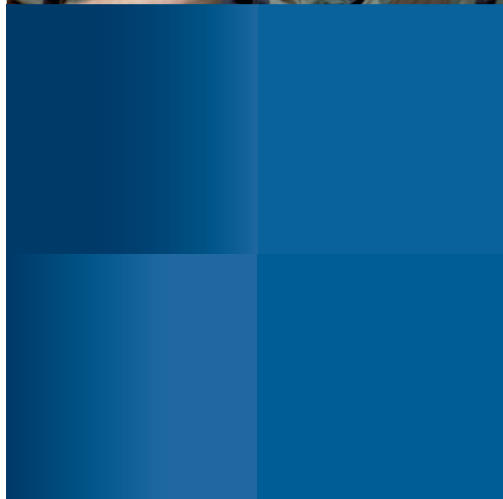




U.S. POSTAL
REGULATORY
COMMISSION

ANNUAL REPORT TO THE PRESIDENT AND CONGRESS

Fiscal Year 2010





CHAIRMAN'S MESSAGE, DECEMBER 2010

For well over two centuries, the United States has benefitted from a successful and ubiquitous Postal Service binding the people of the Nation together. Methods of communications in the country continue to change, and the mail is no longer the primary way we keep in touch. Nevertheless, when, earlier this year, the Commission called for a dialogue on the future of the country's mail, the people of the Nation demonstrated their support for and reliance on the mail. During FY 2010, the Commission received more than 19,000 customer inquiries, suggestions and comments, a nearly 11-fold increase over FY 2009.

It has been a remarkable and challenging year for the Postal Regulatory Commission, marked not only by a record outpouring of public interest but a dramatic increase in our workload and exercise of responsibility. There was a 50 percent increase in docketed proceedings, more than a dozen hearings on complex issues, and wide-ranging, thought-provoking Congressional oversight. I am proud to present the Commission's 2010 Annual Report on behalf of my fellow Commissioners and staff whose unstinting effort and professionalism are evident in the successes documented here.

Exigent Rate Case

The Postal Service did not file for an increase under the Consumer Price Index (CPI) price cap in FY 2010, as recession-caused deflation resulted in a CPI formula of minus 0.356 percent. Rather, it chose to file an Exigent Rate Request of 5.6 percent in July for proposed implementation in January, 2011. The Commission had just 90 days to study and decide upon this precedent-setting request that attracted the involvement of much of the mailing community. After a careful review and with a unanimous vote, the Commission found that the Postal Service failed to meet the legal requirements for an exception to the rate cap. The Commission's decision affirmed the fundamental importance of the statutory price cap in protecting postal consumers and promoting Postal Service efficiency.

Advisory Opinion Dockets

As the Postal Service has explored possible responses to the recession, competition from digital media, and the financial stress of Retiree Health Benefit Fund obligations, the Advisory Opinion process has become an increasingly important platform for the Commission to foster public debate on the future of the Nation's postal system and for the Commission to offer its guidance. The law requires the Postal Service to request a nonbinding Advisory Opinion from the Commission in advance of a "nationwide or substantially nationwide" change in postal services.

In FY 2010, the Commission considered Postal Service requests concerning the process for closing urban and suburban retail facilities (Docket No. N2009-1) and the elimination of Saturday mail delivery, collection and outbound processing (Docket No. N2010-1). During the course of the public review sponsored by the Commission on Docket No. N2009-1, the Postal Service continued to reexamine its candidate list of retail offices designated for possible closing and the list shrank from 3,200 to just 162 locations. In its Opinion, the Commission recommended specific changes to the process to improve planning, enhance customer notification and input, and provide due process consistent with statutory guidelines for closing post offices.



On March 30, 2010, the Commission opened Docket N2010-1 to develop an Advisory Opinion on a Postal Service proposal to end Saturday mail service and related processing and collection activities. We held proceedings in Washington, D.C. and seven field hearings across the country to listen to the public's input and we also solicited public input through the mail, press releases and the Commission's website.

Strengthened Regulation and Oversight

In March, the Commission issued its third Annual Compliance Determination assessing Postal Service performance in accordance with the Postal Accountability and Enhancement Act (PAEA) and enumerated specific actions the Postal Service should take to better balance revenues and costs and to improve service. During the year, work continued on a joint Commission-Postal Service report to Congress on Periodicals cost issues and opportunities to increase efficiency, and the Commission initiated Public Inquiry Docket PI2010-1 to determine if post office closing procedures were being circumvented by the Postal Service through the use of extended emergency suspensions. The Commission also issued new rules and guidelines to improve mail workshare discount methodologies, clarify the Postal Service's involvement in nonpostal business activities and adopt leading federal-sector Freedom of Information Act (FOIA) practices.

Growth and Innovation

The Commission strongly supports efforts by the Postal Service to develop and evaluate new products and to make use of the competitive flexibilities provided by the PAEA. For a second time, we approved seasonal sales initiatives to spur increased First-Class and Standard Mail volume during traditionally slow mailing periods.

The Commission also authorized the Postal Service to test a new experimental product, the "Samples Co-Op Box," to promote growth via cost-effective product sample distribution. This is the second market test requested by the Postal Service since the PAEA was enacted.

In addition, the Commission promptly approved 127 Negotiated Service Agreements (NSAs) proposed by the Postal Service in FY 2010, a 98 percent increase from FY 2009. To date, NSA performance has been generally positive but insufficient to materially affect Postal Service finances. Of the NSA proposals, 124 were in the Competitive Products category and 3 requests were in the Market Dominant category.

Achieving Financial Viability

While an improving economy is strengthening the mail market, the Postal Service faces potential financial insolvency in FY 2011 due to a large and increasing debt load and a statutory cap on its borrowing authority. In our Exigent Rate review, the Commission received documentation from the Postal Service showing that the primary cause of its liquidity crisis is related to an overly ambitious requirement for the Postal Service to pre-fund its Retiree Health Benefit Fund obligations. At the Postal Service's request, and as authorized by law, the Commission also provided an independent actuarial analysis showing the Postal Service's civil service pension obligation may be overstated by as much as \$55 billion. Adjustments to one or both of these obligations could provide the financial stability needed by the Postal Service as it restructures its operations and as Congress considers possible changes to the Postal Service's business model.



Commission Management and Accountability

Our staff of 70 employees successfully managed an unprecedented increase in workload while instituting better, more transparent and accurate procedures, introducing improvements in our information technology platform, enhancing staff professional development and building a more collegial and mutually supportive work environment. Most of all, our focus is on serving the public. The Postal Accountability and Enhancement Act requires the Postal Service to be more accountable and transparent, and the Commission has taken on the challenge as well. Our staff is engaged in ongoing efforts to better communicate with our constituents and more actively address their concerns. The Commission initiated monthly public meetings to report on our activities and arranged to webcast all of our open proceedings. Again, I thank them for their excellent effort and teamwork.

Shared Goals

The Commission – like Congress and the Postal Service – dedicates itself to serving the American people in all we do. The regulatory review and Congressional oversight enacted first in 1971 continues to safeguard the postal services Americans rely on. We thank the Postal Service for its shared commitment to carrying out the laws and regulations as envisioned by Congress.

Finally, I extend my sincere thanks and admiration to the American people for their support of the Commission's work throughout the year.

Sincerely,

Ruth Y. Goldway

Chairman

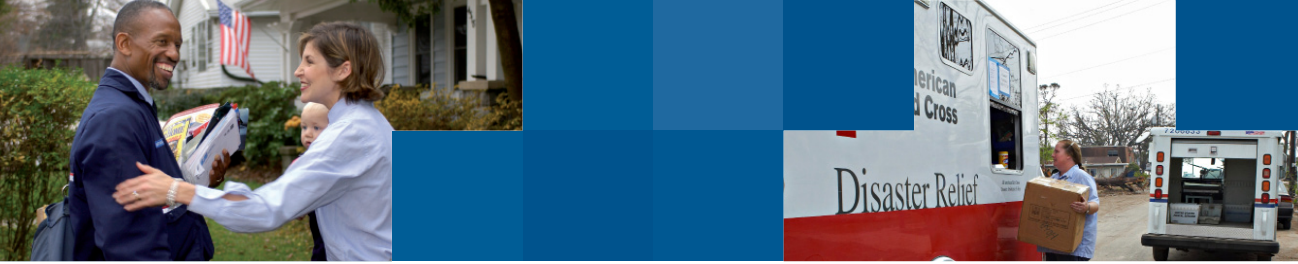


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CHAPTER I

ABOUT THE COMMISSION

The Commission is an independent agency that has exercised regulatory oversight over the U.S. Postal Service since its creation by the Postal Reorganization Act of 1970 (PRA) with expanded responsibilities under the Postal Accountability and Enhancement Act of 2006 (PAEA). The Commission is composed of five Commissioners, appointed by the President, with the advice and consent of the Senate, for a term of six years. The Chairman is designated by the President and serves as the head of the agency. A Commissioner may continue to serve after expiration of his or her term for up to one year. No more than three members of the Commission may be from the same political party.



Ruth Y. Goldway, Chairman

First appointed as a Commissioner on April 7, 1998. Designated Chairman by Barack Obama on August 6, 2009. Term expires November 22, 2014. Former Manager of Public Affairs for the Getty Trust. Former Director of

Public Affairs, California State University, Los Angeles. Former Council Member and Mayor, City of Santa Monica. Founder and Former Chairperson, Santa Monica Pier Restoration Corporation. Former Assistant Director of California's Department of Consumer Affairs. Co-founder of Women in Logistics and Delivery Services.



Tony Hammond, Vice-Chairman

Appointed as a Commissioner on August 15, 2002. Elected Vice-Chairman October 20, 2009. Term expires October 14, 2010. Former owner and managing member, T. Hammond

Company, LLC. Former Senior Consultant to Forbes 2000, Incorporated. Former Senior Vice President of the direct marketing firm, FL&S. Served as Director of Campaign Operations for the Republican National Committee for the 1998 election cycle. Former Executive Director and Finance Director, Missouri Republican Party. Staff to former U.S. Representative Gene Taylor (R-MO).



Mark Acton

Appointed as a Commissioner on August 3, 2006. Term expires October 14, 2010. Served as Vice-Chairman from November 22, 2007, to

October 15, 2008. Served as Special Assistant to former Postal Rate Commission Chairman George Omas. Former Staff Director, Republican National Committee (RNC) Counsel's Office. Former Deputy to the Chairman of the 2004 Republican National Convention. Served as Special Assistant to the RNC Chief Counsel as well as RNC Counsel's Office Government Relations Officer and Redistricting Coordinator. Formerly served as both Executive Director, Republican National Convention, Committee on Permanent Organization and Deputy Executive Director, Committee on Rules. Former Executive Director of the RNC Redistricting Task Force.



Dan G. Blair

Appointed as a Commissioner and designated Chairman on December 15, 2006. Served as Chairman until August 6, 2009. Term expires October 14, 2012. Formerly served as both Acting Director and Deputy

Director, U.S. Office of Personnel Management. Former Senior Counsel to Senator Fred Thompson (R-TN) on the Senate Committee on Governmental Affairs. Former Staff Director, U.S. House of Representatives Subcommittee on the Postal Service. Former Minority General Counsel, U.S. House of Representatives Committee on Post Office and Civil Service. Elected as a Fellow to the National Academy of Public Administration in 2008.



Nanci E. Langley

Appointed as a Commissioner on June 6, 2008. Served as Vice-Chairman from October 2008 - 2009. Term expires November 22, 2012. Former Director of Public Affairs and



Government Relations, Postal Regulatory Commission. Former Deputy Staff Director to Senator Daniel K. Akaka (D-HI), U.S. Senate Committee on Homeland Security and Governmental Affairs' Subcommittee on Oversight of Government Management, the Federal Workforce and the District of Columbia. Communications Director to former U.S. Senator Spark M. Matsunaga (D-HI). Elected as a Fellow of the National Academy of Public Administration in 2009.

STAFF

Assisting the Commission is a staff with expertise in law, economics, finance, statistics, and cost accounting. The Commission is organized into four operational offices:

- Accountability and Compliance;
- General Counsel;
- Public Affairs and Government Relations; and
- Secretary and Administration.

The Commission maintains an independent office for its Inspector General.

MISSION STATEMENT

Ensure transparency and accountability of the United States Postal Service and foster a vital and efficient universal mail system.

GUIDING PRINCIPLES

The Commission is committed to and operates by the principles of:

- Openness;
- Stakeholder (public) participation;
- Collegiality and multi-disciplinary approaches;
- Timely and rigorous analysis;
- Fairness and impartiality;
- Integrity;
- Commitment to excellence; and
- Merit.



