continue operations thereafter. Just prior to the end of FY 2011, by P.L. 112-33 Congress extended the date for the Postal Service's payment of $5.5 billion into the RHFB until November18, 2011.[8] This has subsequently been further delayed by an act of Congress with a stopgap measure until August 1, 2012.[9] This Congressional relief eased the FY 2011 financial pressure, but the delay did not resolve the Postal Service's financial straits. Rather, it exacerbated the FY 2012 obligation to fund the RHBF which now totals $11.1 billion. *Id*. Until Congress acts to alleviate the burden of paying billions of dollars annually to prefund retirements and health benefits, the Postal Service's financial stress will not abate.

A review of the Postal Service's financial results, absent the retirement fund obligations, provides a better picture of the Postal Service's operations. If the Postal Service's obligations to pay into the retirement fund are set aside for purposes of analyzing the Postal Service's compliance with the financial provisions of Title 39 and other sections of the law, the loss in FY 2011 amounted to $2.2 billion.[10] This compares to its goal for FY 2011 of a loss of only $0.9 billion. The financial strings have tightened and the Postal Service is estimating a larger operating loss (apart from its retirement fund obligations) for FY 2012 of $3 billion.[11]

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[7] Congress, by P.L. 111-68 in 2009, reduced the Postal Service's obligation due on September 30, 2010 from $5.4 billion to $1.4 billion. Form 10-K Report at 33.

[8] *Id*.; *See also*, Annual Report to the President and Congress, U.S. Postal Regulatory Commission FY 2011 (PRC Annual Report), at 15 n. 4.

[9] PRC Annual Report at 15.

[10] USPS-FY11-17, Comprehensive Statement on Postal Operations (2011 Annual Report to Congress) at 33.

[11] *Id*.

D. Price Cap Operation.

1. *Price Cap experience since PAEA.* To date, the price cap regime of the PAEA has worked satisfactorily as intended by providing, since 2006, the twin benefits of *price stability* and, as rate changes have been based upon reported changes in the cost of living, *rate change predictability*. These are the primary benefits of a properly administered price cap mechanism. The Commission recognizes that these benefits have flowed from the PAEA's annual rate increase limitation.[12]

Another benefit from a price cap regime is to encourage management to operate more efficiently if its costs are seen to be increasing faster than the benchmark cost of living. The Postal Service's management has responded. The Postal Service initiated several programs to cut costs and continues to do so. For the first few years of the PAEA, through the increased use of borrowing power and drawing down of working capital, the Postal Service maintained enough cash. In addition, the total personnel complement has been steadily reduced. In FY 2011, the Postal Service reduced its career workforce by almost 37,000 to 557,251 from 583,908 with only a slight increase in noncareer employees of 920 to 88,699, up from 87,779.[13]

As FY 2011 began, the Postal Service's plan for an exigent rate increase to exceed the price cap to become effective during FY 2011 remained a reasonable probability.[14] However, the Postal Service failed to tie its request for a $2.34 billion annual rate increase to the exigent circumstances and the Commission rejected the request.[15] The Court of Appeals upheld the Commission's rejection of the exigent rate

[12] Section 701 Report, Analysis of the Postal Accountability and Enhancement Act of 2006, Postal Regulatory Commission, September 22, 3011 at 28. The Commission recommended no legislative changes in this area. *Id.* at 39.

[13] Form 10-K Report at 87.

[14] Docket No. R2010-4, Exigent Request of the United States Postal Service, July 6, 2010.

[15] *Id*, Order Denying Request for Exigent Rate Adjustments, Order No. 547, September 39, 2010.

increase. Although the Postal Service is continuing to press for the $2.34 billion rate increase, its submission following remand was not filed until November 21, 2011.[16]

Despite the setback of the exigent rate request, the cost cutting initiatives in the face of falling mail volumes enabled the Postal Service to maintain its financial ability to continue operations through FY 2011 without significant reductions in service. However, the downward trending mail volumes, the pressures of the huge retirement fund obligation, and the price cap limitation on rate increases motivated Postal Service management to move forward in FY 2011 and initiate new strategies as well as continue previous efforts to reduce costs further to improve its financial condition.

2. *Price Cap--Planned reductions in service to ease cash shortages.* Despite being constrained by law and contracts from dramatically reducing its labor costs to bolster working capital, the Postal Service management has predictably turned to the only operational area remaining where significant savings may be achieved.

In retrospect, FY 2011 was a year for implementing programs and initiating new programs to transition the Postal Service from its old network configuration and service standards to one of reduced services. This was accomplished through continuation of the area mail processing (AMP) program reducing local processing facilities, advocating 5 day delivery service, and reviewing the potential closure of thousands of post offices in small towns and villages throughout the nation. Many of those post offices have been the focal point of many communities for decades and, in some cases centuries.

The Postal Service also obtained a Commission opinion and recommendation on the elimination of Saturday delivery.[17] If Congress permits this change in service, the Postal Service estimates it would reduce annual expenses by as much as $3.1 billion. The Commission estimated savings of only $1.7 billion.[18]

In addition, the Postal Service initiated another strategic initiative to close over 3,650 small post offices. The Commission has issued an advisory opinion on the

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[16] Docket No. R2010R, United States Postal Service Notice of Filing, November 21, 2011.

[17] *See* Docket No. N2010-1, Advisory Opinion on Elimination of Saturday Delivery, March 24, 2011.

[18] *Id*. at 32.

initiative.[19] Although the Commission concluded that it could not estimate the overall savings, *Id*. at 2, the Postal Service publicly stated this initiative may save up to $200 million annually.[20]

In FY 2011, the Postal Service continued its AMP review process to consolidate area mail processing facilities. This AMP realignment program is moving ahead satisfactorily and according to the Postal Service's Office of Inspector General has generated savings well in excess of the amounts anticipated. Additional consolidations are continuing.[21]

Subsequently, FY 2011 transitioned into FY 2012 with mail volumes continuing to deteriorate. The Postal Service started development of new plans for restructuring its network to eliminating many of the Postal Service's major processing facilities. Network realignment necessitates revision of the current delivery standards and the Postal Service filed a request for an advisory opinion on that change.[22]

The combination of service changes by eliminating overnight service for significant portions of First-Class Mail and Periodicals could improve finances by approximately $2.1 billion annually. *Id.* at 4. According to the Postal Service, this operational and service change is necessary due to the changing needs of its customers as reflected by reduced mail volumes and also the *dire* financial circumstances of the Postal Service. *Id.* at 14.

These initiatives will negatively impact the service that customers have been receiving. Unfortunately, combined, these initiatives would not reduce costs or increase rates sufficiently to enable the Postal Service to meet its financial obligations to

[19] Docket No. N2011-1, Advisory Opinion on Retail Access Optimization Initiative (RAOI), December 23, 2011 at 14.

[20] Postal Service witness Klingenberg noted that the Postal Service publically stated that the total savings of the RAOI process might be $200 million. *Id*. at 25.

[21] Of 33 recent AMPs studied by the OIG, $94 million in savings were projected but $323 million were saved due to concurrent initiatives included with the AMP consolidations savings. U.S. Postal Service Past Network Optimization Initiatives Audit Report, Office of the Inspector General U.S Postal Service, Report Number CI-AR-12-003, January 9, 2012 at 1-2.

[22] Docket No. N2012, Request of the United States Postal Service for an Advisory Opinion on Changes in the Nature of Postal Services, filed December 5, 2011.

contribute to retirement funds. Also, the cumulative impact upon customer demand or upon postal operations by combining all of these changes in services is unknown and itself imposes a degree of risk for the system. As the number of post office closings has increased, this Commission has received a significant number of appeals. Similarly, significant reductions in services, particularly unanticipated declines, if perceived as unfair and discriminatory, could lead to a significant increase in complaints to this Commission by customers seeking relief.

3. *Price cap--The traditional effect of a price cap of reducing product supply and quality has begun with the Postal Service's programs to reduce services.* Given the restrictions of the price cap on rate increases, management's move to reduce output is predictable. The Postal Service's move to reduce expenses by reducing the cost of the product is consistent with classic economic theory that price caps will inevitably lead to reduced supply and/or product quality. In the case of the Postal Service where the product is service, the plans to reduce service by cutting delivery days to 5, lengthening service standards, reducing the number of marginal but in many instances socially desirable facilities, is a predictable outcome of the price cap regimen.

