

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Dan G. Blair, Chairman;
Nanci E. Langley, Vice Chairman;
Mark Acton;
Ruth Y. Goldway; and
Tony L. Hammond

Modification of Costing Methods 2008—
Postal Service Proposals Ten and Eleven

Docket No. RM2008-6

ORDER CONCERNING COSTING
METHODS USED IN PERIODIC REPORTING
(PROPOSALS TEN AND ELEVEN)

(Issued October 22, 2008)

I. INTRODUCTION

On September 12, 2008, the Postal Service filed a petition to initiate an informal rulemaking to consider two changes to the cost methods used in its periodic reports to the Commission.¹ PRC Order No. 115 issued October 10, 2008, recently ruled on nine such proposals in Docket No. RM2008-2.

¹ Petition of the United States Postal Service Requesting Initiation of a Proceeding to Consider Further Proposed Methodology Changes for the FY 2008 ACR (Proposals Ten — Eleven), September 12, 2008 (Petition).

Proposal Ten would develop costs for single piece Parcel Post, Parcel Select, and Parcel Return Service (PRS) separately using In-Office Cost System (IOCS), Carrier Cost System (CCS), and Transportation Cost System (TRACS) data. Proposal Eleven would distribute the attributable costs of collecting mail from “blue collection boxes” to products based on current data collected from the City Carrier Cost System (CCCS), rather than on data from a special study submitted in Docket No. R84-1. Petition at 5.

II. PROPOSAL TEN

In Docket No. ACR2007, the Postal Service was only able to disaggregate the costs of the former Parcel Post subclass based on the cost differences associated with worksharing. In its FY 2007 Annual Compliance Determination the Commission separated these costs which led it to conclude that the revenues generated by PRS were not covering its costs.

The Commission noted that its conclusion that costs were greater than revenues may have been, in part, due to the FY 2007 method’s distribution of carrier costs equally among the products of the former Parcel Post subclass. The FY 2007 method was a “top down” analysis of costs which did not comprehensively account for cost differences among the various parcel products. One difference that it did not consider was carrier costs. PRS should incur few, if any, carrier costs. See 2007 Annual Compliance Determination at 24.

The Commission's analysis in the FY 2007 Annual Compliance Determination prompted the Postal Service to collect separate cost data for single piece Parcel Post, Parcel Select, and PRS. The Postal Service proposes using IOCS, CCCS, and TRACS data to develop mail processing, transportation, and delivery costs for these products.² The Postal Service asserts that it will be able to use these data to develop separate "bottom up" costs for these three parcel products and display each as a separate row in the CRA.

A. Commission Information Request

On September 19, 2008, Commission Information Request No. 1 was filed to assist the Commission in evaluating Proposal Ten. The first question sought to clarify how the Postal Service is now able to distinguish among the three products. In response, the Postal Service filed Statistical Program (SP) letters, which outline all changes to its data systems that occurred from FY 2006-FY 2008. For example, the September 6, 2007 and December 7, 2007 letters discuss new procedures for recording characteristics of bulk parcel post for TRACS, IOCS and CCCS.³

The second question asked the Postal Service to explain how it plans to separate Parcel Select and Parcel Return Service TRACS data in the first quarter of FY 2008.

² For FY 2008, as an interim measure, the Postal Service also proposes using TRACS data to split Bulk Parcel Post transportation costs between Parcel Select and PRS, using the same methodology used by the Commission in Docket No. ACR2007.

³ The data collector is asked if the single piece Parcel Post piece has permit indicia. If it does not, the piece is recorded as single piece Parcel Post. However, if the piece does have permit indicia and the data collector records it as single piece, the piece should be photocopied as proof. SP Letter #3, FY2008: Attachment 3 at 1; Attachment 4 at 3; and Attachment 5 at 1. The letters also outline how a data collector should correctly record "bulk Parcel Post". Distinguishing features include "Parcel Select," "PRS," "Drop/Ship" markings or if there is a Mailer-applied destination ZIP parcel barcode. SP Letter #1, FY2008; Attachment 2; Attachment 5 at 1; Attachment 6 at 1; Attachment 7 at 1; and Attachment 8 at 7.

The Postal Service responded that the information needed to separate TRACS data for Parcel Select and PRS were not collected in the first quarter of FY 2008. For each cost pool, it therefore plans to calculate an average distribution factor for quarters two, three and four and impute it to quarter one for FY 2008.⁴

B. Comments

United Parcel Service (UPS) comments that Proposal Ten will lead to “reliable cost estimates at the product level,” which will ensure that the Postal Service is in compliance with the Postal Accountability and Enhancement Act (PAEA) requirement that “market-dominant products do not subsidize competitive products and that each competitive product covers its attributable costs.” UPS Comments at 2.

The Public Representative notes that Proposal Ten is a “substantial improvement over the approach used in the FY 2007 ACR.” Public Representative Comments at 2. He goes on to request the Postal Service to confirm that the two-step process for distributing transportation costs between Parcel Select and Parcel Return Service is only applicable for FY 2008. *Id.* at 4.