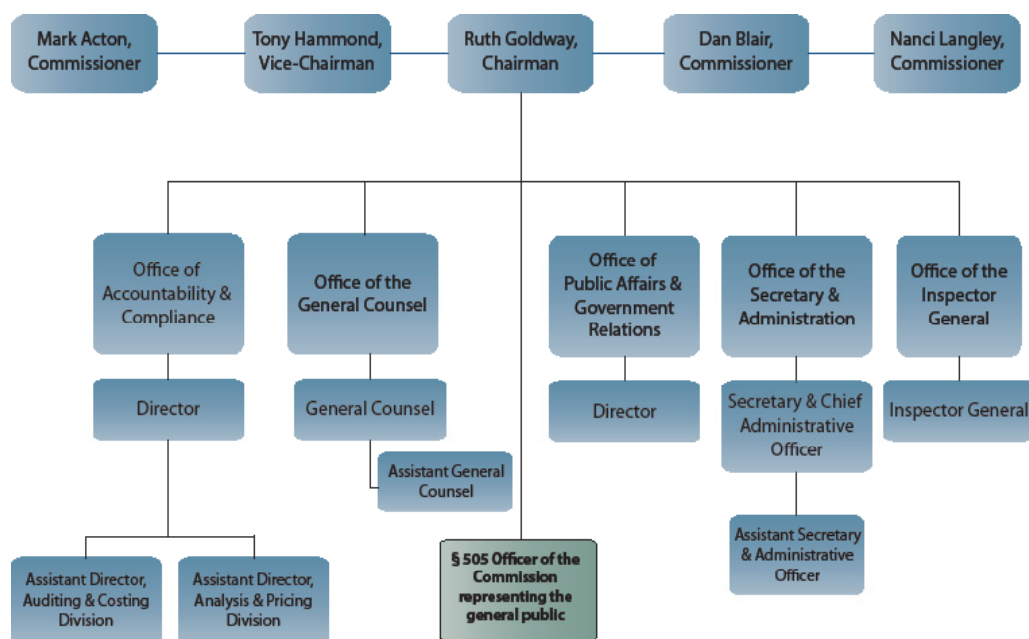
COMMISSION'S STRATEGIC PLAN

One of the Commission's first acts as the Postal Regulatory Commission was to organize and assign the existing operational framework to meet the challenges of the PAEA. Efforts began immediately to develop the Postal Regulatory Commission's first Strategic and Operational Plan for Fiscal Years 2008 through 2012. This Plan outlines the Commission's core Mission and Vision for the first five years, the key Strategic Goals to help the Commission fulfill its Mission and Vision, and the Operational Strategies to meet statutory requirements of the Act. These strategies help ensure transparency and accountability of the United States Postal Service and foster a vital and efficient universal mail system.

As the Commission carries out its responsibilities and duties, and evaluates its progress and performance based on the strategic goals outlined in this Plan, it will make appropriate modifications.

The Strategic Plan can be viewed in its entirety on the Commission's website at www.prc.gov.

PRC ORGANIZATIONAL CHART WITH OFFICE HEADS AND ASSISTANT POSITIONS



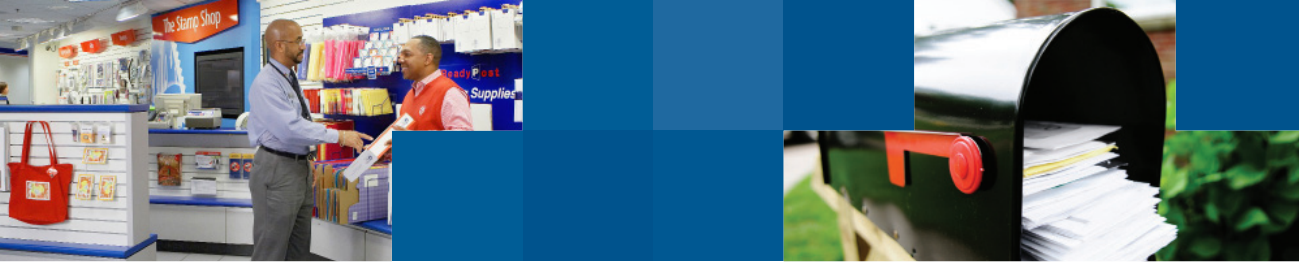


CHAPTER II

EFFECTIVENESS OF THE COMMISSION'S RULES IN ACHIEVING THE OBJECTIVES OF THE PAEA

The Postal Accountability and Enhancement Act (PAEA), Public Law 109-435, requires the Commission to annually assess the effectiveness of its rules and regulations in achieving the objectives under sections 3622 (modern rate regulation) and 3633 (provisions applicable to rates for competitive products) of Title 39 of the United States Code. The objectives of section 3622 are to:

1. Maximize incentives to reduce costs and increase efficiency;
2. Create predictability and stability in rates;
3. Maintain high quality service standards;
4. Allow the Postal Service pricing flexibility;
5. Assure adequate revenues, including retained earnings, to maintain financial stability;
6. Reduce administrative burdens and enhance transparency of ratemaking process;
7. Enhance mail security and deter terrorism;
8. Establish and maintain a just and reasonable schedule for rates and classifications, without restricting the Postal Service's ability to make changes of unequal magnitude within, between or among classes of mail; and
9. Allocate the total institutional costs of the Postal Service appropriately between the market dominant and competitive products.



In addition to these objectives, section 3622 sets limits on discounts related to mail preparation (worksharing). The implementation of the Commission Rules for a Modern System of Ratemaking achieved the pricing objectives of the act. The implementation of the rules relating to periodic reporting, treatment of confidential material, and complaint procedures enhanced transparency and accountability, served to maintain just and reasonable rates, and increased efficiency of postal operations.

The objectives of section 3633 are to:

1. Prohibit the subsidization of competitive products by market dominant products;
2. Ensure that each competitive product covers its attributable costs; and
3. Ensure that all competitive products collectively cover what the Commission determines to be an appropriate share of the institutional costs of the Postal Service.

The efficacy of the Commission's rules in meeting these objectives this year is discussed below.

EFFECTIVENESS OF RULES RELATED TO PRICING

Commission Order No. 43 established rules for changing rates for both market dominant and competitive products. These rules incorporated the statutory requirement that changes in rates for market dominant products may not exceed the annual rate of inflation and encompassed the objectives of 39 U.S.C. 3622 and 3633.

The rules are designed to allow the Postal Service pricing flexibility by applying the Consumer Price Index (CPI) cap at the class level rather than at the rate category level. This flexibility is tempered somewhat by the separate worksharing requirements of section

3622(e) and consideration of other objectives such as maintaining just and reasonable rates.

The Postal Service did not file for a CPI-based rate adjustment this year for market dominant products as the established CPI cap was negative.

Order No. 43 also established rules for expeditiously processing Negotiated Service Agreements (NSAs) between the Postal Service and individual mailers. For market dominant NSAs, the rules direct the Postal Service to provide details demonstrating compliance with statutory requirements of 39 U.S.C. 3622(c)(10), that such NSAs result in either financial or operational benefit to the Postal Service and do not cause undue harm to the market. The rules seek to minimize the administrative and economic burden of implementing agreements. At the same time the signatories of NSA's are required to submit comprehensive relevant data. The rules strike a reasonable balance to foster pricing flexibility, transparency, and accountability.

The Postal Service submitted three market dominant NSAs which were approved by the Commission this year.

The Postal Service has further flexibility in providing experimental products. If a product is deemed to be experimental it is excluded from the requirements of the ratemaking rules. Specific limitations on experimental products are outlined in the PAEA under section 3641 of Title 39 U.S.C.

The Postal Service submitted one experimental product proposal in FY 2010.

Section 3622(d)(1)(E) directs the Commission to implement procedures whereby rates may be adjusted beyond the inflation-based cap due to exceptional or extraordinary circumstances. First, the Commission must determine, after notice and opportunity for a public hearing and comment, whether such



adjustment is “reasonable and equitable and necessary” to enable the Postal Service to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States. Commission rules in 39 CFR 3010.2 refer to rate filings of this type as “exigent.” 39 CFR 3010.6 outlines streamlined proceedings for exigent adjustments, consistent with the 90-day review period and due process considerations.

The Postal Service filed an Exigent Rate Case on July 6, 2010.

The Commission’s rules provide even greater flexibility to price competitive products. The rules allow the Commission 30 days to determine whether the Postal Service’s proposed rates for competitive products are meeting the objectives of section 3633. The Commission uses an incremental cost test to validate compliance with the cross-subsidy requirement that revenue generated from competitive products equals or exceeds the incremental costs of such products. The Commission has set the appropriate share of institutional costs to be borne by competitive products at 5.5 percent, subject to revision as needed.

The Commission approved the Postal Service’s third annual request for a competitive price increase which was implemented in calendar year 2010.

For competitive NSAs, the rules, in accordance with the law, allow for not less than a 15-day review of all agreements. Competitive NSAs are evaluated for compliance with the statutory requirements for competitive products.

The Postal Service submitted 124 competitive NSAs all of which were approved in less than the statutory time period provided.

The rules can be viewed at www.prc.gov/prc-docs/home/PAEA/FinalRulesWeb.pdf.

TECHNICAL DESCRIPTION OF PRICE CAP

The Commission established rules applicable to the price cap in 39 CFR 3010.20 *et seq.* The Commission has set the price cap at the percent change in the level of the seasonally unadjusted Consumer Price Index for All Urban Consumers (CPI-U), between the most recent average 12-month period from the date the Postal Service files its notice of rate adjustment and the average of the preceding 12-month period.

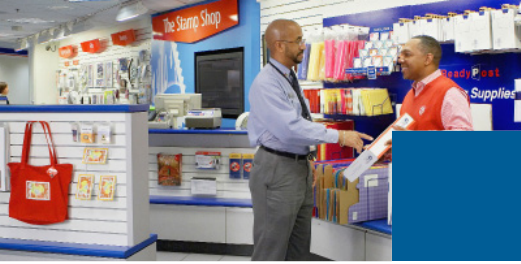
The use of a 12-month average corresponds to the U.S. Bureau of Labor Statistics method for calculating annual changes in the CPI and provides greater stability and predictability.

The difference between the annual price cap and the percentage change, which might be proposed by the Postal Service, is known as the “unused rate authority.” Cumulative unused rate authority can be reserved for use for up to five years. This banked rate authority, which is a feature of the PAEA, can be used to increase rates beyond the annual price cap, with a limitation of two percent in each class in a given year. The banked authority provides the Postal Service with greater pricing flexibility.

Table 1 – FY 2010 Partial Year and Annual Limitations

Month-Year	Limitation	Month-Year	Limitation
Oct-09*	-0.728%	Apr-10	0.482%
Nov-09*	-0.577%	May-10	0.757%
Dec-09*	-0.356%	Jun-10	0.968%
Jan-10	-0.143%	Jul-10	1.252%
Feb-10	0.013%	Aug-10	1.477%
Mar-10	0.236%	Sep-10	1.685%

*Partial Year Limitations



The Commission publishes the 12-month average change in CPI on its website at <http://www.prc.gov/PRC-DOCS/home/CPI.pdf>.

EFFECTIVENESS OF RULES IN ASSURING STABILITY, PREDICTABILITY AND FLEXIBILITY IN PRICING

The Commission's rules related to ratemaking afford the Postal Service substantial pricing flexibility while assuring predictability and stability, and maximizing incentives to reduce costs.

Request for an Exigent Rate Case

On July 6, 2010, the Postal Service filed an "exigent" rate request pursuant to the authority in 39 U.S.C. 3622(d)(1)(E) and 39 CFR Section 3010.60 *et seq.*, seeking to increase rates for market dominant products, on average, by 5.6 percent, effective January 2, 2011.

Because the Postal Service had indicated that it intended to file an exigent rate case, the Commission established a framework for the proceedings after providing a forum for discussions with the general public and mailing community on the technical process. The first of four technical conferences was held on June 16, 2010, providing an opportunity to discuss unique procedural considerations and to identify possible solutions to potential issues "that might otherwise complicate fair and meaningful participation by interested persons." Participants in the June 16, 2010, conference explored a broad spectrum of topics including the desirability of further technical conferences, the nature and extent of permissible discovery, the manner in which participants would be permitted to submit questions to the Commission for response by the Postal Service, and procedures for filing written comments.

The Postal Service's filing asserted that the circumstances it faced were "extraordinary or exceptional" and that the proposed rates were reasonable, equitable, and necessary. The Postal Service's proposed rates involved the identification of available CPI-U based price caps by class (an average of 0.578 percent), an explanation of why the revenue generated from increases limited by those caps would be inadequate, and an alternative proposed set of higher-percentage price increases. According to the Postal Service, this methodology could potentially be viewed as an exercise in borrowing against future price caps and that if future circumstances permit, the Postal Service might be able to "pay back" some or all of the exigent increase by basing future price increases calculated below levels that future CPI-U calculations might otherwise indicate.

In its filing, the Postal Service stated that it was facing an impending cash flow crisis and the exigent request was only one of several steps intended to improve its financial condition. The Postal Service stated that while the proposed increases would not eliminate a revenue shortfall, this was one of the few options which could reasonably be expected to have a short-term positive impact.

The Commission thoroughly reviewed the goals of postal reform legislation, and the role that the exigent rate authority plays in the new system of rate regulation. A wide variety of participants submitted extensive legal arguments that assisted the Commission in properly interpreting the exigent rate provision.

After consideration of all evidence, testimony and comments submitted for the record, the Commission unanimously decided to deny the Postal Service's request for rate increases in excess of the price cap.



In Order No. 597 (9/30/10), R2010-4, the Commission concluded that to be valid, an exigent rate adjustment must be shown to be:

- Due to either extraordinary or exceptional circumstances;
- Reasonable, equitable, and necessary under best practices of honest, efficient, and economical management; and
- Necessary to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.

A majority of the Commission found that the recent recession, and the decline in mail volume experienced during the recession, did qualify as an extraordinary or exceptional circumstance. However, the Commission found that the requested exigent rate adjustments were not designed to respond to the recent recession, or its impact on mail volume. Rather, adjustments represented an attempt to address long-term structural problems not caused by the recent recession.

The law, 39 U.S.C. 3622(d)(1)(E) and 39 CFR 3010.60, as well as the legislative history indicate that the price cap can only be breached in certain, limited situations. All of the three tests set out above must be met. The “due to” requirement in the law prevents a bona fide extraordinary or exceptional circumstance from being misused as a general revenue enhancement mechanism that circumvents the price cap.