There is a growing economic literature on the topic of price-cap regulation and the associated expected effects on service quality standards. The theoretical literature typically finds that price-cap regulations create incentives for regulated firms to lower costs by decreasing quality levels.[23] However, the empirical analyses performed have, in general, found mixed evidence linking decreased service quality to price-cap regulation.[24] Unfortunately, the body of literature on this topic is in the context of utility and telecommunications regulation, so extrapolating predictions to the Postal Service should be done with caution.

Regardless, it cannot be denied that in the years since the implementation of price-cap regulation the Postal Service has reduced and is continuing to reduce the

[23] For a thorough review, see Armstrong and Sappington "Recent Developments in the Theory of Regulation" *Handbook of Industrial Organization, Vol. 3* Chapter 27 (2007).

[24] For a literature survey, see Weisman, D. (2005). "Price regulation and quality", *Information Economics and Policy*, 17(2), pp. 165–74.

number of post offices and the number of mail processing locations and facilities. These efforts to reduce costs may have been accelerated by the price cap restrictions but would also represent reasonable managerial efforts to operate efficiently absent a price cap incentive. Whether these changes amount to a reduction in maximum effective and regular service or, at least, reductions in service quality is being debated.[25]

On the other hand, the proposed reduction in delivery days and the planned increase in time of delivery resulting from network realignment in response to financial pressures from the price cap would clearly constitute a reduction in service quality to many customers, even if many other customers are indifferent to those service quality downgrades.[26] This reduction in service can be the unfortunate fallout of price cap regulation. Reducing costs by improving efficiency is desirable under the price cap regime, but reducing costs by reducing the value of the product desired by customers can creates other less desirable consequences such as reducing demand. It is difficult in a time of technological change to forecast whether falling demand is due to technological change, the recent recession, or reduction in product quality.[27]

Nevertheless, in some cases pricing differentials could be a vehicle to make available services demanded by customers with preferences for services being eliminated or reduced. In any event, only changing customer needs brought about by technological and structural change, but not dire Postal Service financial circumstances brought about by artificial market constraints, should warrant product service reductions.

In proceedings reviewing previous ACRs, Public Representatives have expressed concern that the price cap is creating financial dislocation. They further contended that it is within the Commission's authority to remedy the financial shortfalls by ordering rates that pierce the price cap. For instance, in FY 2010 in response to the

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[25] A Postal Service witness Klingenberg stated that a 2009 Gallup poll found that 88 percent of Americans opposed closing their local post office as a means to cut costs. Docket No. N2011-1, Advisory Opinion on Retail Access Optimization Initiative, December 23, 2011 at 24.

[26] The Postal Service continues to conduct surveys to measure the extent customers are willing to accept these service changes. The ongoing debate is whether costs should be eliminated for services that are desired by a certain number of customers.

[27] *See* Form 10-K Report at 33.

Commission's invitation for comments on the Commission's authority to raise rates in excess of the price cap in order to bring cost coverage to 100 percent,[28] the Public Representative argued, "[T]he Commission has authority to pierce the price cap when a class's failure to cover attributable costs has become a systemic and perpetual problem."[29] The Commission ruled the price cap takes precedence over other objectives and goals of Title 39 and may not be pierced.[30]

4. *Price cap--Price flexibility for service level improvements.* However, the Commission has suggested that Congress increase price flexibility by allowing the price cap to be exceeded to recover costs incurred for positive improvements in service performance. *Id.* at 40. The underlying assumption of the proposal is that additional expenses warrant additional revenue.[31] Unfortunately, at this time, without additional significant financial relief from Congress, the Postal Service does not appear to be in a position to take advantage to this type of pricing regimen.

5. *Price cap--Price flexibility to retain current service levels*. Currently, most useful to the Postal Service and the public in general would be the ability to obtain price relief in excess of the price limitations. This could be accomplished by legislation or perhaps by Commission directive pursuant to section 3662. Prices for affected products may be permitted to exceed the price ceiling to recover sufficient revenues to maintain the level of service available when the PAEA was passed . As a minimum, prices could be increased to maintain a level of efficient, effective and regular service contemplated by Title 39.

In some cases, rate increases to avoid significant service reductions would not be large. For instance, as noted above, the Postal Service has stated the FY 2011 initiative to close 3,650 small post offices would save about $200 million. With the

[28] Docket. No. ACR2010, Notice of Postal Service's Filing of Annual Compliance Report and Request for Public Comment, Order No. 636, January 4, 2011 at 6.

[29] Docket No. ACR2010, Public Representative Comments at 1.

[30] ACD2010 at 18-19.

[31] The Commission specifically rejected the notion that Congress should require a decrease in prices if service is decreased. *Id*. at 40.

experience generated to date by the RAOI program, reasonably accurate cost savings could be estimated. In lieu of that program, a rate increase of about $200 million would be relatively minor. As noted above, another service-related initiative, to reduce deliveries to five days per week, may save the Postal Service as much as $3.1 billion but the Commission asserts it would save $1.7 billion. A rate increase by an appropriate amount to save 6 day delivery service would provide positive returns to postal customers by forestalling service reductions that are important to many customers. Similarly, the current initiative to reduce processing plants is also expected to lengthen service times. This could be avoided with a rate increase to cover the savings that would be generated by that program in order to maintain 6 day services.[32] In this way, the more pernicious effects of the price cap limitations that reduce product quality can be alleviated under controlled circumstances.

E. Request for Operational Information Due to Cash Shortages.

Given the possibility that postal services could be disrupted in the near future for lack of operating cash, certain information is not available in the ACR that should be available to the Commission. The Postal Service forecasts extremely low working capital projected by the end of September, 2012. If cash becomes so deficient that service is interrupted, particularly if service interruptions are irregular and spotty, in the absence of a publicly available plan for service curtailment that appears fair and reasonable, complaints of discrimination could flow into the Commission.

The Commission should request the Postal Service to:

(1) provide the Commission with working capital estimates *by month* for the remainder of FY 2012;

(2) report whether it is making payments to creditors within contractual terms and if not, the current level of delay and whether and the extent the delay is increasing; and

(3) describe the Postal Service's priorities and plans for the payment of creditors in the event of a cash shortage to fund operations and explain the impact on each product service.

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[32] Of course, appropriate adjustments would need to account for the price elasticity of the products.

(4) describe its priorities and plans for providing service across the Nation and across classes in the event cash shortages require services to be reduced.

In addition, the Commission should obtain from the Postal Service's OIG:

(5) documents related to the review by the Office of Legal Counsel at the U.S. Department of Justice related to the deferral of payments to the FERS retirement fund.

These documents are necessary to review the Postal Service's level of compliance with Title 39 during FY 2011 and to understand the Department of Justice's views as to the level of flexibility the Postal Service may, or may not, have to forego its financial obligations to the U.S. Treasury in the immediate future in the event of a recurring cash shortage.

II. CRA ANALYSIS—MARKET DOMINANT PRODUCTS

The Postal Service has provided in its FY 2011 Annual Compliance Determination a financial analysis regarding its compliance with Title 39 for market dominant products in Library Reference USPS-FY11-1. Overall, the Public Representative notes that 8 products generate insufficient revenues in FY 2011 to cover attributable costs and therefore do not contribute towards institutional costs. Although the products that did not cover attributable costs (underwater) in FY 2011 are the same as those that were underwater in FY 2010, the Public Representative commends the Postal Service for some improvement in cost coverage percentages. However, the total dollar shortfall from these products increased significantly in FY 2011 to $2.3 billion from $1.7 billion in FY 2010.[33] It is even more critical than last year that the Postal Service take all necessary steps to improve the cost coverage of products that are not contributing to institutional costs. The Public Representative urges the Commission to direct the Postal Service to improve the dollar amount of its cost coverage.

[33] FY 2010 Annual Compliance Determination at 81.