After agreeing with Proposal Ten, the Public Representative makes three points. The first is that the ability to distinguish between Parcel Select and PRS volumes in the CCCS data with regard to parcels found in collection boxes would provide only a “lower bound” on the PRS volumes that should be accounted for. He says the volumes of PRS collected by pre-arranged carrier pick-up service, and the volumes dropped at the DDU

⁴ Response of the United States Postal Service to Commission Information Request No. 1, September 24, 2008, at 3.

for collection by the permit holder also need to be reflected. Public Representative Comments at 3.

The Public Representative's second point appears to be that to obtain a comprehensive "bottom up" attributable cost for single piece Parcel Post, Parcel Select, and PRS, the Postal Service would need to be able to distinguish between them for purposes of distributing Vehicle Service Driver (VSD) costs. He notes that how this should be done depends on how the Commission decides the more general issue of what distribution key should be used to distribute VSD attributable costs to all products. See Order No. 115, October 10, 2008, at 36-39 (Proposal Seven).

The Public Representative's third point is that some Parcel Select volume induces PRS volumes. He argues that to get comprehensive attributable and incremental costs for Parcel Select, it is necessary to account for the PRS volumes and attributable costs that Parcel Select induces. He reasons that Parcel Select mailers that have PRS permits and use them indirectly induce PRS volume. Therefore, he argues, the costs and revenues of Parcel Select and PRS should be "bundled" (analyzed together) "for pricing purposes." To facilitate this, he argues, the Postal Service should separately track the portion of Parcel Select volume that is mailed by holders of PRS permits in order to separately estimate the costs of such mail. *Id.* at 5-7.

In its reply comments, the Postal Service addresses the points raised by the Public Representative concerning Proposal Ten. It confirms that in the future it will have TRACS data for all three products for all four quarters of the year. Postal Service Reply Comments at 2. With respect to distinguishing among the three parcel products in

estimating attributable VSD costs, the Postal Service says this will be done in a manner that is consistent with the distribution of these costs to other products, since no two-step interim procedure will be required after FY 2008. *Id.* at 2. Finally, the Postal Service takes issue with the Public Representative's conclusion that Parcel Select and PRS are mutually dependent, and therefore analysis of their costs and revenues should be "bundled." It notes that Parcel Select existed before PRS, and that PRS can be purchased in conjunction with a parcel that a third party, such as UPS, initially delivers. The Postal Service considers bundled analysis irrelevant to Proposal Ten, since Proposal Ten proposes to disaggregate attributable costs for the three parcel products, and no further. *Id.* at 2-3.

C. Commission Analysis

The availability of cost data taken directly from the Postal Service's main data collection systems disaggregated for each of the three parcel products is a significant advance. It will enable the Postal Service to develop attributable costs "from the ground up" which should produce a comprehensive estimate of the attributable cost of each of these products. This will give the postal community a means of verifying that each product is covering its attributable costs. The Commission accepts Proposal Ten.

III. PROPOSAL ELEVEN

Street delivery costs are found in Cost Segment 7. One component of those costs is the cost of collecting mail from blue collection boxes. These costs are incurred on both letter routes and special purpose routes. The volume variability of these costs

is estimated by special studies. In FY 2007, there were \$9.4 million in attributable blue collection box costs incurred on regular letter routes and \$46.7 million incurred on special purpose routes.

Currently, a special study is used to distribute these attributable costs to products. The study was first submitted in Docket No. R84-1. It sampled the share of blue collection box volume for the four broad classes of mail. Mail that did not fall into one of the broad classes was labeled "Other." "Other" mail that is eligible for deposit in blue collection boxes includes Priority, Express, U.S. Postal Service Mail, Free for the Blind, and International Mail. The current method is to apportion "Other" volume to these products in proportion to their shares of RPW volume.⁵

For FY 2008, Proposal Eleven would replace the current method of determining the product shares of volume in blue collection boxes with a proxy consisting of a direct measurement of those shares collected from blue collection boxes on letter routes in CCCS data. The relative product shares measured on letter routes would then be imputed to the 83 percent of attributable collection costs that is incurred on special purpose routes. Petition at 5. The FY 2008 CCCS data show that First-Class Mail now makes up more than 99 percent of volume in blue collection boxes retrieved by carriers on letter routes.⁶

⁵ See Notice of the United States Postal Service Regarding Materials Distributed or Requested at the August 27, 2008 Technical Conference, filed August 29, 2008, at 6-7.

⁶ *Id.* at 6. The Postal Service does not indicate how much of that is First-Class single piece Letters and Cards, First-Class single piece Flats, and First-Class single piece Parcels.

A. Comments

No comments were received on Proposal Eleven.

B. Commission Analysis

The Commission accepts Proposal Eleven for FY 2008. It represents a significant improvement over the current distribution key for attributable blue collection box costs, which is based on the 25-year-old special study. Proposal Eleven is a fresher and a more direct measure of the product shares actually in blue collection boxes served by letter routes. We expect the Postal Service to supplement this with representative data of volume shares of collection mail served by special purpose routes.

It is Ordered:

Proposals Ten and Eleven contained in the Petition of the United States Postal Service Requesting Initiation of a Proceeding to Consider Further Proposed Methodology Changes for the FY 2008 ACR (Proposals Ten — Eleven), filed September 12, 2008, are accepted.

By the Commission

Judith M. Grady
Acting Secretary