The Commission’s decision was supported by analyses showing that the impending cash flow crisis identified by the Postal Service was not a result of the recession. To the contrary, this cash flow crisis would have occurred whether or not the recession took

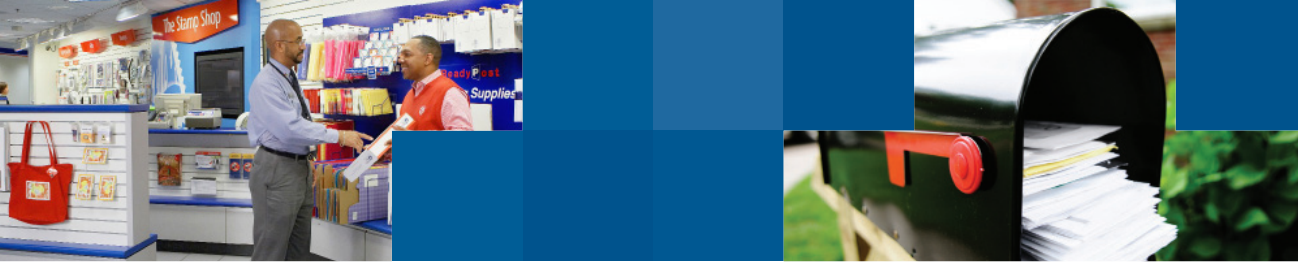
place, and is the result of other unrelated structural problems. The Commission’s analysis showed that the proposed exigent rate adjustments would neither solve nor delay that crisis.

The decision also included an analysis of the impact of the current retiree health benefits payments schedule on the Postal Service’s retained earnings and liquidity. This analysis shows that the Postal Service has been unable to meet the statutory payment schedule with funds from operations, and has instead used all of its retained earnings and drawn down from its \$15 billion borrowing authority. Whether the requested rate increases were approved or not, the Postal Service would be unable to meet this annual obligation in 2011, or in succeeding years.

The Commission analyzed the Postal Service’s efforts to cut costs in response to the recent recession. The Postal Service achieved more than \$6 billion in cost reductions in 2009, and cost containment programs are now resulting in workhour reductions outpacing volume declines.

The Commission concluded that exigent rate increases are limited to amounts shown to be needed due to specific exigent circumstances. It found that in this instance, the Postal Service failed to quantify the impact of the recession on Postal finances, address how the requested rate increases related to the recession’s impact on postal volumes, or identify how the requested rates would resolve the crisis at hand.

In October 2010, the Postal Service filed a petition with the U.S. Court of Appeals for the District of Columbia Circuit, seeking a review of the Commission’s interpretation of how prices can be set under extraordinary and exceptional circumstances. The matter is currently pending before the Court on an expedited schedule.



Concurring Opinions on R2010-4

Concurring Opinion of Commissioner Blair (Summary)

Commissioner Blair filed a separate concurring opinion whereby he found the Postal Service's exigent request "did not meet the threshold test of showing the existence of 'extraordinary or exceptional circumstances' as required by the Postal Accountability and Enhancement Act." In Commissioner Blair's view, the Postal Service's argument that its current financial crisis resulted from a broken business model dependent on volume growth and the steep decline in mail volume was not an "extraordinary or exceptional circumstance." Rather, he determined that this requirement contemplated the imposition of new, additional or unexpected costs on the Postal Service.

He acknowledged that the drop in mail volume was significant, resulting from the recession and the continuing trend of electronic diversion. However, such events had been contemplated for some time by policy makers and the Postal Service, and pointed to the inability of the Postal Service to respond to and plan for foreseeable and periodic changing market conditions as the source of the Postal Service's financial crisis. In concluding, he stated claims of a flawed business model dependent on mail volume growth did not meet the "extraordinary or exceptional circumstances" test necessary to justify raising rates above and beyond inflation.

Concurring Opinion of Commissioner Langley (Summary)

Commissioner Langley filed a separate concurring opinion in which she stated her belief that the recession-driven volume declines experienced by the Postal Service probably had measurable financial impact that may have warranted some financial relief.

However, she found that the written and oral testimonies of Postal Service witnesses did not demonstrate that the proposed rates were intended to offset the financial harm caused by the exigent circumstance nor that the rate adjustments were reasonably related to the financial harm caused by that circumstance. Moreover, it became apparent through these testimonies that the Postal Service's request was designed to be a part of its long-term recovery plan, not to deal with an emergency situation.

Commissioner Langley further observed that the in-depth analysis provided by all parties further illuminated the unique conditions that must exist in order to pierce the cap through an exigent request.

Standard Mail Incentive Program

On February 26, 2010, the Postal Service filed a motion for a price adjustment, for Standard Mail letters and flats. The proposal was similar to an incentive program approved by the Commission in June 2009. The Commission approved the program to begin on July 1, 2010, and expire on September 30, 2010.

The 2010 Incentive Program represents the Postal Service's efforts to further exercise its pricing authority under the PAEA. The Postal Service estimated that the 2010 Incentive Program would provide incremental revenue of between \$34 million and \$157 million from new volume. The 2010 Incentive Program was also designed to provide the Postal Service with information on how to improve future price adjustments by generating data for measuring the impact of short term price changes on mailing behavior.

As a result of concerns raised during the proceedings and the review of the prior incentive program, on June 8, 2010, the Commission initiated a Proposed Rulemaking concerning methods to estimate volume changes caused by pricing incentive programs. The



purpose of the proceeding is to develop methods to determine how much mail volume is the result of each pricing incentive. This proposed rulemaking is still in the procedural stages. Comments were filed by interested parties in July 2010. To date, no final Order or Rule has been issued.

First-Class Mail Incentive Program

On August 11, 2009, the Postal Service filed with the Commission a notice announcing its intention to adjust prices for certain First-Class Mail, presorted letters, flats, and cards sent by qualifying mailers. The Postal Service characterized the planned adjustment as a temporary First-Class Mail incentive program to spur volume growth during the recession. The stated intent of the Program was to provide an incentive for customers to increase presorted, non-parcel, First-Class Mail volume above any volume they would have otherwise mailed. The Postal Service incorporated provisions to address the possibility of strategic shifting or withholding of volume. The plan included as a key element a 20 percent rebate on qualifying incremental volume above certain volume thresholds for a three-month duration from October 1, 2009, through December 31, 2009. The Commission approved the Program on September 16, 2009, and required the Postal Service to file relevant revenue and cost data within 15 days of crediting rebates to qualifying mailers.

Data to assess the success of this incentive program was filed by the Postal Service in July 2010. The data collection report filed by the Postal Service indicated that the Program generated \$18 million in contributions on 212 million incremental pieces.

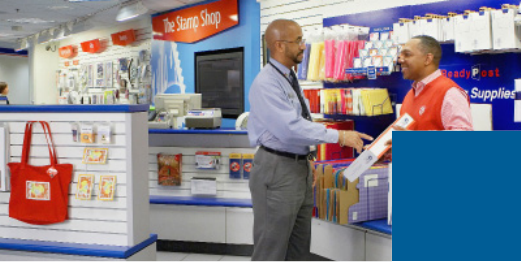
Competitive Product Cases and Negotiated Service Agreements

The Commission reviewed 124 Competitive Product cases and three Market Dominant Negotiated Service Agreements filed by the Postal Service this fiscal year. As seen in Table 2, the number of cases reviewed in FY 2010 nearly doubled from 2009. These cases were all reviewed and approved by the Commission in a timely manner.

Table 2 – Negotiated Service Agreements Approved by Commission

Type of NSA	Cases		
	FY 2010	FY 2009	FY 2008
Competitive Domestic	13	31	2
Competitive International	111	32	19
Total Competitive	124	63	21
Market Dominant Domestic	0	0	0
Market Dominant International	3	1	0
Total Market Dominant	3	1	0

In addition to competitive product cases and NSAs, the Commission approved a change in rates of general applicability for competitive products in Order No. 353, issued December 4, 2009, to take effect on January 4, 2010. In terms of domestic competitive products, Express Mail prices, overall, increased by 4.5 percent. Priority Mail prices increased by 3.3 percent overall. Parcel Select increased on average by 4.7 percent and Parcel Return Services decreased by an average of 3.0 percent. For International Competitive products, Global Express Guaranteed service increased on average by 4.1 percent. Express Mail International increased on average by 2.9 percent and Priority Mail International by 3.0 percent.



Review of Price Adjustment and Classification Changes Related to Move Update Adjustments

In Docket No. R2010-1, Order No. 348, issued on November 25, 2009, the Commission approved in part, and rejected in part, a Postal Service proposal to establish Move Update Assessment charges for First-Class Mail. The Postal Service filed its proposal with the Commission on October 15, 2009. The proposed changes were scheduled for implementation on January 4, 2010.

The Commission approved the application of the proposed seven cent Move Update Assessment Charge to Presort First-Class Mail mailings that fail the Performance Based Verification (PBV) test and cannot demonstrate compliance with Move Update requirements. Similarly, it approved the Move Update Assessment Charge for Standard Mail. However, the Commission rejected the proposal to apply Single-Piece First-Class rates to Move Update noncompliant Standard Mail mailings. Thus, the Move Update Noncompliance Charge of seven cents per piece remained the approved charge for Standard Mail noncompliance. While the Commission authorized the proposed rate structure, it urged the Postal Service to consider alternatives which may accomplish its Move Update objectives in a more equitable fashion.

Review of Experimental Products

Section 3641 authorizes the Postal Service to “conduct market tests of experimental products in accordance with this section.” A product may not be tested under this provision, however, unless it satisfies each of the following conditions: (1) the product is significantly different from all products offered by the Postal Service within the two-year period preceding the start of the test (section 3641(b)(1)); (2) the product will not result in unfair or inappropriate competitive advantage for

the Postal Service or any mailer, especially in regard to small business concerns (section 3641(b)(2)), and; (3) the product is correctly characterized as either Market Dominant or Competitive (section 3641(b)(3)).

The Postal Service proposed to conduct a market test designed to gain information concerning the operations, costs, and potential market for an experimental product provisionally titled Samples Co-Op Box. The Samples Co-Op Box is a parcel which will contain assorted product samples from multiple consumer package goods companies.

The market test consists of one mailing of several hundred thousand co-op boxes to consumers in two test markets. The Postal Service indicated that it expected the mailing to be completed in a single week. The market test also includes research, conducted by the Postal Service or its partner, designed to gain information about the proposed product.

The Commission approved the proposed experimental product in May 2010. In its order, the Commission noted that should the Postal Service want to add Samples Co-Op Boxes to its Competitive Products List, it should file adequate cost and revenue data demonstrating that the proposed product covers its attributable costs.

EFFECTIVENESS OF RULES IN ACHIEVING WORKSHARING LIMITATIONS

The Commission’s oversight has been effective in balancing the Postal Service’s pricing flexibility with the statutory requirements related to workshare discounts. (Workshare discounts are reduced rates based on costs avoided by the Postal Service when mailers undertake certain mail preparation and processing tasks.) This has been accomplished either through requiring the Postal Service to adjust discounts or by



accepting the Postal Service justification of exceptions to the rules. The Commission notes that basing discounts on historical cost avoidance calculations is problematic because costs will change during the time the discounts are in place.

Section 3622 of 39 U.S.C. imposes limitations on workshare discounts. Section 3622(e)(2) directs the Commission to ensure that workshare discounts do not exceed the costs avoided by the Postal Service, unless certain conditions are met. This provision effectively limits the Postal Service's ability to set workshare discounts that exceed 100 percent of avoided costs. The Commission's rules require the Postal Service to justify any proposed workshare discounts that exceed 100 percent of avoided costs by explaining how they qualify for one of 4 exceptions permitted under the PAEA. Worksharing discounts are permitted to exceed 100 percent if the discount is:

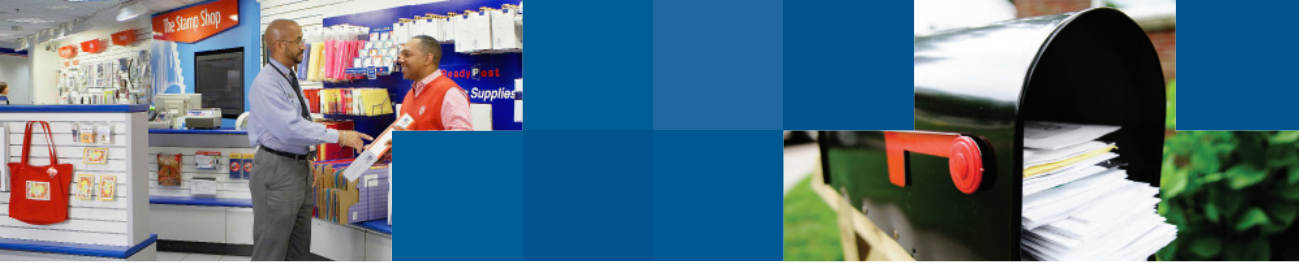
(1) Associated with a new postal service, a change to an existing postal service or with a new workshare initiative related to an existing Postal Service and necessary to induce mailer behavior that furthers the economically efficient operation of the Postal Service and the portion of the discount in excess of the cost that the Postal Service avoids as a result of the workshare activity will be phased out over a limited period of time; (2) The amount of the discount above costs avoided is necessary to avoid rate shock and will be phased out over time; (3) The discount is provided in connection with subclasses of mail consisting exclusively of mail matter of educational, cultural, scientific or informational value; or (4) Reduction or elimination of the discount would impede the efficient operation of the Postal Service.