A. First-Class Mail.

As a class, First Class Mail represents 44 percent of market dominant mail volume and 76 percent of total contribution for all Market Dominant Products. Volume for First Class Mail *decreased* in FY 2011 by 6.1 percent from FY 2010, however overall First-Class unit-contribution increased by 0.6 percent to 21.7 cents per piece. The FY 2011 First-Class Mail cost coverage was 199.4 percent, which is 1 percent greater than FY 2010. The class contribution was $16 billion, which represents a $1 billion decrease from FY 2010. In general, revenues and volumes have *decreased* for every First-Class mail product except for parcels.

1. *Volume changes.* The Public Representative notes in Table 1 that the Postal Service continues to face decreasing volumes for Single-Piece, Pre-Sort, and Flats, but Parcels experienced a turnaround, with volume up 12 percent when compared to FY 2010. For low volume International Mail in FY 2011, Outbound volume declines eased, but Inbound volume declines sharpened. Overall, International volumes have stayed roughly constant.

Table 1[34]

First Class Mail	**Volume Change FY 11-FY 10 (%)**	**Volume Change FY 10-FY 09 (%)**
Single-Piece Letters and Cards	-9.58	-9.64
Pre-Sort Letters and Cards	-3.74	-3.56
Flats	-10.19	-13.28
Parcels	11.06	-1.10
Outbound FCM International	-7.20	-26.74
Inbound FCM International	-31.21	-21.34
Total	-6.10	-6.72

The National Bureau of Economic Research declared that the last recession officially ended in June 2009. The Public Representative therefore expected to see

[34] Data Source: Library References USPS-FY11-1 USPS-FY10-1 and USPS-FY09-1.

some signs of improvement in First-Class Mail volume, but volumes of the major First Class products continued to decline dramatically for almost all products. This suggests that factors external to the macroeconomy play an important role in First-Class Mail demand. First-Class Mail products represent some of the highest market dominant contributions to institutional cost. To ensure future financial viability, the Postal Service must identify the factors contributing to the loss in mail volume and take steps towards reversing these trends.

2. *Commercial Bulk Letters.* Regarding the cost coverage of First-Class Mail commercial bulk letters, the Public Representative recalls concerns voiced by the National Postal Policy Council (NPPC) in Docket No. ACR2010.[35] NPPC expressed concern that the cost coverage for First-Class bulk mail products was no longer “just and reasonable” in reference to the growing divide between the per-unit contribution of single-piece letters and cards and bulk letters and cards. In the FY 2011 ACD, the Commission did not find that the cost coverage for bulk letters violated 39 U.S.C. 3622(b) but indicated that it will continue to monitor cost coverage to ensure compliance.[36] Since then, coverage worsened somewhat. The small increase in cost coverage warrants continued monitoring without a recommendation to reduce the current cost coverage.

The Public Representative notes that in FY 2011, the unit-contribution of Single-Piece Letters/Postcards has decreased to 17 cents per piece, whereas the unit-contribution of Pre-Sort Letters/Cards increased to 23.2 cents.[37] This trend indicates that the burden of contribution continues to shift from single-piece mail to bulk mail products and serves to support the previous concerns of NPPC. This phenomenon is similarly noted by the Postal Service.[38] The Postal Service indicates that the underlying cause is founded in the Commission’s workshare rules, claiming that the “difference in unit contribution is almost certain to grow.” The Public Representative hopes that the

[35] FY 2010 Annual Compliance Determination at 85.

[36] *Id*.

[37] USPS-FY11-1.

[38] FY 2011 Annual Compliance Report at 17.

Postal Service and the Commission will come together to provide a solution to this pressing issue.

3. *First-Class Parcels.* The unit-contribution of First-Class parcels experienced marked improvement, going from a 0.2 cent loss per piece to an 18 cent contribution per piece. The FY 2010 ACD noted improvement in the cost coverage for First-Class parcels, and in FY 2011 First-Class Parcels continued this trend with a growth in cost coverage of 10 percent to 109 percent cost coverage. The Postal Service should continue efforts to improve cost coverage for First-Class Parcels.

4. *International.* The only First-Class product with attributable costs exceeding revenue is inbound international mail, which is subject to Universal Postal Union (UPU) rates. Typically, outbound international mail has subsidized inbound international mail delivery, and indeed in FY 2011 the $36.2 million shortfall for inbound international mail is more than made up for by the $209.2 million contribution of outbound international mail. However, the unit contribution of outbound international First-Class mail has decreased by 31 percent from FY 2010. Although the Postal Service is one of many negotiators involved in setting UPU terminal dues rates, this imbalance of outbound versus inbound international mail contribution should be kept in mind as the 25th UPU Congress approaches.

B. Periodicals.

As a class, Periodicals represents only 4.3 percent of market dominant mail volume. Periodicals volumes decreased 2.7 percent from FY 2010, and the class as a whole remains underwater. Individually each of its products, within-county and outside-county, are also underwater. The cost coverage of the class is 74.9 percent, which represents a 0.7 percent decrease in cost coverage when compared to FY 2010. The shortfall of within-county periodicals, which represent 9 percent of total volume for the class, was $20 million. The shortfall of outside-county periodicals was $597 million and is an increase in the shortfall over FY 2010. Although the total dollar shortfall of the class of $608.9 million was a slight improvement over FY 2010, the class remains significantly underwater and does not satisfy section 3622(c) of Title 39.

In the FY 2010 ACD, the Periodicals' failure to cover attributable costs generated a point of contention. Many interveners suggested ways the Postal Service could improve efficiency and reduce costs in the processing of Periodicals, particularly in the area of manual mail processing. The Commission did not recommend a price increase as advocated by some commenters, but rather suggested that the Postal Service should look to the cost side to improve Periodicals cost coverage.

The Postal Service implemented the maximum rate increase allowable for Periodicals under the price cap of 2.133 percent on January 22, 2012. In addition, they also created a new price cell for Origin Mixed Area Distribution Center (ADC) to encourage greater palletization of Periodicals to increase efficiency. It is apparent that only moderate improvements in cost coverage can be implemented and that the Periodicals class will not cover its attributable costs anytime soon, if ever, without significant changes in the cost or revenue structure to comply with section 3622(c).

C. Standard Mail.

The Standard Mail class is the largest mail class by volume representing 51 percent of all Market Dominant mail volume and 27.2 percent of the total market dominant contribution to institutional costs. Standard mail volumes have increased 2.63 percent since FY 2010 and the cost coverage has increased 0.7 percent. The overall contribution of Standard mail to institutional costs was $5.7 billion (compared to $16 billion for First-Class).

The Public Representative commends the Postal Service on the overall increase in Standard Mail volumes. Volumes have increased for virtually all Standard Mail products except for Standard Mail Flats and steady for Carrier Route. Volume for the class as a whole has increased by 2.6 percent, compared to the 0.2 percent decline which occurred in FY 2010.

Volumes for the individual Standard Mail products increased for High-Density Letters, Flats, and Parcels, for Standard Letters, and for Non-Flat Machinables (NFMs) and Parcels. Carrier Route volumes declined, although only by 1 percent, and Flats volumes declined by 3.8 percent. It should be noted that Standard Mail NFMs will be re-titled "Marketing Parcels" and will have different mailing standards than NFMs. Also, Machinable and Irregular Parcels were moved to the competitive product list under the title of "Lightweight Parcel Select", effective January 22, 2012.

1. *Standard Nonflat Machineables and Parcels*. Additionally, the Public Representative applauds the Postal Service for continuing to take steps to address the historically persistent financial shortfalls of Standard Nonflat Machineables and Parcels. Not only has this product's volume increased by 7.5percent, but the unit-contribution has increased by 39 percent and the cost coverage has increased by 9.8 percent to 84.8 percent, thereby continuing a favorable trend of increasing cost coverage. Similarly, the contribution towards institutional costs by NMFs/Parcels has reduced its loss to 15.9 cents per piece, compared to a 26.1 cent loss per piece in FY 2010. The Postal Service continues to follow the directive of the Commission in making a serious effort to increase coverage Standard NFMs/Parcels.