In its FY 2009 Annual Compliance Determination issued in March 2010, the Commission identified 30 workshare discounts that exceeded avoided costs. Seventeen of those discounts were justified by the exceptions in the statute. For the 13 that were not justified, the Commission ordered that they be realigned in the next general market dominant adjustment filing. In its exigent rate filing, the Postal Service responded to the Commission Order by proposing adjustments to many of the workshare discounts which exceeded 100 percent of avoidable costs. However, that rate request was denied, and the concerns must be addressed in the future.

The Commission established docket RM2009-3 to examine the legal, factual and economic bases underlying the discounts for First-Class and Standard Mail previously approved in the May 2009 Market Dominant Price Adjustment and to consider any alternative workshare discount rate design and cost avoidance methodologies proposed by participants.

In Commission Order No. 536 issued September 14, 2010, the Commission concluded that, as a legal matter, the worksharing discount pricing constraint established in 39 U.S.C. 3622(e) may apply within, or across, products. Whether the limit on workshare discounts prescribed by section 3622(e) applies to particular groups of mail depends on whether the groups in question serve the same, or different, markets. If they serve the same market, the selection of an appropriate benchmark depends on what types of mail within the base group would have incentive to shift to the workshared group in response to changes in their relative prices.

The Commission concluded that there is a substantial subset of Single-Piece First-Class Mail that serves essentially the same market as presort First-Class Mail,



and that a worksharing relationship exists between the two types of mail. However, the Commission acknowledged that the reference group or “benchmark” currently used to measure presort First-Class Mail avoided costs is obsolete. In the follow-on proceeding, RM2010-13, instituted simultaneously with Order No. 536, the Commission solicited comments on whether the current Bulk Metered Mail (BMM) reference group should be discarded as a benchmark in favor of a number of alternatives, including Information Based Indicia (IBI) mail, a weighted average of BMM and IBI mail, “Qualified PC Postage” mail, or some other group of Single-Piece First-Class Mail. The specific cost characteristics to be included in the reference group selected are also being examined. This docket is pending with comments to be filed early in 2011.

EFFECTIVENESS OF RULES IN MAINTAINING JUST AND REASONABLE RATE SCHEDULE

Rules for Complaints and Rate and Service Inquiries

The Commission rules for complaints are designed, in part, to facilitate maintenance of a just and reasonable rate schedule by enabling the Commission to hear and resolve complaints in a streamlined and efficient manner while providing appropriate due process for all participants. These rules establish a separate procedure for dealing with issues that do not require the more formalized procedures applicable to complaints.

Complaints during FY 2010

There were three Complaints before the Commission during FY 2010.

Complaint of GameFly, Inc.

The Complainant in this proceeding is a mailer of DVDs who alleges that the Postal Service is discriminating in

favor of certain other DVD mailers by providing them with preferential service.

DVDs sent through the mail are vulnerable to breakage when processed by automated letter processing equipment. The Complainant alleges that the Postal Service unlawfully implemented a national policy that affords select DVD mailers preferential processing, such as hand culling and sorting that prevents damage to DVDs, at no additional charge. Complainant claims that it and other DVD mailers have been unlawfully denied such preferential service with the result that they must pay significantly higher mailing costs in order to achieve comparable reductions in DVD breakage rates. The Postal Service argues that there are valid operational and other reasons for limiting the availability of the allegedly preferential services to certain specific mailers.

This is the first complaint proceeding to be adjudicated under the formal complaint procedures adopted by the Commission under the PAEA. Extensive discovery has been conducted and administrative hearings have been held. The parties completed the filing of legal briefs during November 2010, and a formal decision is forthcoming.

Complaint of Personal Assistance Services Council

In this proceeding, the Complainant alleged that the Postal Service had unlawfully denied its application to send mail at Nonprofit Standard Mail rates. The Postal Service moved to dismiss the complaint for failure to satisfy the regulatory requirement that a Complainant meet and confer with the Postal Service to resolve any differences before a complaint may be filed. The Complainant did not oppose the dismissal of its complaint. The parties will work to achieve satisfactory resolution of the dispute. The Commission dismissed the complaint without prejudice.



Complaint of Lance P. McDermott

The Complainant in this proceeding sought to challenge the sale by the Postal Service of the Queen Anne Post Office in Seattle, Washington (Queen Anne Station). An earlier attempt by the same Complainant to appeal the closing of the Queen Anne Station was rejected as premature in light of the fact that the facility was, at that time, still in operation and no final disposition document had been issued by the Postal Service. The complaint alleged that the Postal Service had not followed statutory requirements for sale of the facility. The Commission granted the Postal Service's motion to dismiss on the grounds that it lacked jurisdiction to consider Complainant's specific claims.

EFFECTIVENESS OF RULES IN ASSURING ADEQUATE REVENUES AND INCENTIVES TO REDUCE COSTS

FY 2010 continued a string of net losses for the Postal Service that began in the first year under the PAEA, FY 2007. During FY 2010 the Postal Service had a net loss of \$8.5 billion, the largest net loss in Postal Service history. However, the operating deficit was much less, \$0.6 billion. About \$2.5 billion of the loss was due to a non-cash fair-value adjustment to the workers compensation liability which was charged to expenses during the fourth quarter of FY 2010. Additionally, the Postal Service was required to pay the full scheduled payment of \$5.5 billion into the Postal Service Retiree Health Benefits Fund in FY 2010. The Postal Service sought to receive deferral of the payment, similar to what Congress allowed in FY 2009. However, Congress did not include a deferral for FY 2010, before it recessed near the end of the fiscal year. The losses are causing a significant strain on the Postal Service's ability to continue to finance operations. At the end of FY 2010 total debt reached \$12 billion, leaving only

the maximum annual amount of \$3 billion available during FY 2011. The Postal Service ended FY 2010 with a cash balance of \$1.2 billion, significantly less than would be reasonable to start the ensuing fiscal year. The Postal Service estimates that by the end of FY 2011, it will be unable to make the PAEA required \$5.5 billion payment to the Retiree Health Benefits Fund because of insufficient cash on hand. Table 3 shows the cash position of the Postal Service from the passage of PAEA in FY 2007 through FY 2010.

Table 3 – USPS Cash Flows FY 2007–2010
(\$ in Millions)

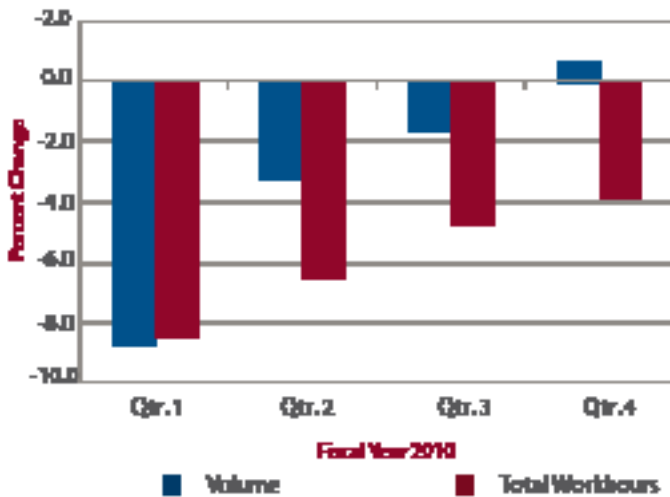
	FY 2007	FY 2008	FY 2009	FY 2010
Net Income/(Loss)	(5,142)	(2,806)	(3,794)	(8,505)
Non-Cash items and Other Cash Flows	2,539	2,367	5,367	5,213
Cash Flows from Investing Activities	500	(1,938)	(1,806)	(1,323)
Cash Flows from Financing Activities	2,005	2,910	2,890	1,687
Net Increase/(Decrease) in Cash	(98)	533	2,657	(2,928)
Cash Balance BOY	997	899	1,432	4,089
Cash Balance EOY	899	1,432	4,089	1,161
Debt Outstanding	4,200	7,200	10,200	12,000

Commission analysis in its Exigent Rate decision demonstrated the effectiveness of the Price Cap regime on reducing costs. One of the goals of price cap regulation was to incent the Postal Service to reduce costs and improve efficiency. As seen in Figure 1, in FY 2010 the Postal Service was able to reduce workhours faster than its volume declined.

In FY 2009, the Postal Service eliminated over \$6 billion in costs, and in FY 2010 it was able to reduce costs again by almost \$4 billion. By August of 2010, cost reductions were outpacing postal volume and



Figure 1– Change in Volume and Workhours by Quarter FY 2010



revenue declines, indicating that FY 2011 will be a more favorable year for the Postal Service except for the Retiree Health Benefits Fund issue. Most of the cost reductions were achieved through workhour reductions. In FY 2009, the Postal Service was able to reduce workhours by 115 million. In FY 2010, the Service reduced workhours by more than 80 million, resulting in a savings of almost \$3 billion. The Postal Service has also been able to reduce non-personnel expenses by altering transportation networks and renegotiating supply contracts with many vendors.

EFFECTIVENESS OF RULES IN ENHANCING TRANSPARENCY

A key tool for achieving transparency in Postal Service operations is the annual review of information provided by the Postal Service to the Commission, in accordance with regulations adopted by the Commission. The Postal Service has 90 days after the close of the fiscal year to collect, audit, and submit data which the Commission determines necessary. The Commission has an additional 90 days to solicit comments from the public, evaluate the data, and provide

a written determination of Postal Service's compliance with applicable statutory policies.

Annual Compliance Determination

On March 29, 2010, the Commission issued its third Annual Compliance Determination. The report assessed the Postal Service's FY 2009 performance. It focused on three main areas: financial condition, including a detailed analysis of the impending cash flow crisis; strategic goals; and pricing policies. The PAEA identifies multiple policy considerations that apply to these three areas. To the extent possible, the Commission identified the most relevant statutory objectives and factors and, where necessary, balanced the importance of each. In a number of areas the policy requirements, objectives and factors of the PAEA were not fully satisfied in FY 2009. However, the Commission found that in many cases the Postal Service had initiated actions to address these problems. Consequently, the Commission did not take any immediate actions but identified several issues that needed to be addressed in the near term. The Postal Service's progress in these areas will be assessed in the FY 2010 Annual Compliance Determination, which will be issued in March 2011.

The Commission's financial analysis identified the seriousness of the Postal Service's financial difficulties early in 2010. It identified losses resulting from the economic recession, continuing Internet substitution, and losses resulting from rates that were below-cost for certain major classes of mail. The Commission's Annual Compliance Determination report highlighted for Congress that the expected losses raised serious doubts about the Postal Service's continuing ability to meet its financial obligations, and to fulfill its statutory obligation to provide fundamental postal services to the Nation.



Importance of Data in the ACD to Assure Transparency

The Commission's regulations applicable to the annual review were promulgated pursuant to the PAEA, codified as 39 U.S.C. 3652, which requires the Postal Service, using such methodologies as the Commission may prescribe, "to demonstrate that all products during such year complied with all applicable requirements of this title." The Postal Service is required to submit cost, revenue, volume and service information in its annual report to the Commission.

In the 2009 ACD, the Commission identified 14 market dominant products and services whose revenues failed to cover attributable costs. Much of this mail was flat-shaped. Therefore, the Commission requested a specific timeline for achieving a positive contribution from these pieces.

In response to the Commission's request, as part of its Exigent Rate case, the Postal Service filed USPS-LR-R2010-4/9 "Flats Strategy" on July 6, 2010. The Flats Strategy was separated into two sections. The first section, "Operations," contained programs the Postal Service identified as opportunities to realize operational savings. The second section, "Pricing Strategies," contained a description of the Postal Service's approach in pricing flat-shaped products, which, in concert with the operational strategies, would improve the cost coverage of Flats. The Flats Strategy contained 30 operational programs. Four of the programs concerned transportation operations, nineteen concerned mail processing operations, and seven concerned delivery operations. The Postal Service provided a qualitative financial impact for each program, but did not provide any quantitative estimate of savings. The expected implementation dates ranged from 2010 to 2016. In response to questions posed

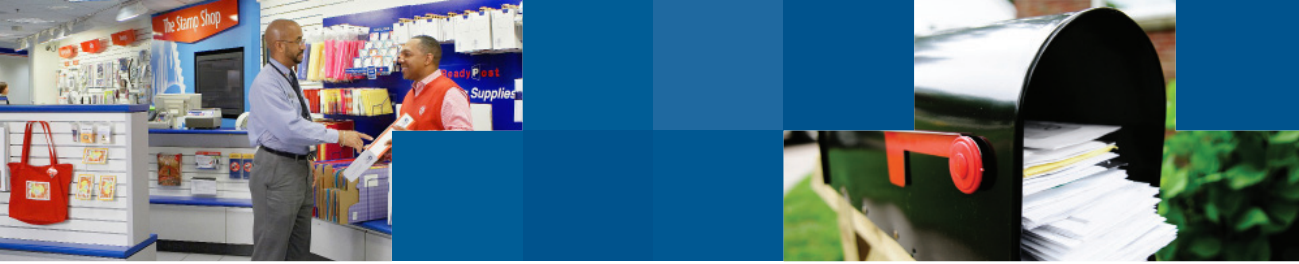
at a technical conference, the Postal Service provided supplemental information: an estimated date for the realization of anticipated savings, and progress in implementation for each program. The programs were defined as either concepts or in development. The Postal Service estimated that, under a specific set of assumptions, it will take approximately five years for Standard Mail Flats to cover costs.

In its 2009 ACR, the Postal Service also discussed its compliance with the objectives and factors of section 3622. The Commission noted in its review of the Postal Service's annual report that while some of the objectives and factors do not easily lend themselves to a quantifiable measure of compliance, such as Objective 2 (predictability and stability in rates), there are some objectives that can be measured against financial standards, accounting principles and historical results, such as Objective 9 (the allocation of institutional costs between market dominant and competitive products).

Similarly, there are several factors listed in section 3622(c) that are quantifiable and provide reasonable benchmarks on which a finding of compliance could be based. These include Factor 2 (the requirement that each class or type of mail cover its attributable costs and make a reasonable contribution to overhead), Factor 3 (rate impact), and Factor 10 (whether special classification improved the Postal Service's net financial position and did not cause unreasonable harm to the marketplace).

Periodic Reporting Rules on Service Performance Measurement and Customer Satisfaction

In order to maintain high quality service standards, the Commission continues to address the need for adequate measurements and disclosure of results.



Section 3622 of Title 39 of the United States Code provides that the Commission by regulation establish “a modern system for regulating rates and classes for market dominant products.” The quality of service, and its reporting forms an integral part of many of the objectives and factors set forth in that section. Reporting on quality of service allows assessment of whether the Postal Service is meeting the objective of maintaining the high quality service standards established under section 3691. It furthers the objective of increasing the transparency of the rate making process and allows assessment of the factors addressing the value of service and by association with the proposed measurement systems, the value of intelligent mail. Finally, it is important when analyzing whether quality of service is impacted in order to comply with rate cap requirements of 39 U.S.C. 3622(d).

Section 3652(a)(2) of Title 39 requires that the Postal Service include in an annual report to the Commission an analysis of the quality of service “for each market-dominant product provided in such year” by providing “(B) measures of the quality of service afforded by the Postal Service in connection with such product, including – (i) the level of service (described in terms of speed of delivery and reliability) provided; and (ii) the degree of customer satisfaction with the service provided.”

The Commission issued Order No. 465 in Docket No. RM2009-11 on May 25, 2010. Order No. 465 established final rules concerning periodic reporting of service performance measurement and customer satisfaction. Within this Order, the Commission established a timeline for full compliance with all reporting requirements by the filing date of the FY 2011 Annual Compliance Report (ACR) unless waivers were sought. The order established two separate processes for seeking waivers.

The first step in the process was addressed in Order No. 531 in Docket No. RM2010-11, and consisted of the Postal Service petitioning the Commission for semi-permanent exceptions from reporting, pursuant to rule 3055.3. The second step consisted of the Postal Service petitioning the Commission for temporary waivers of reporting until such time that reporting can be provided. The Postal Service subsequently filed for temporary waivers from periodic reporting on October 1, 2010, in Docket No. RM2011-1.

Postal Service Cost Methodology Rules

In anticipation of filing its 2009 ACR, the Postal Service filed 30 proposals with the Commission from June 2009 through December 2009 seeking consideration of a number of proposed changes in costing methodologies and data collection methods. These proposals led to a series of rulemakings. The Commission accepted 27 of the proposed methodology changes, accepted one with one exception, and rejected one.

The Postal Service has filed eight additional proposed changes to its costing methodologies in anticipation of filing its 2010 ACR. One proposal has been accepted by the Commission and the other proposals are currently under evaluation by the Commission’s staff.

Rules on Confidential Materials filed by the Postal Service

On June 19, 2009, in Order No. 225, the Commission adopted final rules that establish a procedure for according appropriate confidentiality for non-public materials filed with the Commission. Essentially, “non-public materials” means any document, information, or thing filed with the Commission and claimed exempt from disclosure under applicable sections of the United States Code by the Postal Service or protected from dis



closure under Federal Rules of Civil Procedure 26(c) by a third party with a proprietary interest in the materials. These rules lay a foundation for the Commission's treatment of non-public materials filed by the Postal Service and other parties.

Obtaining Information from the Postal Service—Subpoenas

The Commission issued its final rule in Docket No. RM2009-12 on April 9, 2010, which established procedures for obtaining information from the Postal Service. In compliance with PAEA section 602 which, among other things, authorizes: (a) the issuance of subpoenas requiring officers, employees, agents, or contractors of the Postal Service to appear and present testimony or to produce documentary or other evidence, and (b) the issuance of orders that require the taking of depositions and responses to written interrogatories by any of those same persons. Section 504(f) further authorizes the enforcement of subpoenas by appropriate district courts of the United States.

Financial Reporting

As required by 39 U.S.C. 3654, the Commission has been monitoring the Postal Service's progress towards compliance with section 404 of the Sarbanes-Oxley Act (SOX). Section 404 requires establishment of internal controls for financial reporting. The Postal Service reports that it was fully compliant in FY 2010.

Freedom of Information Act Rules

Order No. 322, issued on October 23, 2009, revised procedures for the Commission's handling of FOIA requests to reflect the Openness Promotes Effectiveness in our National Government Act of 2007, Pub. L. 110-175, 121 Stat. 2524 (OPEN Government Act). The substantive changes included a

declaration of a presumption of openness, a provision to allow partial grants of requests, a mechanism for requesters to receive a tracking number for each FOIA request, a rule barring the collection of fees if the Commission does not comply with the 20 working day time limit, and a designation of the FOIA Public Liaison.

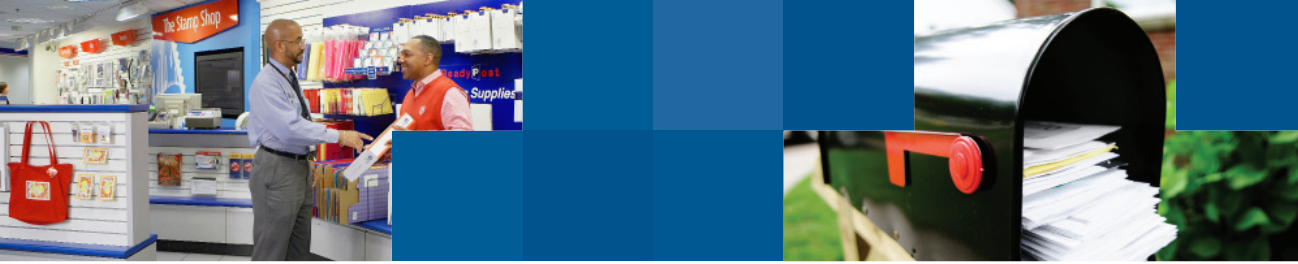
The Commission was the first federal agency to issue rules citing President Barack Obama's January 21, 2009 Memo on the Freedom of Information Act, and Attorney General Eric Holder's March 19, 2009 FOIA guidelines.

EFFECTIVENESS OF RULES IN ACHIEVING THE OBJECTIVES OF SECTION 3633 OF THE PAEA

Competitive Rate Change

The Commission's review of rate adjustments for competitive products is governed by section 3633(a) of 39 U.S.C. Section 3633(a) establishes three statutory standards, incorporated into the Commission's rules, applicable to competitive products. First, each competitive product must cover its attributable cost. Second, competitive products must collectively cover their appropriate share of the Postal Service's institutional costs, which the Commission has determined to be, at a minimum, 5.5 percent of the Postal Service's total institutional costs. Third, competitive products may not be cross subsidized by market dominant products.

In FY 2010, the Postal Service filed two notices of changes in rates of general applicability for competitive products. The first notice was filed on November 4, 2009, and set forth price adjustments for domestic competitive products: Express Mail, Priority Mail, Parcel Select and Parcel Return Service, and for international competitive products: Global Express Guaranteed, Express Mail International, and Priority Mail



International. The Commission found that the planned price increases in this docket satisfied the statutory and regulatory requirements of 39 U.S.C. 3633 and 39 CFR 3015.7 and approved the rate adjustment by Order No. 353, issued on December 4, 2009. The new prices went into effect on January 4, 2010. The second notice was filed on November 17, 2009, pursuant to 39 U.S.C. 3642 and 39 CFR 3020.30. It called for adding Inbound Air Parcel Post at Universal Postal Union (UPU) Rates to the Competitive Products List to take effect January 1, 2010. The Commission's statutory responsibilities in this docket entailed assigning the Inbound Air Parcel Post at UPU Rates to either the Market Dominant Product List or to the Competitive Products List. The Commission also reviewed the proposal for compliance with PAEA requirements. The Commission found that based on the filed supporting data, Inbound Air Parcel Post at UPU Rates met all statutory standards applicable to competitive products.

Accounting and Periodic Rules

The Commission, to further ensure that the objectives of section 3633 are met, issued Order No. 479 on June 25, 2010 in Docket No. RM2009-9. The Commission's Order was in response to the Postal Service's proposed methodology, filed on July 23, 2010, detailing how each asset and liability account identified in the Chart of Accounts would be allocated to the theoretical competitive products enterprise. In its June 25 Order, the Commission resolved issues pertaining to the allocation of assets and liabilities to the theoretical competitive products enterprise.

The Commission has developed Accounting and Periodic Reporting Rules applicable to competitive products for the establishment and application of: (a) the accounting practices and principles to be followed by the Postal Service and (b) the substantive and procedural rules for determining the assumed Federal Income tax on competitive products income. The funds generated by this assumed tax are to be put in the Postal Service's General Fund to further contribute to offsetting overhead expenses.



CHAPTER III

COSTS OF THE UNIVERSAL SERVICE OBLIGATION AND VALUE OF MAIL MONOPOLY

ESTIMATED COST OF THE UNIVERSAL SERVICE OBLIGATION

The PAEA requires the Commission to provide annual updates on the estimated cost to the Postal Service for providing universal service. The law requests three separate estimates: (1) the cost of providing service to areas of the Nation that would not receive service but for the universal service obligation; (2) the revenue foregone by providing free or reduced rates for postal services as required by 39 U.S.C. 2401(c); and (3) other public services or activities related to the universal service obligation. Table 4 provides the estimate for the first and third components. Table 5 provides the estimate for the second component. At this writing, the data necessary to compute the costs for FY 2010 were not available. Therefore, the cost estimates utilize FY 2007, FY 2008 and FY 2009 data. Most of the increase in the cost of six-day delivery between FY 2007 and FY 2008 is due to refinement of the method used to calculate indirect costs of delivery. The USO cost of six-day delivery is based on the George Mason University method used in previous annual reports. It has been updated for FY 2009, and certain calculations have been refined. Refinements over the course of time may be necessary.



Table 4 – Cost of Universal Service (\$ in Billions)

Mandate	FY 2009	FY 2008	FY 2007
Six-Day Delivery Instead of Five Day Delivery ¹	2.080	2.160	1.930
Impact of Nonprofit Mail Discounts Net of Costs	1.322	1.223	1.150
Unzoned Media/Library Rates	0.096	0.094	0.063
Losses on Market Dominant Products	0.696	0.437	0.448
Maintaining Small Post Offices	0.536	0.549	0.586
Alaska Air Subsidy	0.121	0.124	0.107
Uniform Rates for First-Class Mail	0.081	0.212	0.130
Total Cost of Universal Service Obligation	4.932	4.799	4.414

¹ The USO cost of Six-Day Delivery in FY 2009 is based on GMU method and it may change depending on the Commission's decision in N2010-1.

The Postal Service provides statutorily discounted rates for the nonprofit rate categories in Periodicals, Standard Regular, and Standard Enhanced Carrier Route. Additionally, statutory discounts are given to Periodicals, Classroom and Science of Agriculture and to Library Rate. Table 5 presents the Commission's estimates of revenue forgone by the Postal Service in providing discounted rates to preferred categories of mail in FY 2007, FY 2008, and FY 2009.

ESTIMATED VALUE OF THE MONOPOLY

While not required by law, the Commission updated its combined and mailbox monopoly values for the present year using the base case assumptions and methodology outlined in its 2008 Report on Universal Postal Service and the Postal Monopoly. The updated and previous year values are shown on the next page.

The value of the monopoly estimates the profit lost by the Postal Service if potential competitors are allowed to enter and compete in the Postal Service's letter

Table 5 – Revenue Not Received from Free and Reduced Price Mail (\$ in Billions)

Mail Class	Estimated Revenue Not Received		
	FY 2009	FY 2008	FY 2007
Standard Mail			
Nonprofit	1.001	0.969	0.757
Nonprofit - ECR	0.097	0.072	0.150
Total Standard Mail	1.098	1.041	0.908
Periodicals			
Nonprofit	0.013	0.011	0.013
Classroom	0.001	0.001	0.001
Total Periodicals	0.014	0.012	0.014
Library Rate	0.001	(0.001)	(0.000)
Free-for-the-Blind Mail	0.054	0.052	0.061
Total	1.167	1.104	0.982

monopoly (stemming from the Private Express Statutes) and the mailbox monopoly. In other words, if the Postal Service's combined monopoly (letter monopoly and mailbox monopoly) and, separately, the mailbox monopoly are eliminated, the value of the monopoly estimates how much the Postal Service would lose. The updated "base case" monopoly values reported below are lower than last year's values due to the reduction in volume this year and higher fixed network costs. Due to both factors, the Commission concludes that potential competitors would find entry into previously monopolized areas less profitable and thus less attractive. As a result, the Commission's estimates reflect a lower profit lost by the Postal Service because of a lower incidence of entry by competitors when eliminating either monopoly. The Commission estimates entry on 32 percent of total routes under the base case combined monopoly. This figure is considerably lower than the 41 percent value estimated for



Table 6 – Value of the Monopoly (Billions)

	FY 2009	FY 2008	FY 2007
Mailbox Monopoly	0.79	1.07	1.33
Combined Monopoly	2.11	2.96	3.48

FY 2008. Similarly, for the mail box monopoly, the percentage of profitable routes decreases from 45 percent to 33 percent.