2. *Standard Flats.* Standard Flats volumes have decreased by 3.8 percent, and this is indicative of the worsening compliance issues for the Standard Flats mail product. The Commission has previously noted their "significant concern" for historically persistent low cost coverage levels, even going so far as to rule that the financial performance of this product fails to satisfy 3622(c)(2).[39] Efforts by the Postal Service to rectify the financial performance of Standard Mail Flats were further complicated by issues related to the exigency case in Docket No. R2010-4.

Standard Flats continue to remain underwater, and the situation with Standard Mail Flats has gotten worse in FY 2011. Flats cost coverage decreased by 2.9 percent to 79.26 percent, and its contribution to institutional costs has fallen to a loss of 9.6 cents per piece, representing a 16.4 percent decrease from FY 2010. Finally, Flats add $651 million to the institutional burden of the Postal Service.

The Postal Service has taken steps to remedy this problem. Although, in FY 2011, the prices for Standard Mail increased by a scant 0.835 percent, there was an above-average price increase of 2.209 percent in January 2012 for Standard Mail Flats.[40] This above average increase in the price of Flats demonstrates that the Postal

[39] FY 2011 Annual Compliance Determination at 103.

[40] *See* Table 2.

Service is serious about ending the intra-class subsidy benefiting Standard Flats mailers. However, it does not appear to the Public Representative that the Postal Service will be able to bring Standard Flats into compliance in a reasonable period of time by continuing with annual modest above-average prices increases within the framework of the price cap.

In the FY 2010 ACD, the Commission directed the Postal Service to provide thorough reports in subsequent ACRs on all operational changes and costing methodology improvements designed to address the fiscal problems of Standard Flats.[41] In the FY 2011 ACR, the Postal Service has not provided any such documentation. Given the worsening financial state of Standard Flats, the Public Representative believes such an omission is significant and urges the Commission to request from the Postal Service its plan to bring this product back into compliance given the constraints of the price cap.

Table 2

Product	**Price Changes %**
Letters	1.867
Flats	2.209
Parcels	2.864
High Density / Saturation Letters	2.298
High Density / Saturation Flats and Parcels	2.121
Carrier Route Letters, Flats and Parcels	2.425
Overall	2.041

Source: Order No. 987 at 19

[41] FY 2010 ACE at 107.

D. Package Services.

As a class, Package Services represents only 0.4 percent of total market dominant mail volume, but the total volume of Package Services increased by 2.6 percent in FY 2011. Although the class as a whole remained underwater, with losses of $102 million in FY 2011, the cost coverage of Package Services increased by 5.3 percent to 94.0 percent coverage. Of the five products in Package Services, only Media/Library Mail experienced a decrease in cost coverage. In contrast, only one domestic product, BPM Flats, covered its costs.

In FY 2011, the Postal Service increased rates of Package Services 1.741 percent, and in FY 2012 the Postal Service implemented above-average increases to the two worst-performing Parcel Services products in terms of cost coverage, Single Piece Parcel Post and Media/Library mail. This suggests that the Postal Service is working to alleviate the low cost coverages in Package Services but needs to continue to do so in the future.

The Public Representative would like to commend the Postal Service for overall improvements to the Package Services mail class, which has seen marked improvement in its percentage cost coverage for almost all products. Except for Media/Library Mail that has experienced a decrease in volume of 11.9 percent and a decrease in cost coverage of 4.2 percent from FY 2010, the Public Representative notes that the Postal Service has reversed historical trends of Package Services. Parcel Post volumes have increased 14.3 percent and cost coverage has improved to 89.2 percent. Although the volume of BPM Parcels remained relatively stagnant, cost coverage was brought to near 100 percent cost coverage levels, increasing by 6.9 percent from FY 2010. On the whole, cost coverage for Package Services has increased by 5.3 percent to 93.97 percent and volume increased by 2.6 percent. The Postal Service must continue efforts to bring this mail class to full cost coverage.

E. Conclusion on CRA Analysis—Market Dominant Products

The Public Representative applauds the efforts of the Postal Service to improve financial performance of all market dominant mail products. However, the continued volume declines of First-Class Mail remained a problem in the 2011 fiscal year. Given the significance of the contribution of First-Class mail to institutional costs, the Public Representative urges the Postal Service to undertake efforts to stymie these volume losses. In addition, the financial performance of Standard Flats continues to present significant challenges to the Postal Service, and the Postal Service has not presented any concrete plans for future improvement. The Public Representative urges the Postal Service to heed the directive of the Commission to provide a thorough accounting of all measures undertaken to address the compliance problems of this product.

III. WORKSHARING DISCOUNTS

A. Background.

The PAEA requires the Commission to ensure that workshare "discounts do not exceed the cost that the Postal Service avoids as a result of workshare activity" unless the discount fits within an exception specified in 39 U.S.C. 3622(e)(2). Commission rules have clarified that the Postal Service must justify proposed workshare discounts that exceed 100 percent of avoidable costs by explaining how it meets one or more of the exceptions in Section 3622(e)(2).

The Public Representative focused on products that had passthroughs greater than 00 percent based on the prices accepted in Order No. 987. The Public Representative appreciates the Postal Service's provision of files depicting worksharing discounts assuming the Commission does, or does not, accept the outstanding methodology proposals. However, the Commission should note that the Postal Service has made little effort to provide an analysis that a passthrough over 100 percent complies with Section 3622(e)(2) of the Commission's rules.

The Public Representative compared worksharing discounts with and without the acceptance of outstanding methodological changes. Table 3 shows there are currently 5 out of 26 products with passthroughs above 100 percent that would come closer to 100 percent by accepting the proposed methodological changes than by rejecting them.

With the exceptions of Automation ADC Flats and Nonmachinable Nonauto 3D/SCF Periodical Flats, there is no substantial improvement in the passthrough structure where the methodology proposals are accepted. The Public Representative concludes that

Table 3
Products with Passthroughs Above 100% in R2012-3
Where Accepting ACR Proposals
Substantially Improves Passthrough Structure*

	R2012-3 [1]	Proposals Not Accepted [2]	Proposals Accepted [3]	Accepting Minus Rejecting
First-Class				
Automation ADC Flats	227%	226%	135%	92%
Outside County Periodicals				
Nonmachinable Nonauto 3D/SCF Flats	165%	938%	833%	104%
Machinable Automation MADC Flats (barcoding)	123%	123%	110%	13%
ADC Automation Letters	250%	250%	235%	15%
Standard Flats				
Automation Mixed AADC Flats (barcoding)	228%	315%	271%	43%

*5-digit Library Mail had a passthrough of 106 percent in R2012-3, and the passthrough if all proposals were to be accepted would be lower than if they were rejected. However, the “Proposal Accepted” passthrough was 53 percent, and not a good indication that this improved the passthrough structure.

Sources:
[1] Docket No. R2012-3, USPS Notice of Market-Dominant Price Adjustment, Attachment B Workshare.xls.
[2] Docket No. ACR2011, Discounts and Passthroughs of Workshare Items, FY11.3.Worksharing Discount Table_Final.xls
[3] Docket No. ACR2011, Discounts and Passthroughs of Workshare Items, FY11.3.Alternate.Worksharing Discount Table_Final.xls

the decision to either accept or reject the proposed methodology changes does not depend on their worksharing implications, with a caveat pertaining to the utilization of the FSS by Periodical mailers.

The Postal Service repeatedly excuses the existence of passthroughs which exceed 100 percent by suggesting that it will take steps to address these problems in a future rate case. However, the timing of the next general rate case is uncertain and likely almost one year into the future, so that the validity of the claim that the problem will be addressed and implicitly corrected is not demonstrated. Moreover, in cases where the Postal Service seeks to invoke statutory exemptions for passthroughs in violation of Section 3622(e)(2), it largely fails to provide meaningful justifications. In light of this, the Commission’s must ascertain whether or not a given passthrough that exceeds 100 percent significantly reduces efficiency incentives and is a major factor explaining negative contributions towards the recovery of the Postal Service's institutional costs.

To this end, Table 4 identifies products with passthroughs that increased substantially above 100 percent in this ACR and which cannot be corrected in the near term. The Commission should seriously weigh the appropriateness of these passthroughs.