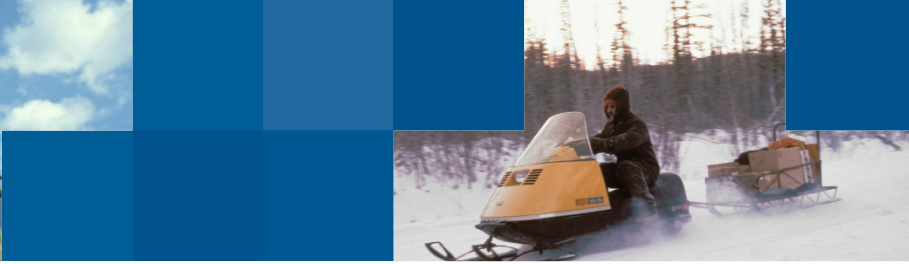
The base case assumptions applying to competitors in the present analysis include: (1) full diversion of local contestable mail when discounting existing Postal Service rates by at least ten percent; (2) competitors incur only delivery costs, and deliver three times a week under the combined monopoly, and once a week under the mail box monopoly; and (3) competitors are ten percent more cost efficient than the Postal Service. Besides differences in delivery frequency, mail subject to diversion under the mail box monopoly is much more restricted in scope compared to the combined monopoly, as explained in detail in the Commission's USO report.

The method employed to estimate both monopoly values is also the same as in last year's approach. The Commission's model estimates competitor profits for all routes based on contestable volumes, discounted rates and adjusted delivery costs. Entry occurs only on routes with positive profits. The monopoly value is estimated as the sum of lost contributions on routes from volume diversion to competitors.

The Commission's estimates should be viewed as "upper bounds" for several reasons. As described in the USO report, it is entirely possible that entry would only occur on profitable co-located routes that are. Because the Commission's model evaluates entry for each route regardless of the extent of route clustering, monopoly values are likely overstated. Second, the

Commission's model ignores any carrier route sorting required by potential entrants for five-digit sorted letter mail entering the system at the plant or delivery unit level. Inclusion of these costs would also lower the extent of entry to some degree.

On the price side, the model does not address the added pricing flexibility that the Postal Service would be granted if either monopoly is lifted. Presumably, either lifting the mail box monopoly or eliminating the Private Express Statutes or both means that affected mail could no longer be classified as market dominant. Further, exclusion of such mail from the price cap also means that the Postal Service could freely price the newly competitive products without affecting rates for the remaining market dominant products, if any. Under such circumstances, the Postal Service could be expected to respond to competitive entry by lowering its own rates and/or delivery frequencies where and when these changes would still be expected to generate positive contributions. Although such contributions from contestable products would likely be lower than under existing market dominant values, they would likely be higher than if volumes would be fully diverted to competitors because of inflexible rates or delivery frequencies. The Commission will be researching these and other issues related to estimating monopoly values under more realistic conditions.





CHAPTER IV

OTHER LEGAL PROCEEDINGS

STATION AND BRANCH OPTIMIZATION AND CONSOLIDATION INITIATIVE, DOCKET NO. N2009-1

On July 2, 2009, the Postal Service filed a request with the Commission asking for a determination whether a plan to optimize the Postal Service's retail network by consolidating the operations of some retail stations and branches into nearby facilities constitutes a change in the nature of Postal Services, within the meaning of 39 U.S.C. Section 3661(b). The Postal Service described the plan as the Postal Service Station and Branch Optimization and Consolidation Initiative.

The Initiative focused on stations and branches that report to USPS Executive and Administrative Schedule level 24 (EAS-24) and above Postmasters. These facilities represent approximately two-thirds of the over 4,800 Postal Service classified stations and branches nationwide.

The Commission held field hearings on September 16, 2009, at the Independence Civic Center in Independence Ohio and at Fordham University, Bronx, N.Y. on September 23, 2009. In addition, a hearing to enter the Postal Service's direct case and provide an opportunity for participants to orally cross-examine Postal Service witnesses was held on September 30, 2009. A hearing to enter participants rebuttal cases and provide an opportunity for participants to orally cross-examine rebuttal witnesses was held on November 18, 2009. The Commission's Advisory Opinion was subsequently issued on March 10, 2010.



In its Advisory Opinion the Commission found that it was consistent with applicable public policy for the Postal Service to adjust its retail footprint to recognize changing customer needs and usage. However, the Commission also found that a number of changes should be made to the current Postal Service process to ensure that adequate and efficient service is maintained.

First, the Commission found that the Postal Service should improve opportunities for customers to offer input. Second, the Commission found that the financial analysis used to determine the cost savings from closing a facility should be improved. Finally, the Commission found that the Postal Service should provide the local managers responsible for development of proposals to close facilities with written guidance on obtaining relevant information and applying qualitative decision factors.

In conclusion, the Commission indicated that if the improvements identified by the Commission were adopted by the Postal Service, the planned subsequent nationwide applications of this process would be consistent with public policy. As of the issuance of the advisory opinion, it appeared that the initial application of the station and branch discontinuance process would affect a smaller number of facilities than originally proposed. A more recent Postal Service filing indicated that only 162 stations and branches were currently under review. However, the Postal Service has indicated that this review process would continue to be applied in the future to numerous retail facilities.

SIX-DAY TO FIVE-DAY STREET DELIVERY AND RELATED SERVICE CHANGES, DOCKET NO. N2010-1

The Postal Service, on March 30, 2010, filed a request with the Commission for an Advisory Opinion under the provisions of 39 U.S.C. 3661 for the elimination of Saturday delivery. The Postal Service is proposing to eliminate Saturday delivery nationally, except for delivery of Express Mail and delivery to those Post Office Boxes currently receiving Saturday delivery. The Postal Service is also proposing to eliminate Saturday initial processing of all mail except Express Mail and qualifying destination entry bulk mail. The collection of mail from street collection boxes would also be eliminated on Saturday, except to collect overflow on an as-needed basis.

The Postal Service estimated the annualized cost savings expressed in 2009 dollars at \$3.103 billion per year. The Postal Service noted that the estimate could be affected by future increases in hourly labor costs, input unit costs, number of delivery points, and reduced mail volumes. The Postal Service states that extensive market research has revealed that the elimination of Saturday delivery would have little impact on its consumer and commercial customers. It estimated the potential volume loss at 0.7 percent, which results in an annual revenue loss of \$428 million.

Customer outreach by the Postal Service in the early stages of the proposal's development led to modifications. It was determined that Saturday retail service and post office box delivery for Post Offices currently open on Saturdays would be retained. Remittance mail would still be processed and transported over the weekend so that it would continue to be available for pickup seven days a week. In addition, if needed,



parcel deliveries would be added on several Saturdays before Christmas.

The Commission heard from various witnesses on both sides of the issue. Concerns were expressed about the Postal Service's proposal such as possible adverse effects on rural America, vote-by-mail programs, and pharmaceuticals-by-mail programs. Further, concerns were expressed about a possible reduction in the benefits that may exist from the presence of carriers on the streets under the Postal Service's current six-day delivery schedule.

Other customers have indicated that they could adapt to five-day delivery to street addresses, particularly if the plan would result in strengthening of the Postal Service's financial situation or reducing the need for future rate increases.

Section 3661(c) of Title 39 requires that the Commission afford an opportunity for a formal on-the-record hearing of the Postal Service's Request under the terms specified in sections 556 and 557 of Title 5 of the U. S. Code before issuing its advisory opinion. Pursuant to the requirement of section 3661(c) of Title 39, Public Representatives were appointed to represent the interests of the general public.

The Postal Service presented the direct testimony of 11 witnesses supporting its request. Hearings on the Postal Service's direct case were held from July 14 to July 22, 2010 in Washington, D.C. On August 2, 2010, rebuttal testimony was filed by three parties. The Commission held hearings on the rebuttal witnesses on September 13-16, 2010. On September 23, 2010, the Postal Service submitted surrebutal testimony of four witnesses. The Commission heard cross-examination of two rebuttal witnesses.

Senator Daniel K. Akaka (HI) and Senator Lisa Murkowski (AK) each asked that the Commission hold

field hearings in Hawaii and Alaska, respectively, to better understand the unique role postal services play in those states. Unfortunately, the Commission was unable to travel to those states to hold field hearings. Senator Murkowski appeared before the Commission to present testimony on the Postal Service's proposal. In addition, both Senator Murkowski and Senator Akaka submitted written statements to the Commission. Senator Murkowski testified that exceptional conditions exist in Alaska in terms of the sheer distances of travel, and the challenges of terrain, transportation, and weather. She reminded the Commission that 82 percent of the communities in Alaska are not connected by roads. There are no mail trucks and small planes are used for the most part. Senator Murkowski was concerned that mail delivery, which is already slower in the state, would take even longer if Saturday processing and delivery were to be discontinued.

Senator Akaka informed the Commission that the state of Hawaii faced similar challenges to mail delivery, citing a combination of logistical, physical and financial barriers. In addition, he noted that Hawaii's elections could be impacted due to the state's use of vote-by-mail.

In addition to the hearings held in Washington, D.C., the Commission held seven field hearings:

- Las Vegas, Nevada, May 10, 2010
- Sacramento, California, May 12, 2010
- Dallas, Texas, May 17, 2010
- Memphis, Tennessee, May 19, 2010
- Chicago, Illinois, June 21, 2010
- Rapid City, South Dakota, June 23, 2010
- Buffalo, New York, June 28, 2010

The Commission is evaluating the proposal.



REVIEW OF NON-POSTAL SERVICES DOCKET NOS. MC2008-1 PHASE I AND PHASE II

MAIL CLASSIFICATION SCHEDULE UPDATES

The Mail Classification Schedule (MCS), codified at 39 CFR Appendix A to Subpart A of Part 3020, includes the Market Dominant Product List and the Competitive Product List. The products appearing on these lists are products that the Postal Service currently is authorized to offer. In FY 2011, a formal rulemaking will be initiated to augment the Mail Classification Schedule to include descriptions of all products. The Commission and the Postal Service have cooperated on development of draft language for the product descriptions and have used this draft language to communicate various classification changes that have been reviewed by the Commission over the past two years.

APPEALS OF POST OFFICE CLOSINGS

Under 39 U.S.C. 404(d) the Commission's authority to review Postal Service decisions to close or consolidate post offices is limited to a review of the procedures used by the Postal Service to reach its decision; the adequacy of the record supporting the decision; and determination of whether the decision was arbitrary, capricious, or otherwise contrary to law. If the Commission found that a Postal Service determination to close or consolidate post offices was legally flawed in some manner, the proceeding could be remanded to the Postal Service for reconsideration. The Commission may not modify a determination of the Postal Service.

A2010-1 Cranberry, Pennsylvania 16319

On October 6, 2009, a petition was filed with the Commission seeking review of the Postal Service's actions regarding the Cranberry post office. Petitioners

argued that the Postal Service failed to follow the closing procedures set forth in 39 U.S.C. 404(d). The Postal Service maintained that the Cranberry post office was not closed but instead suspended. The Commission found that the Postal Service had failed to follow its suspension procedures. It directed the Postal Service to provide regular updates describing its progress in producing a plan of action regarding the Cranberry post office. In the update filed October 25, 2010, the Postal Service indicated that the proposal to close the Cranberry post office has been posted.

A2010-2 Steamboat Springs, Colorado 80487

On December 29, 2009, a petition was filed with the Commission seeking review of the Postal Service's closure of the Sundance post office located in Steamboat Springs, Colorado. The Petitioner argued that the Postal Service had failed to follow the closing procedures established in 39 U.S.C. 404(d). The Postal Service maintained that formal closing procedures need not be followed because Sundance was a station and not a post office, and the final decision to close the station had not been made. The Commission dismissed the appeal finding that the Postal Service's actions constituted a rearranging of retail facilities within the community and not a closing as envisioned under 39 U.S.C. 404(d).

A2010-3 Elko, Nevada 89803

On February 22, 2010, a petition was filed with the Commission seeking review of the Postal Service's decision to close the East Elko station. Petitioner complained that the Postal Service had not followed the closing procedures mandated in 39 U.S.C. 404(d). The Postal Service argued that since the facility was a station and not a post office the Commission lacked jurisdiction to hear the appeal. The Commission



dismissed the appeal finding that the procedures of 39 U.S.C. 404(d) were not applicable given the close proximity of the Elko Main Post Office and the fact that the same services were available at that office.

A2010-4 Crescent Lake, Oregon 97733

The petition for review in Docket No. A2010-4 was filed on March 12, 2010. Members of the Crescent Lake community argued that the notice informing citizens of the closing was inadequate and failure to maintain the zip code after closing resulted in misdirected mail. The Postal Service moved to dismiss the appeal, arguing that it was filed late. The Commission dismissed the appeal as untimely since it was not filed within 30 days of the posting of the final determination to close the post office. The Commission suggested that to avoid potential confusion for patrons of offices subject to discontinuance in the future, the Postal Service should consider providing direct notice to affected persons via the mail.

A2010-5 Rentiesville, Oklahoma 74459

The petition for review in this proceeding was filed on August 25, 2010. Petitioner argues that the Postal Service failed to consider what effect closing the Rentiesville post office would have on the community. The Postal Service contends that it has complied with applicable law and filed a copy of its final determination to close the Rentiesville post office on December 21, 2010. The matter was remanded to the Postal Service for further consideration.

A2010-6 Renfro Valley, Kentucky 40473

The petition for review was filed on August 25, 2010. Petitioner argues that the Postal Service has failed to consider the effect closing the Renfro Valley post office will have on the community. The Postal Service asserts that it has adequately addressed the issues raised in Petitioner's appeal. Further, the Postal Service indicates that it has consolidated the Renfro Valley post office and established a community post office 2.6 miles away in Mt. Vernon, Kentucky. On December 16, 2010, the Commission issued Order No. 609 affirming the Postal Service's determination to consolidate the Renfro Valley Post Office and establish a community post office.





CHAPTER V

INTERNATIONAL ACTIVITIES

Throughout FY 2010, the Postal Regulatory Commission continued its active international engagement, including review of the Postal Service's growing international initiatives. The Postal Service increased its filings of international Negotiated Service Agreements (NSAs) by nearly 400 percent from 30 in FY 2009 to 114 in FY 2010. This represented almost 90 percent of all NSAs filed with the Commission. All but three of these were for competitive products and services.

The Commission also continued its participation in the work of the Universal Postal Union (UPU), particularly with respect to inter-administration delivery payments, quality of service, reform of the Union, universal service, and strategic planning. The UPU is an international treaty organization and specialized agency of the United Nations whose mission is to promote an affordable, quality universal service in all 191 member countries. Through the UPU, members negotiate, *inter alia*, rates for the delivery of international mail, technical standards, product development, and security procedures. Commissioners and senior staff served as members of the U.S. delegation to major UPU meetings, including the Postal Operations Council, Council of Administration and Strategy Conference.

The Commission has a statutory obligation under 39 U.S.C. 407 to provide its views to the Department of State on any amendments to a rate or classification in an international treaty. The Commission has therefore become increasingly engaged in the UPU's work on inter-administration payments for letter mail delivery, or terminal dues, particularly in light of the Postal Service's loss of nearly \$100 million on inbound international mail, including registered service, in FY 2009. The Commission worked cooperatively with the Department of State, Postal Service and other UPU members to develop alternative payment methodologies that would improve the Postal Service's cost coverage for inbound international mail while preserving the affordability of international mail for U.S. citizens.



In FY 2010, the Commission also built on earlier initiatives to promote the sharing of information and best practices with other postal regulators. In FY 2009, then-Chairman Blair launched the Postal Regulatory Dialogue as a proactive initiative to bring together postal regulators from diverse geographical regions to share technical information and best practices in postal regulation. As a result of the overwhelming positive response of other regulators to this effort, China hosted a second Postal Regulatory Dialogue in May 2010, in which the Commission participated, that focused on various aspects of universal service. The European Commission will organize the third Postal Regulatory Dialogue in June 2011.

During two UPU Forums on Postal Regulation held during FY 2010, Chairman Goldway presented overviews of postal reform in the United States, the role of the Commission, and challenges to the U.S. postal system. Participants represented not only postal regulators, but also postal operators, governments, and the private sector. In addition, recognized by the European Commission for its commitment to the international promotion of postal regulatory best

practices, the Commission was the only non-European postal regulator invited to speak at the 2nd European High-Level Conference on Postal Services in Valencia, Spain to an audience that included European Commissioners, ministers and heads of postal operators and regulatory entities.

The Commission also hosted visits by international postal regulators who wanted to learn more about the Commission's activities and interaction with key postal stakeholders. The Commission held technical meetings with the Executive Director of the National Postal Agency of Ecuador, which regulates the postal market, as well as two Commissioners from ARCEP, the French Telecommunications and Regulatory Authority. As part of these visits, the Commission organized meetings with senior officials in Congress, the Postal Service, and the private sector to provide these visitors with broad exposure to the U.S. postal market. These international officials also attended public hearings held by the Commission on major filings and experienced first-hand the transparency of the review process.



PRC Commissioners meet with visiting French postal commissioners.



Chairman Goldway addressing the symposium in Nanjing, China.

The Commission is committed to working closely not only with the Department of State and Postal Service, but also with other government agencies that are involved in the postal or express delivery industry, such as the Department of Commerce and Office of the U.S. Trade Representative. In October 2009, Chairman Goldway led the U.S. delegation to the third U.S.-China Symposium on Postal Reform and Express Delivery, organized by the Department of Commerce in conjunction with State Post Bureau, the regulator of the Chinese postal market. Through this initiative, Chairman Goldway promoted a level playing field for the Postal Service and express delivery providers in the Chinese market.

Lastly, the Commission renewed its commitment to participate in the Department of State's Federal Advisory Committee on International Postal and Delivery Services. This Committee, created under 39 U.S.C. 407, serves in an advisory capacity to the Department of State on international postal issues and is primarily comprised of stakeholders from the private sector.





CHAPTER VI

PUBLIC AFFAIRS AND OUTREACH EFFORTS

OVERVIEW

The Office of Public Affairs and Government Relations (PAGR) serves as the public face of the Commission. The Office is the Commission's primary resource in support of public outreach and education, media relations, and liaison with Congress, the Postal Service and other government agencies. The PAGR Director advises Commissioners and Commission staff on legislative issues and policies related to the Commission and the Postal Service in addition to coordinating the preparation of both Congressional testimony and Congressional inquiries concerning Commission policies and activities.

CONGRESSIONAL TESTIMONY

Chairman Goldway and the Director of the Office of Accountability and Compliance (OAC) appeared before Congressional Committees to report on the program plans and actions of the Commission and respond to questions from Members. Chairman Goldway testified before the Senate Appropriations Subcommittee on Financial Services and General Government in March of 2010. The Chairman also testified before a joint hearing of the House Committee on Oversight and Government Reform and the House Subcommittee on the Federal Workforce, Postal Service and the District of Columbia in April of 2010. Also in April, the Chairman testified before the Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security. In May of 2010, the Director of OAC testified before the House Subcommittee. Congressional testimony by Commissioners and staff is available online at the Commission website.

3/18/2010—Testimony of Chairman Ruth Goldway before the Senate Appropriations Subcommittee on Financial Services and General Government. The purpose of the hearing was to discuss the Postal Service plan to eliminate Saturday mail delivery. Goldway explained the Commission role in the process of reviewing the



impending Postal Service proposal for a reduction in delivery frequency.

4/15/2010—Testimony of Chairman Ruth Goldway before a joint hearing of the House Committee on Oversight and Government Reform and the Federal Workforce, Postal Service and the District of Columbia Subcommittee entitled, “Continuing to Deliver: An Examination of the Postal Service’s Current Financial Crisis and its Future Viability.” Goldway described her views regarding any potential reductions in service to the public. In considering the future of the Postal Service, Goldway noted that the Commission must consider what the Constitution and law require, what is best for the Nation, and the maintenance and improvement of the universal service obligation. Chairman Goldway also encouraged Postal Service development of a detailed, innovative new retail strategy. Also discussed was the Commission’s support for a readjustment of the Postal Service’s scheduled payments for future retiree health benefits; upcoming Commission work on an Advisory Opinion related to 5-day mail delivery; and a Commission review of the Office of Personnel Management’s calculation of the CSRS pension liability.

4/22/2010—Testimony of Chairman Ruth Goldway before a hearing of the Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security entitled, “The Future of the Postal Service.” Chairman Goldway described work the Commission is engaged in to address the vulnerability of the Postal Service, fulfill its legislative mandate for a modern, transparent system for regulating rates and assure high quality service performance. Goldway detailed both the review process the Commission planned to undertake for N2010-1 and Commission involvement in the recalculation of the CSRS pension liability.

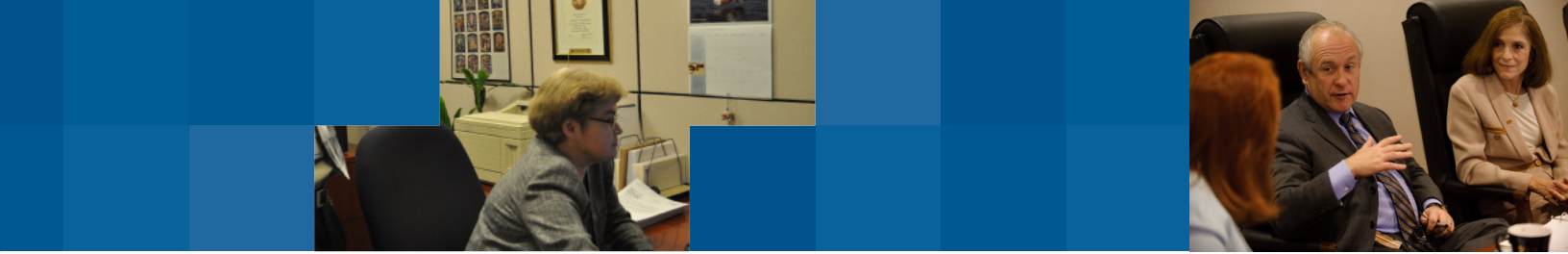
5/12/2010—Testimony of Office of Accountability and Compliance Director John Waller before a hearing of the House Subcommittee, entitled “The Price is Right, or is it? An Examination of USPS Workshare Discounts and Products that do Not Cover Their Costs.” Waller noted that properly designed workshare discounts act to control costs and create competition within mail processing. He described the Commission’s use of Efficient Component Pricing, to develop prices for the individual components of a service with the goal of promoting the efficient use of each component. Also detailed was the Commission’s statutory role when a discount exceeds avoided costs. Waller also identified cost coverage problems associated with three products: Periodicals, Standard Mail Flats and Standard Mail Non-Flat Machinables.

OUTREACH ACTIVITY

In its normal course of activities, the Commission routinely hears from members of the public involved in or representing the mailing industry as well as members of Congress. The Commission performed a number of public outreach activities to engage citizens and other stakeholders as a key part of its statutory responsibilities.

The Commission affords public comment on rulemakings, complaints, mail classification cases, public inquiries, rate cases and other matters. There is an opportunity for both formal and informal comment and both initial and reply comments. Commenters are encouraged to use the electronic filing system to file their comments online. Comments filed electronically are published on our website under the appropriate docket number.

In conjunction with the Commission’s review of the Postal Service’s proposal to eliminate Saturday mail delivery to street addresses, Docket N2010-1, field



hearings were held in Las Vegas, Nevada; Sacramento, California; Dallas, Texas; Memphis, Tennessee; Chicago, Illinois; Rapid City, South Dakota; and Buffalo, New York. These hearings promoted greater public input into the Commission’s Advisory Opinion. In each city, witnesses from the mailing community, the general public, labor unions and professional organizations, and the Postal Service testified. Attendees were afforded the opportunity to make comments or raise questions at the close of each hearing.

The Commission also maintains a public commenter file containing letters, emails and faxes for each docket. The file is available for public viewing.

CONSUMER RELATIONS

The Consumer Relations Specialist responds to public comments and customer inquiries, handles complaints which do not rise to the level of formal complaints, and serves as liaison with the Office of Consumer Advocate of the Postal Service for service issues. The Consumer Relations staff manages and tracks public inquiries, informal complaints of a rate or service nature, and correspondence utilizing a Public Inquiry Log database developed in-house. Inquiries are tracked based on source and nature of the inquiry.

Further in-depth breakdown of categories are used to determine issues of significance to consumers and the mailing industry. Other factors the Commission deems of interest to the public are also tracked. This process provides a tool for the Commission to perform general analyses related to quality of service and helps to identify concerns, trends, and potential systemic problems as part of the PAEA’s requirement to monitor service. The Public Inquiry Log is posted on the Commission’s website on a quarterly basis under the “What’s New” column. A new web page is currently

being developed to archive quarterly and yearly logs for interested consumers.

During 2010, the Commission received over 19,000 inquiries, suggestions and comments, which was nearly an 11-fold increase over the 1,800 received in 2009. Consumer queries were received largely through the Commission’s website link, “Contact PRC,” found on the top banner of the home page.

Table 7 – Method of Contact

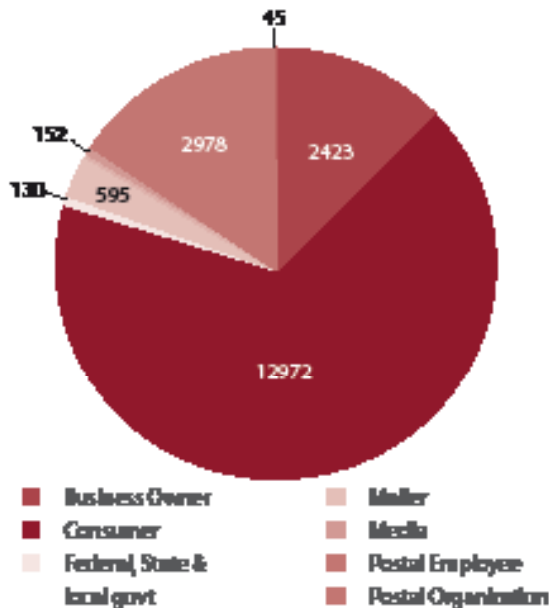
Contact PRC	12,978
Mail	4,912
Other email	216
FAX	488
Phone	701

As seen in Figure 2, 12,972 comments were from Consumers, 2,423 from Business Owners whose comments were solicited by the National Association of Letter Carriers, 595 from Mailers, and 2,978 identified as Postal Employees. The vast majority of comments were in regard to Docket N2010-1 on the Postal Service’s proposal for a change from 6-day to 5-day delivery. Time of response for the majority of the customer contacts averaged one day despite the tremendous increase in volume over the previous year.