Table 4
Products With Inefficient and High Passthroughs That Cannot Be Corrected In The Near Term

	R2012-3	Proposals Not Accepted	Proposals Accepted
First-Class Mail			
Automation Mixed AADC Letters	100%	147%	147%
Qualified Business Reply Mail			
Letters	157%	288%	288%
Cards	157%	288%	288%
Outside County Periodicals			
Nonmachinable Nonautomation 3D/SCF Flats	165%	938%	833%
Nonmachinable Automation ADC Flats	67%	91%	81%*
Nonmachinable Automation 3D/SCF Flats	148%	678%	678%
Standard Letters			
Nonmachinable Nonautomation 3-digit Letters	100%	152%	146%
Standard Flats			
Automation Mixed ADC Flats	228%	271%	271%
Standard Mail Parcels			
NDC Irregular Parcels	256%	301%	301%
Mixed NDC Machinable Barcoded Parcels	164%	156%	156%
Mixed NDC Irregular Barcoded Parcels	164%	156%	156%
Standard Mail NFMs			
NDC NFMs (Irregular Parcels)	175%	180%	180%
SCF NFMs (Irregular Parcels)	134%	139%	139%

* USPS-FY11-11 PER OC flats Alternate.xls, Sheet: Periodicals OC Props 12 &18, contains an incorrect value for the mail processing costs of Nonmachinable Automation MADC Flats, which produced an incorrect passthrough of 960 percent for Nonmachinable Automation ADC Flats.

Sources: Same as Table 3

Unfortunately, as was previously mentioned, the Postal Service justifies inefficient passthroughs by claiming that it will work to bring them closer to 100 percent in the future, offering little explanation or misleading the reader. For example, the Postal Service fails to identify the substantial increase in the passthrough for First-Class Automation Mixed AADC Letters, which would increase from 100 percent in FY 2010 to 147 percent.

The most alarming change in passthroughs exists for Outside County Periodicals. The passthrough for Nonmachinable Nonautomation 3D/SCF Flats increases 668 percent, from 165 percent to 833 percent. Similarly, Nonmachinable, Automation, 3D/SCF, Periodical Flats have unnecessarily high passthroughs of 678 percent. The proposed passthrough of 678 percent is 530 percentage points higher than the current passthrough. The magnitude of the shift in incentives for non-machinable Periodical mailers facing workshare discounts is disconcerting and largely goes unmentioned by the Postal Service.

B, Bundle, sack and pallet price-cost ratios.

It is difficult tell if these inefficient incentives will be offset by the changes the Postal Service is proposing for bundle, sack and pallet price-cost ratios, which certainly confounds critical analysis of Nonmachinable passthroughs. Generally, sack and pallet price-cost ratios decline at least several percentage points across the board, and they decline 2-5 times more for origin entered pallets. However, the reduction in the price-cost ratios for sacks does not provide the right incentives for the cost savings potential introduced by the increased implementation of the FSS, which requires entry of bundles on pallets in order to be processed. Unfortunately, there is insufficient opportunity in this proceeding for the Public Representative to determine whether the combination of dramatically higher passthroughs for Nonmachinable Flats and lower bundle, sack and pallet price-cost ratios will provide incentives for Periodical mailers to prepare a substantial share of their mail to be sorted on the FSS. The Public Representative recommends the Commission focus on this issue and recommends appropriate action because increasing the efficiency of Periodicals' processing is the only way to substantially reduce its $600 million negative contribution without piercing the price cap.

It will take many years before the price-cost ratios of Periodicals bundles and containers are 100 percent. However, the Postal Service should consider introducing greater choice and flexibility in the acceptance of Periodicals Pallets. The Postal Service deserves credit for moving in this direction. It has proposed and received approval for a new mail classification which allows mailers to prepare bundles comprised of combined Periodicals and Standard Mail pieces that are entered on the same pallet, as well as allowing Periodicals and Standard Mail bundles to be co-mailed on the same pallet. This classification may give Periodicals mailers the opportunity to take advantage of larger pallets, which have a lower cost per piece and per bundle, than pallets solely comprised of Periodicals mail. Ultimately, the Public Representative believes that the Periodicals model's pricing and costing of bundles, sacks, and containers at various entry levels provides the greatest opportunity for improving the efficiency of Periodicals mailings, provided greater preparation flexibility is implemented.

The Postal Service should also consider relaxing the requirement for mailers to prepare a pallet as soon as the mailing reaches a weight of 500 pounds. There may be cases where it may be cheaper for the mailer to put all of its mail on a single, 700 pound pallet, rather than one 500 pound pallet with bundles, and enter residual mail in sacks. *See Domestic Mail Manual, 705.8.5.2.* The Postal Service should also propose a mail classification that allows Periodicals Mailers to enter residual mail from MADC sacks onto MADC pallets comprised of the residual mail from other Periodicals mailers.

C. Standard Flats.

If the flexible preparation effort for Periodicals mailings is successful, the Postal Service should develop a similar model for Standard Flats. In the current regulatory regime and economic climate of low inflation, increasing discounts that reward efficiency of Periodicals and Standard Flats mailers provides the greatest opportunity to improve the overall efficiency and profitability of the Postal Service.

D. Timing of recent price adjustment.

In previous years, the Postal Service has filed for a price increase after it has updated its costs for a particular ACR filing, which has given the Postal Service the opportunity to adjust rates and discounts to reduce the number of products with passthroughs greater than 100 percent.[42] Unfortunately, because the Postal Service's latest rate adjustments were submitted and approved just before the filing of the FY 2011 ACR, improving the structure of passthroughs will not occur before the Commission issues its FY 2011 ACD. This implies that it will not be possible to make necessary improvements to rates and discounts before the next general rate case—a case with an unknown date, and for which accurate cost data is not yet available.

In consideration of the increased passthrough for Standard Automation Mixed ADC Flats, the Postal Service has proposed exemption by claiming that the passthroughs promote barcoding.[43] In response, the Public Representative echoes the view that excessive pre-barcoding discounts are no longer needed.[44] The Postal Service appears to recognize that the pre-barcoding discounts are too large and supports reducing them. However, the Postal Service also argues that an unexpected decrease in avoided costs is at fault for the increased passthrough. This argument exemplifies the advantage of setting rates *after* annual cost avoidances are calclated, and therefore passthroughs, can be determined, rather than before.

Moreover, the Postal Service recognizes that the passthroughs for many Standard Mail Parcels, especially Irregular Parcels and Nonflat Machinables, have generally increased. The Postal Service attributes this result to the use of a new cost model for Standard Mail NFMs and Parcels, developed in Docket No. RM2010-12, which substantially increased cost avoidances.[45] This offers simply another example of the problems in implementing a general rate change prior to the filing of an entire year of cost data in the ACR.

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[42] For example, in Docket No. R2009-2 the Postal Service was able to reduce discounts, and therefore passthroughs, on 23 of 28 products with passthroughs that were greater than 100 percent in ACR 2010, which was filed before, not after, the rate case.

[43] FY 2011 Annual Compliance Report at 55.

[44] Docket No. ACR 2010, Public Representative Comments in Response to Order No. 636 at 22.

[45] FY 2011 Annual Compliance Report at 56.

E. Conclusion on Worksharing.

The Postal Service's worksharing comments make clear that it does not believe setting discounts equal to the costs avoided by worksharing activities results in an efficient rate structure that will improve the efficiency and ultimately the financial stability of the Postal Service. The Public Representative understands that worksharing has been delegated a less significant role in the PAEA than the PRA. The Public Representative also recognizes that the price cap constrains the Postal Service in its ability to develop a fully efficient passthrough structure by the price cap. In spite of these conditions, the Public Representative still maintains that sending efficient worksharing incentives to mailers will both reduce mailer costs and increase Postal Service efficiency.

IV. PERFORMANCE AND STRATEGIC INITIATIVES

A. 2011 Comprehensive Statement on Postal Operations (USPS-FY11-17).

The Postal Service's Comprehensive Statement on Postal Operations (Comprehensive Statement) is required by 39 U.S.C. 2401(e) to provide to the Committee on Governmental Affairs of the Senate and the Committee on Government Reform of the House of Representatives a comprehensive statement which addresses postal operations.[46] Broadly, the Comprehensive Statement must address postal operations generally, including information on mail volumes, productivity, speed and reliability of its product base, and an analysis of how internal and external factors impact the Postal Service.[47] To be included in the comprehensive statement are an Annual

[46] Library Reference USPS-FY11-17. The Postal Service's FY 2011ACR includes, as USPS-FY11-17, its 2011 Comprehensive Statement on Postal Operations.