The top consumer issue was public interest in Docket N2010-1. Over 20,000 public comments and suggestions were received. In addition to this outpouring of opinions, other top consumer issues included 837 queries and comments on rates and Docket R2010-4, the Postal Service’s request for an exigent rate increase; 367 mail delivery issues which included misdelivered, missing and delayed mail, and hold mail;



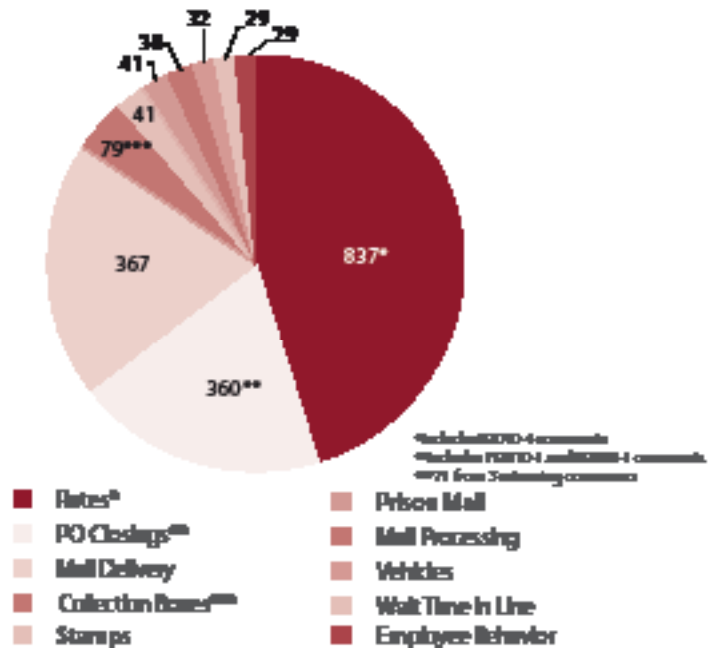
Figure 2—Inquiries by Source



360 emergency suspension and post office closing queries which included comments on Docket PI2010-1, public inquiry investigation on suspended post offices, and Docket N2009-1, nature of service inquiry on the Postal Service's Station and Branch Optimization and Consolidation Initiative; 79 collection box issues; 41 stamp suggestions and issues; 41 prison inmate queries; and 38 queries on mail processing consolidation issues. Figure 3 features a breakdown of these consumer concerns.

Commission Order No. 195 established that rate and service inquiries forwarded to the Postal Service's Office of the Consumer Advocate require a response by the Postal Service within 45 days. In 2010 the Commission forwarded 701 rate and service inquiries to the Postal Service. The Order also requires the Postal Service to file a monthly report summarizing the general nature of these inquiries. The reports are filed on the Commission's website under "What's New" and with Postal Service Periodic Reports.

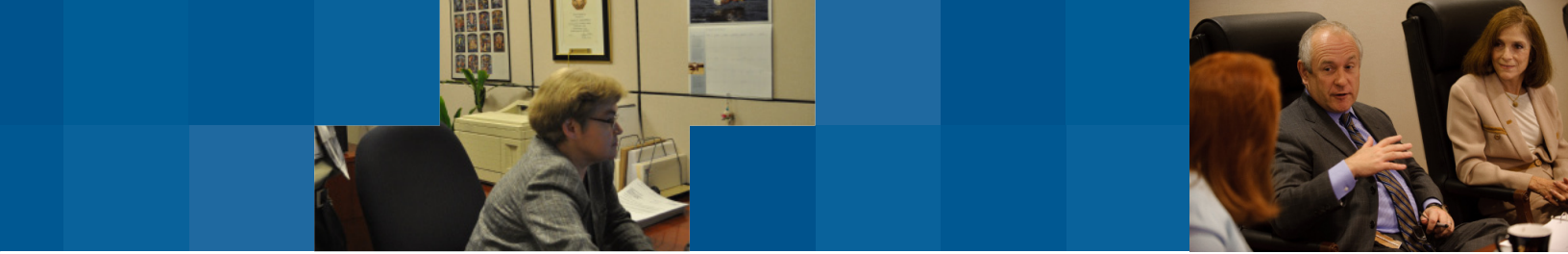
Figure 3—Top Consumer Issues
(not including over 20,000 comments on USPS proposal to change delivery service from 6 days to 5 days)



PUBLIC REPRESENTATIVE

Title 39 U.S.C. 505 requires that in all public proceedings by the Commission, the Commission shall designate an "officer of the Postal Regulatory Commission" to represent the interests of the general public. The Public Representative focuses on the interests of the general public as distinct from the interests of other groups, such as business mail users, and enterprises in the private sector.

The Public Representative is generally not bound by *ex parte* restrictions imposed on Commissioners and staff involved in decision-making, and may draw upon analytical and legal resources of the Commission as required. However, the Public Representative does not participate in any Commission deliberations regarding the matter in question. By Commission rules, the Public Representative may not – except for formal comments submitted for the record – discuss the matter under



consideration with Commissioners and their assistants. Anyone from outside the Commission may contact and consult with the Public Representative during the course of a case to discuss how the public interest may be affected. The name and contact information for a designated Public Representative for each active docket is noticed in the initiating order and posted on the Commission's website. There is also a link on the home page that contains a regularly updated listing of Public Representatives, the dockets in which they serve, and their contact information.

COMMISSION WEBSITE

The Commission added a new section to its website titled "Information for Postal Consumers." In one convenient location, consumers can now access Commission online resources; information on Commission and Postal Service performance; and simple, easy-to-use tools for complaints and questions. New links include: Current USPS Service Performance Results; PRC and USPS frequently asked questions; how to request PRC assistance with a postal service issue or problem, a Template for a Formal Complaint, and a Guide to Complaints and Rate or Service Inquiries. The Guide to Complaints was developed by the Office of the General Counsel to assist customers in determining whether their complaint could be handled through the informal rate or service inquiry process or was suited to a more formal complaint process. A web page was added to archive Monthly USPS Reports on Rate and Service Inquiries, and a new page has also been developed to archive quarterly and yearly PRC Public Inquiry Logs.

FREEDOM OF INFORMATION ACT (FOIA)

The Commission disseminates its official orders, opinions and Federal Register Notices through the Library and Dockets section of its website. Any public document, including its own, which is filed with the Commission, is available the same day on the website's Daily Listing link. Subscribers can receive email notification of new postings. We believe that broad access to Commission records and data has limited the number of FOIA requests that would have otherwise been made.

The Commission received 22 FOIA requests in FY 2010, many of which were redirected to the Postal Service in an average of five days. The Commission uses both written and electronic methods, depending on the initial contact, to respond to the public. The Commission recently certified its online FOIA Reading Room as meeting statutory requirements.





CHAPTER VII

OTHER COMMISSION ACTIVITIES

SEGAL REPORT ON POSTAL SERVICE FUNDING OF CIVIL SERVICE RETIREMENT SYSTEM

Pursuant to a report by the USPS Office of the Inspector General (USPS-OIG) dated January 20, 2010, the Postal Service requested that the Commission perform an independent review of the current allocations of the Civil Service Retirement System (CSRS) costs in accordance with PAEA Section 802(c) (not codified). The Commission, through an open bid process, engaged The Segal Company to perform an independent review.

Currently, the administrator of the CSRS, the Office of Personnel Management (OPM), allocates to the Postal Service all residual costs in excess of the “frozen” benefit calculated based on the accrued pension percentage and final rate of pay as of June 30, 1971, when the Postal Reorganization Act of 1970 (P.L. 91-375) established the Postal Service as an autonomous Federal entity and transferred to it the responsibilities of the Post Office Department (POD).

In its report, Segal recommended the continued usage of the pension plan’s accrual formula for the allocation of costs of the CSRS benefit payments for former POD employees. In lieu of the currently used final POD salary to determine the Federal Government’s share of the costs of benefit payments, Segal recommended using the final average high three-years of Postal Service salary to determine the Federal Government’s share. Segal finds the USPS-OIG and OPM’s methodologies within the range of acceptable options and notes that the current allocation, though fair and equitable solely within the context of P.L. 93-349, overstates USPS responsibility for CSRS payments to former POD employees by approximately \$50 to \$55 billion.



On June 30, 2010, the Commission submitted its independent actuarial report “Civil Service Retirement System Cost and Benefit Allocation Principles (Segal Report)” to Congress, OPM and the Postal Service. The Commission concurred that an adjustment of \$50-\$55 billion in favor of the Postal Service would be equitable and in conformance with current generally accepted actuarial principles and practices.

URBAN INSTITUTE STUDY ON THE SOCIAL VALUE OF THE MAIL

In October 2009, the Commission awarded a contract to The Urban Institute to identify the array of benefits provided by the Postal Service that contribute to the social value of the post in the United States. The study was intended to categorize these benefits and identify possible metrics and methods for estimating their value.

The Urban Institute conducted a literature search, interviewed a large number of knowledgeable individuals, and drew upon analytical experience in the fields of sociology and economics. The contractor submitted its final report on February 2, 2010.

The report identified and described dozens of benefits, clustered around the following eight broad categories:

- Consumer
- Business
- Safety and Security
- Environmental
- Delivery of Other Government Services
- Information Exchange
- Social Linkage
- Civic Pride and Patriotism

The study also described additional research methodologies that could quantify the social and economic value of the described social benefits.

On May 7, 2010, the Commission issued a Request for Proposal to quantify some or all of the social benefits identified in the study, and received 13 proposals by the deadline. Three of these proposals were selected for further research work, beginning in August 2010 and continuing into FY 2011. The contractors are SJ Consulting, Joy Leong Consulting, and The Urban Institute.

PERIODICALS COST STUDY

Section 708 of the PAEA directs the Postal Service and the Commission to jointly study the quality of the data used to determine the attributable costs of Periodicals mail and opportunities for improving the efficiency of this mail class. The PAEA does not establish a deadline for issuance of this report. To date, the Commission and the Postal Service have:

- Developed an outline of the final report
- Analyzed data related specifically to publications
- Analyzed overall cost data
- Conducted meetings with mailers
- Conducted a webinar on cost issues related to Periodicals mail
- Visited Postal Service facilities to view how Periodicals mail is processed
- Produced a first draft
- Discussed recommendations

The Commission anticipates publication of the final report to Congress in FY 2011.



CONSULTATION WITH THE POSTAL SERVICE

39 U.S.C. 3652(a)(2)(B) requires the Postal Service, in consultation with the Commission, to establish modern service standards for market dominant products. Through a series of monthly consultations, the Commission has monitored Postal Service progress toward compliance with PAEA provisions, in particular those related to service performance measurements. The Commission has continued these monthly consultations to monitor Postal Service progress in implementing systems for measuring Postal Service performance in meeting the agreed upon service standards.





CHAPTER VIII

ADMINISTRATION

EMPLOYEE WELFARE

The Postal Regulatory Commission continues to provide a safe work environment for its employees. The Commission ended FY 2010 accident free with no on-the-job injuries or lost workdays. In 2010 the Commission formed a Health and Wellness Committee to focus on safety and welfare initiatives and education, including a monthly program of safety, health and welfare outreach and activities. The Commission also offered an enhanced Flexible Work Program to include Alternative Work Schedules and Telework.

The biennial Federal Employee Viewpoint Survey (FEVS) administered or distributed by the Office of Personnel Management is a tool that measures employees' perceptions of whether, and to what extent, conditions that characterize successful organizations are present in their agencies. In the 2010 FEVS survey, the Commission had a 75 percent response rate, compared to the overall government response rate of 52 percent. In addition:

- 97 percent of Commission employees agreed they are willing to put in the extra effort to get a job done.
- 92 percent of employees rate the overall quality of work done by their Commission workgroup as very good/good.
- 83 percent of employees believe that the Commission is successful in accomplishing its mission.
- 75 percent of Commission employees would recommend the PRC as a good place to work.



The complete Postal Regulatory Commission Federal Employee Viewpoint Survey can be found on our website at: <http://www.prc.gov/prc-pages/about/hr/humancapitalsurvey.aspx>

EQUAL EMPLOYMENT OPPORTUNITY (EEO)

During FY 2010, the Commission had no EEO complaint filings and provided EEO training for all of its employees.

INFORMATION TECHNOLOGY

Improvements to the Commission's Information Technology in 2010 include: an enhanced dockets platform; conversion of Commission documents from a legacy Laserfiche document access software system to a modern searchable file format for incorporation into our online archives; expanded telecommunications, teleconferencing and telework capabilities; and a more robust Continuity of Operations Plan. An electronic procurement system was successfully implemented along with the first phase of automating employee personnel records.

DIVERSITY

In FY 2010, the Commission continued its commitment to recruit, develop and retain a skilled, high-achieving, and diverse workforce. The Commission ended the year with 57 percent of its female employees in executive or professional level positions. Women and minorities now represent 50 percent of the executive and professional workforce and 58 percent of the overall workforce. The Commission also provided expanded internship opportunities to aid in the recruitment and development of minority employees.

TRANSPARENCY AND OPEN GOVERNMENT

As part of its mission of ensuring transparency, accountability and openness, the Commission this fiscal year began holding monthly public meetings under the provisions of the Government in the Sunshine Act and provided live audio-casts of hearings, technical conferences and public meetings which were posted to the www.prc.gov website.

NEW AWS AND TELEWORK POLICIES

In 2010, the Commission expanded Telework and Alternative Work Schedule programs. The Telework Program provides employees an alternative worksite setup that allows: more flexibility in meeting personal and professional responsibilities; freedom from office distractions; and the ability to work productively during an emergency. Improvements in technology, such as allowing staff to connect directly to their work desktops from their home offices, make telework efficient and effective. The Commission Alternative Work Schedule (AWS) Program allows employees to complete their 80-hour biweekly work requirement in less than 10 workdays through a compressed schedule.

Both of these programs enhance employee work life, make the Commission more competitive as an employer, and increase employee retention. Telework and AWS also support high-priority initiatives of Congress, under OMB Directive and the Executive branch such as reducing environmental impact; energy conservation; and emergency preparedness. During the historic snow storms of February 2010, the Commission was able to continue its work through the efforts of the many staff people who worked from their home offices. More than 50 percent of Commission employees participated in these programs in 2010.