[47] 3 9 U.S.C. 2401(e) requires "a comprehensive statement" ;relating to the following matters: "(1) the plans, policies, and procedures of the Postal Service designed to comply with all of the provisions of section 101 of this title; (2) postal operations generally, including data on the speed; and reliability of service provided for the various classes of" ;mail and types of mail service, mail volume, productivity, trends; in postal operations, and analyses of the impact of internal and ;external factors upon the Postal Service; (3) a listing of the total expenditures and obligations incurred by the Postal Service for the most recent fiscal year; for which information is available, an estimate of the total; expenditures and obligations to be incurred by the Postal Service; during the fiscal year for which funds are requested to be appropriated, and the means by which these estimated expenses will be financed and; (4) such other matters as the committees may determine necessary to ensure that the Congress is fully and currently

Performance Plan, codified in 39 U.S.C. 2803 and an Annual Performance Report, codified in 39 U.S.C. 2804.[48] These Reports are provided to the Commission pursuant to the Commission's Rules. 39 CFR 3050.42.

The Public Representative finds that the Annual Plan and Report prepared by the Postal Service for FY 2011 has only barely met the requirements of 39 U.S.C 2803(a) "…covering each program activity set forth in the Postal Service budget[.]"[49] In its current iteration, the relevance of this document has been dramatically reduced in terms of the quality of information disseminated as compared to the FY 2010 Comprehensive Statement prepared by the Postal Service. The legislative directive contemplates a transparent exposition by the Postal Service in providing an in-depth explanation of the innovative strategies it employed to improve its precarious financial situation. Instead, the Postal Service has, at best, presented a superficial overview that highlights only some of the FY 2011 initiatives undertaken and the necessary objective benchmarks for future progress.

1. *Service performance measurement*. In the Annual Performance Report for FY 2011, the Postal Service does not meet the statutory requirement to cover *each* program activity set forth in the Postal Service's operating budget, as was noted in ACR2011 CHIR #2, Question 19.[50] Moreover, this failure has been explicitly noted by the Commission in the past.[51] In particular, the Postal Service continues to measure service improvement through the on-time performance of its First-Class Mail product as an organization-wide benchmark, failing to consider the on-time performance of any other market dominant products.

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consulted and informed on postal operations, plans, and policies.

[48] The Comprehensive Statement is pages 25-21 of the Postal Service's 2011 Annual Report to Congress and the 2011 Annual Performance Report and 2012 Annual Performance Plan are pages 32-36 of the 2011 Annual Report to Congress.

[49] 39 U.S.C. 2802(a).

[50] Chairman's Information Request No. 2, January 31, 2011. *See* 39 U.S.C. 2803(a).

[51] *See* FY 2010 Annual Compliance Determination at 50, "But the Plan did not '[cover] each program activity set forth in the Postal Service budget'."

The ramifications of the proposals set forth in Docket No. N2012-1,[52] which seek to reduce service standards for First-Class Mail, in combination with declining First-Class Mail volumes and steady Standard Mail volumes, imply that the future of the Postal Service rests in the products encompassed by the Standard Mail class. Given this change of focus, the Postal Service should find it prudent to report the on-time performance for Standard Mail products in the Plan and to consider improvement of Standard Mail performance as an organization-wide goal.

It is also worth noting that the Postal Service continues to center its report on the on-time performance of its long-standing best performing product, First-Class *Single-Piece* Mail. In many ways, these figures mask the true service standards challenges facing the Postal Service, both within First-Class Mail and across market dominant products as a whole. The Postal Service should be more forthcoming in acknowledging service standards problems for all classes of mail and target them for future improvement.

2. *Financial and Management Performance*. The FY 2011 Plan is the first to implement the new Financial Performance measures proposed by the Postal Service in the FY 2010 Annual Compliance Report, Operating Income and Deliveries per Work Hour. The Commission expressed concern in the FY 2010 ACD about the use of such financial measures. It noted that Operating Income, which fails to include payments to the Retiree Healthcare Benefit Fund (RHBF) and Workers Compensation liability adjustments, does not follow the recommendations of the Generally Accepting Accounting Principles (GAAP).[53] Moreover, replacing Total Factor Productivity with Deliveries per Work Hour explicitly ignores major workload components, such as collecting, processing, transporting, and sequencing.[54] For comparative purposes, the Postal Service should have computed these financial performance figures for FY 2009 and FY 2010 and provided these figures for reference in the Organization-Wide Goals

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[52] Docket No. N2012, Request of the United States Postal Service for an Advisory Opinion on Changes in the Nature of Postal Services, filed December 5, 2011.

[53] *See* FY 2010 Annual Compliance Determination at 51.

[54] *Id.*

presented in the Plan.[55] In its current form, the Commission has no indication as to whether these numbers represent an improvement from years past. Without full and transparent disclosure, the Commission can only note that the Postal Service fell short of its 2011 goals. To assist in its analysis, the Commission should request Deliveries per Work Hour for FY 2009 and FY 2010.

That the FY 2012 goal for Operating Income is for a loss of $3 billion is alarming because the magnitude of this loss will be further exacerbated by the inclusion of additional payments to the RHBF. Given the constraints of the price cap, the Postal Service seems to be left with very few options that will yield an additional $3 billion in income. This further supports the need for the Postal Service to present a more comprehensive statement on postal operations which clearly outlines how the Postal Service intends to get back on the path to, at the very least, break-even footing.

In the FY 2010 Comprehensive Statement on Postal Operations, the Postal Service introduced and described nine strategic initiatives intended to strengthen the connection between strategic goals and objectives as a response to the Commission's request in its FY 2008 and FY 2009 ACDs. In the current FY 2011 Comprehensive Statement on Postal Operations, the Postal Service provided an analysis of whether these strategic initiatives had been met but did not update the initiatives to include FY 2012 targets.[56] The Public Representative feels that without future targets, the Postal Service fails to inspire confidence in its ability to reform processes and implement necessary innovations for future profitability.

Although the Postal Service met many of the goals outlined in the FY 2010 Strategic Initiatives, it missed the mark on two goals: Intelligent Mail Barcodes (IMb), and Flats Sequencing System. For Intelligent Mail, the Postal service set an aggressive target of 90% for workshared mail containing an IMb. However, by the end of the fourth quarter, only 72% of workshared mail contained an IMb. The Postal Service has been working on implementation of IMb since 2008, and IMb is critical for service performance measures and for identification of process improvements. That the Postal

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[55] *See* 2011 Comprehensive Statement on Postal Operations at 33.

[56] This issue has been raised in this docket by the Chairman's Information Request No. 2, January 31, 2012, Question 23.

Service has again missed an IMb deadline is troubling. Moreover, the Postal Service's FY 2011 Target for Flats Sequencing was to increase the percentage of flat mail on an FSS to 72 percent. In FY 2011, the percentage of flat mail on FSSs was 59 percent. Both of these initiatives were intended to demonstrate marked improvement in infrastructure and processing and thus increased productivity. In failing to meet these targets, the Postal Service has signaled to interested parties that it will continue to face significant challenges in future operations.

B. Annual Report on Service Performance for Market Dominant Products (USPS-FY11-29).

The Postal Service is required by 39 U.S.C. 3691(d) to measure service performance of each market dominant product via an external measurement system except in situations where the Commission has allowed an internal measurement,[57] as is the case for measurement of bulk mail products via IMb. The Postal Service outlines the service performance of each market dominant product in the Annual Report on Service Performance for Market Dominant Products.[58]

1. *Single-Piece Service Performance Measurement.* First-Class Mail Single-Piece Letters/Postcards and Flats were measured using the EXFC system in which performance is measured from the street collection box or lobby chute to the delivery mailbox.[59] First-Class Single-Piece Parcels were measured using an internal Product Tracking System, which measures based on the Delivery Confirmation service. It should be noted that both Single-Piece Flats and Parcels served as proxies for the entire Flats and Parcels product measurement in First-Class Mail due to methodological problems with the Intelligent Mail System. The Public Representative applauds the Postal Service in exceeding its service targets for Overnight and Two-Day service categories for Letters/Postcards, although this occurred only in Quarters 3 and 4. However, Table 4 shows that for Single-Piece Flats and Parcels, the Postal Service fell well below its service targets.

[57] 39 U.S.C. 3691(b)(1).

[58] Library Reference USPS-FY-29.

[59] USPS-FY11-29 at 1.

Table 5					
First-Class Single-Piece Mail Performance	**FY 2011 National**	**FY 2011 Target**	**FY 2011 Difference from Target**	**FY 2010 National**	**Annual Change in National Performance**
Letters/Postcards					
Overnight	96.7	96.65	0.09 %	96.4	0.3
2-Days	94.2	94.15	0.02 %	93.7	0.5
3-5 Days	91.9	92.85	(0.91 %)	92.4	(0.5)
Flats					
Overnight	90.3	96.65	(6.38 %)	90.7	(0.4)
2-Days	84.0	94.15	(10.16 %)	85.1	(1.1)
3-5 Days	80.0	92.85	(12.82 %)	81.6	(1.6)
Parcels					
Overnight	90.33	96.65	(6.32 %)	91.2	(0.9)
2-Days	83.19	94.15	(10.96 %)	84.3	(1.1)
3-5 Days	86.63	92.85	(6.22 %)	87.3	(0.7)

The Commission has previously noted these service standards problems for Single-Piece Flats and Parcels and recommended that the Postal Service take steps to improve these service performances.[60] In fact, Table 5 shows that the service performance scores for all Flats and Parcels service categories for FY 2011 are below FY 2010 levels. The Postal Service reports a margin of error of +/- 2.0 percentage points at the 95 percent confidence level for Flats, indicating that the reported decline in service standards may not be statistically significant. However, service performance for Parcels is based on all measurable retail First-Class Parcels with Delivery Confirmation, indicating a real decline in service standards for First-Class Parcels. In all cases, the Postal Service has certainly failed to improve service standards for Flats and Parcels, despite the FY 2010 ACD recommendation of the Commission. The Public Representative urges the Commission to direct the Postal Service to address these shortcomings and to highlight any future Postal Service initiatives undertaken to improve service.

[60] FY 2010 Annual Compliance Determination at 60.

2. *Bulk Mail Service Performance Measurement*. In FY 2011, the Postal Service continued to use a hybrid system based on IMb measurements and a composite last mile factor to measure service performance. Annual results presented by the Postal Service are comprised of data only from Quarters 3 and 4. Quarters 1 and 2 contain no data due to certification issues for Full Service Intelligent Mail mailers. In FY 2010, the Postal Service provided service performance measures that were based on pilot data from the IMb system and were admittedly plagued with data errors.[61] In fact, the Commission urged the Postal Service to address issues related to the implementation of the IMb adoption rates and concluded that the FY 2010 reported figures were not an acceptable representative sampling of bulk mail.[62] The Public Representative has not seen adequate improvement regarding these service performance measures using IMb data in FY 2011. Data is only fully available for Quarter 4, and even in Quarter 4, the Postal Service indicates that the total mail volume available for measurement was approximately 15 percent of all Standard Mail letters and flats.[63] The Postal Service should provide to the Commission a detailed plan of how it intends to increase participation in the Full-Service Intelligent Mail system.

Despite problems with the data, the results presented by the Postal Service indicate actual service for bulk products are as much as 40 percent below the service standard target.[64] The Postal Service blames poor results on the low adaptation of Full Service Intelligent Mail® without presenting any specific plans for increasing the participation rate of mailers. The Public Representative recognizes that the implementation of Full-Service IMb is an ongoing process; however, given the importance of the Standard Mail class to the future of the Postal Service, reliable service performance measures for bulk-mail products are of critical importance. The Public Representative requests the Commission to urge the Postal Service to improve its on-time service performance for bulk mail products and thus comply with the requirements of 39 U.S.C. 3691(b)(2).

[61] FY 2010 Annual Compliance Determination at 65.

[62] *Id*. at 67.

[63] USPS-FY11-29 at 13, Standard Mail Carrier Route.

[64] USPS-FY11-29 at 13.

In the FY 2010 ACD, the Commission indicated that unless the IMb participation improves, it may review its decision to allow the Postal Service to proceed with the IMb based hybrid measurement system. The Commission should consider this option unless the Postal Service can demonstrate how the situation will improve before the FY 2012 Annual Compliance Report.

3. *Conclusion on Service Performance Measurement.* The Commission must be disappointed with the quality of information presented in the Comprehensive Statement which offers many superficial claims of progress in FY 2011 without objective proof and without providing concrete strategies for improvement toward a goal to ensure the future financial success of the Postal Service. Measurement of the Comprehensive Statements and Annual Performance Reports by length alone indicates that that Postal Service did not take seriously the role that the Comprehensive Statement and the Performance Report and Plan Report play in building confidence of future success.[65]

Moreover, by almost all measures, the service performance of market dominant products did not improve in the past fiscal year, and in many cases has probably decreased. The state of reporting for Standard Mail is plagued with data problems that prevent the Public Representative, or the Commission for that matter, from properly addressing whether the Postal Service has met the requirements of U.S.C. 3691(b)(2). The Public Representative is left with the overall impression that the Postal Service needs to focus improvement strategies on the class in which it has indicated is its future: Standard Mail.

V. CUSTOMER ACCESS TO POSTAL SERVICES

A. Customer Satisfaction.

The Postal Service's ACR must include a report addressing consumer satisfaction. As a minimum it must include an evaluation of retail facilities, customer

[65] The FY 2010 Comprehensive Statement on Postal Operations (USPS-FY10-17) contained 70 pages of analysis. The FY 2011 Comprehensive Statement contains 36 pages of analysis.

waits in line, availability of postal collection boxes, and number of delivery points. 39 CFR 3055.91.[66] Also, Customer Experience Measurement Surveys are required to measure customer *experience*. 39 CFR 3055.92. The Postal Service has sought to comply with these requirements through the filing of USPS-FY11-38. In addition, information on certain consumer access statistics is available in the Postal Service's Annual 10-K Report filed with the Commission. However, neither USPS-FY-38 nor the Form 10-K Report includes information on collection boxes. The Commission noted this omission of this data in the Chairman's Information Request No. 1, Question 27. The Commission should direct the Postal Service to include these statistics initially in its FY 2012ACR as required by 39 CFR 3055.91(c)(1)-(4).

Table 6, below, provides information on the footprint of postal facilities for FY 2011 and FY 2010. Although the difference is slight, the Postal Service has reduced the number of facilities it operated in FY 2011. Given the recent network optimization initiatives of the Postal Service, the Public Representative anticipates that these downward trends will be more severe in the FY 2012 Annual Compliance Report. To this end, the Commission should direct the Postal Service to provide a more detailed breakdown of the changes to the postal mail processing network in future filings. This should include an analysis of the changes that occur with some emphasis on the Contract Postal Units and the Community Post Offices that are cited at times as providing some stopgap measure of postal services to local areas where post offices are being closed.

Table 6
Postal Facilities

	FY 2011	**FY 2010**	**Change**
Post Offices	26,927	27,077	(150)
Classified Stations, Branches, and Carrier Annexes	5,219	5,451	(232)
Contract Postal Units	2,931	2,931	0
Community Post Offices	706	763	(57)
Total Post Offices	35,783	36,222	(439)

Source: Annual Form 10-K Report 2011 of the Postal Service at 88

[66] *See* FY 2010 Annual Compliance Determination at 71.

As in the FY 2010 ACR, the Postal Service's CEM survey measured the perception of its customers' average time spent waiting in line rather than conducting a statistically accurate special study based on actual observations. Results of the CEM are presented in Table 7, below. The Public Representative commends the Postal Service for improvements in this service benchmark. In particular, in FY 2010, 68 percent of Small/Medium Business customers and 70 percent of Residential customers believe they waited 5 minutes or less.[67] In FY 2011, the Postal Service improved both of these measures. Unfortunately, the Postal Service has failed to include any statistics on actual customer wait time as is required by 39 CFR Section 3055.91(d).[68] Without such statistics, it is difficult to assess any improvement. Moreover, in FY 2010, the Commission directed the Postal Service to improve wait time in line through future service goals.[69] The Postal Service has not done so.

The Public Representative believes that it is important to continue to improve the postal customer's perception of wait time in line, especially in light of the negative publicity surrounding the Postal Service's financial performance and planned downgrading of delivery standards. The Commission should ensure that the Postal Service includes the Wait-Time-In-Line CEM indicator in its service performance goals for FY 2012.

Table 7
Wait Time In Line

11. During your most recent visit to the Post Office, how long did you wait in line for a clerk?

	Less than 1 minute or No wait	1-3 minutes	4-5 minutes	*Subtotal 5 min or less*	6-10 minutes	11-15 minutes	16 minutes or more
Residential	18.51%	30.70%	23.61%	*72.82%*	15.46%	6.43%	5.29%
Small/Medium Businesses	17.56%	29.27%	23.09%	*69.92%*	16.59%	7.41%	6.07%

Source: CEM Survey Question 11

[67] *See* FY 2010 Annual Compliance Determination at 73.

[68] *See* ACR2011, Chairman's Information Request No. 2, January 31, 2012, Question 10.

[69] *See* FY 2010 Annual Compliance Determination at 73.

Issues of customer access to the Postal Service's network are of continued importance in the upcoming fiscal year as the Postal Service begins to implement various network optimization initiatives. The Postal Service already has in place, through its CEM Survey, tools for monitoring its customers' perception of access to the postal network. Some of these measures are provided in Table 8. In general, the Public Representative commends the Postal Service for the positive customer perceptions about their access to postal services. The Commission should direct the Postal Service to be forthcoming in analyzing these survey instruments in future Annual Compliance Reports so that the Commission may easily evaluate the customers' perception of the Postal Service's network consolidation efforts.

Table 8
Questions Measuring Access Perception

	Strongly Agree	Somewhat Agree	Neither Agree nor Disagree	Somewhat Disagree	Strongly Disagree
7a. The mail collection box pickup schedule is convenient for me					
Residential	54.69%	28.97%	9.74%	4.44%	2.15%
Small/Med	48.71%	29.93%	10.97%	6.19%	4.19%
7b. Mail collection boxes are conveniently located for me					
Residential	54.61%	26.07%	8.21%	6.62%	4.49%
Small/Med	51.79%	26.12%	10.78%	6.30%	5.01%
10a. The Post Office location is convenient for me					
Residential	68.32%	24.08%	3.32%	2.88%	1.40%
Small/Med	65.41%	25.83%	3.94%	3.25%	1.57%
10b. Hours of operation are convenient for me					
Residential	57.53%	29.45%	4.33%	6.20%	2.50%
Small/Med	52.40%	31.85%	5.10%	7.52%	3.14%

Source: CEM Survey FY 2011 USPS-FY11-38

In addition, the CEM Survey is designed to contain a set of rotating questions that are changed each quarter. The Public Representative found that the FY 2011 rotating questions, with a small but important language shift, yield important information about postal customer's overall satisfaction and should be included permanently in the survey. In particular, the Quarter 1 question 20 identifies a set of Post Office activities and seems to ask respondents whether these activities demonstrate efficient service.[70] This wording apparently seeks to identify a kind of "wish list" of characteristics indicative of efficient service, rather than identifying whether or not customers actually witness these activities. For example, "Clerks moving quickly to handle packages, apply postage, and accept payment." The Public Representative believes that there would be little disagreement as to whether or not, if witnessed, this would represent an efficient post office. However, it would be more useful to identify whether or not these customers actually witness the listed activities and to monitor these perceptions over time. The wording of the question is somewhat ambiguous as some respondents can interpret the question to be asking whether this type of service is actually witnessed. The Postal Service should (1) rework the rotating Quarter 1 and Quarter 2 questions so that they identify witnessed behavior and (2) include these modified questions with the regular survey.

Ultimately, the Postal Service is to be commended for implementing a new CEM system, administered by Maritz Research, which has the ability to provide the Postal Service with important feedback on the customer experience with the Postal Service. The Public Representative agrees with past opinions of the Commission that the Postal Service should incorporate the results of this survey into future performance goals. Moreover, the Postal Service should present the results of this survey in future filings of the Annual Compliance report so that the Commission can easily monitor how the reorganization efforts by the Postal Service are perceived by the public at large.

Given the ongoing initiative of the Postal Service to consolidate operations to alleviate financial pressures, the Commission should, now more than ever, carefully monitor the changing perceptions of postal customers. However, the Postal Service provides only a cursory analysis of the Customer Experience Measurement (CEM) Survey as it pertains to perception of Market Dominant Products. The Postal Service does not provide any analysis regarding its customer's perception of accessibility that is

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[70] USPS-FY11-38 at 2.

captured through the CEM Survey. The Commission should direct the Postal Service to address these issues in future filings of their Annual Compliance Review.

B. Offshore Special Study Results.

Included in the ACR2011 pursuant to 39 CFR 3055.7 is a special study by class of mail of delivery performance to remote areas of the Alaska, Caribbean, and Honolulu postal districts.[71] The Commission's rule requires the report every two years after the rule becomes final.[72] The Offshore study is undated, but the submission apparently is the first study prepared pursuant to the rule and relates to service during FY 2011.[73] The Offshore study is 23 pages and provides a comprehensive review and analysis of the service levels to outlying offshore areas.

On time percentage scores are provided for each class. The report compares the primary gateway on-time percentage score for each of the three districts located outside the United States. The results are mixed, but generally significant improvements are needed for the outlying areas, especially for the Standard Mail and Package services.

For example, in First-Class, for single-piece First-Class Letters/Cards/Flats, the scores for service to 3-digit offshore districts were frequently "significantly lower" than the scores for the 3-digit gateway Zip Code areas. *Id*. at 7. In Alaska, two-day service was significantly lower in four of five 3-digit areas, but for three-to five day service, the percentage score was only lower in one of five 3-digit areas. However, in all but one case, the scores were well within 3 percentage points of the gateway score. In the Caribbean, of nine reported scores for overnight, two-day and three-to-five day service, four scores were below the gateway score with one above. With one exception, the Caribbean scores were within three percentage points of the gateway score. In Hawaii, with two outlying three-digit ZIP Codes, two of four scores were well below the gateway

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[71] USPS-FY11-29, Offshore Special Study Results. Conducted in Response to Order 465, Rule 3055.7 (Offshore study).

[72] Docket No. RM2009-11, Order Establishing Final Rules Concerning Periodic Reporting of Service Performance Measurements and Customer Satisfaction, Order No. 465, May 25, 2010.

[73] Offshore study at 4.

score and one score was above the gateway score. The four day standards from continental United States to the outlying ZIP Code 967 area in Hawaii essentially met or exceeded the gateway score. The scores for delivery to Guam were significantly lower.

For Standard Mail, outlying area performances were often well below gateway scores. In Alaska, of 16 scores, only one outlying area scored as well, and most were 10 or more percentage points below the Standard Mail gateway score. The Caribbean fared better, but the scores for Hawaii are very low. For the 3-digit area 967, the end-to-end score for letters was 5.7 percent ; for Flats, only 1.0 percent was delivered on time. *Id*. at 13. The study concludes that for Standard Mail to Hawaii it is worthwhile to review the service standards and processing operations to review what is realistic. *Id*. at 14. Service for the Standard Mail class was relatively worse than for other classes. *Id.* at 22. It is clear that Standard Mail and Package services to the outlying areas of the three districts fail to meet service standards most frequently. Package service to Hawaii meets standards 6 percent of the time, well below reasonable levels of service.

Overall, the analysis appears fair and complete and a good report on which to base future action. The Postal Service has much work ahead to increase the performance scores to outlying areas within the range of gateway scores and to increase all scores for Standard Mail and Parcel services. It remains to be seen whether the Postal Service will be able to improve its service within two years when the next report is due.

VI. CONCLUSION.

The Public Representative respectfully submits the foregoing comments for the Commission's consideration.

Respectfully submitted,

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