

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Annual Compliance Report, 2011

Docket No. ACR2011

INITIAL COMMENTS OF TIME INC.
ON USPS FY 2011 ANNUAL COMPLIANCE REPORT
(February 3, 2012)

Pursuant to Order No. 1095, Notice of United States Postal Service's Filing of Annual Compliance Report and Request for Public Comments [ACR] (issued January 3, 2012), Time Inc. hereby submits its initial comments on the Postal Service's FY 2011 ACR.

In its FY 2010 Annual Compliance Determination (ACD), the Commission concluded:

management has not yet fully brought to bear efficiency enhancements, network adjustments, and related changes which could alter the attributable cost picture for Periodicals. The Commission believes it is appropriate to allow time for these measures to be implemented and take hold.

FY 2010 ACD (issued March 29, 2011), at 17.

Just four months ago, the Commission's concluding "Findings" in the *Periodicals Mail Study: Joint Report of the United States Postal Service and Postal Regulatory Commission*, stated in part:

Significant opportunities exist to improve efficiency and reduce costs for Periodicals, most notably with respect to mail processing. The Postal Service has introduced a series of automation mail processing methods over the past 20 years. However, although 97.8 percent of Periodicals mailpieces receive discounts for automation eligibility, up to 40 percent of

Periodicals in the incoming secondary operation are manually processed.[Footnote omitted.] The most appropriate estimate of potential savings from increased operational efficiency would be calculated by comparing processing within Periodicals Outside County. However, the data necessary to estimate these costs are not available. . . .

A more accurate estimate of the savings that may be generated by the Postal Service's efforts to implement best processing practices will require data on the percent of Periodicals pieces processed on automated equipment versus pieces processed manually; the percent of Periodicals bundles processed on automated equipment versus manually; and the percent of Periodicals volume that fails to meet critical entry time but receives overnight service.

The Commission recommends that the Postal Service develop a comprehensive plan to reduce manual handling of automation-compatible Periodicals mail.

Periodicals Mail Study (issued September 2011), at 97-98.

In its FY 2011 ACR, at 33-34, the Postal Service appears to be in accord with the Commission about some of the steps it ought now to be taking to improve the situation of Periodicals class:

The Postal Service and the Commission, as well as Periodicals publishers and mailers, have recognized the special role and longstanding deteriorating financial situation of Periodicals. The Postal Service continues to pursue operational efficiencies as detailed in the *Periodicals Mail Study*,¹³ as well as opportunities to fine-tune prices that signal the appropriate level of cost-reducing behavior. In particular, the Postal Service is focusing pricing research on bundle and container "cost passthroughs" (price as a percent of cost), which have been low since the new Periodicals pricing structure was recommended by the Commission in Docket No. R2006-1. This inquiry has been encouraged by the Commission's findings in the FY 2010 ACD.

¹³ *Periodicals Mail Study: Joint Report of the United States Postal Service and Postal Regulatory Commission* (Sept. 2011), at Chapter 6.

Time Inc.'s comments in this case, as in previous annual compliance determinations, address the "efficiency enhancements, network adjustments, and related changes which could alter the attributable cost picture for Periodicals" that Postal Service management "has not yet fully brought to bear" (FY 2010 ACD, *quoted supra*). They address as well the inevitable difficulties with respect to service quality that such changes carry with them.

Time Inc. submits as its initial comments in this proceeding the comments of two individuals who are known to the Commission, as is their extensive familiarity with the issues they discuss.

The comments of James O'Brien, Time Inc.'s Vice President of Distribution & Postal Affairs, on FY 2011's Periodicals cost coverage and service performance are appended hereto as Attachment A.

The comments of Halstein Stralberg, Time Inc.'s longtime postal consultant, on the serious problems he has found in the Proposal Eighteen Periodicals flats model, which the Postal Service implements in the FY 2011 ACR, are appended as Attachment B.

Respectfully submitted,

s/

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ATTACHMENT A

**COMMENTS OF JAMES O'BRIEN ON FY 2011 PERIODICALS
COST COVERAGE AND SERVICE PERFORMANCE**

COMMENTS OF JAMES O'BRIEN ON FY 2011 PERIODICALS COST COVERAGE AND SERVICE PERFORMANCE

Purpose

The purpose of my comments is to address two issues, Periodicals cost coverage and Periodicals service performance. Periodicals cost coverage continued to decrease in FY 2011, in spite of significant efforts by the Postal Service and the periodicals industry to drive out costs. And Periodicals service performance in FY 2011 continued to fall significantly short of its 91% on-time delivery target.

I. 2011 Was a Bitter Disappointment for Periodicals Mailers as Outside County Cost Coverage Once Again Declined—to 74.49%

In FY 2010, cost coverage for Outside County Periodicals, as measured by the Postal Service, was 74.99%. That figure was a disappointment to the many Periodicals mailers who had worked very hard with the Postal Service to drive costs from the system and improve Periodicals Class cost coverage over the twelve years since 1999, when a Periodicals Operations Review Team comprised of members from the industry and the Postal Service had identified a number of initiatives with the potential for reducing Periodicals costs. The Periodicals mailing industry had taken significant strides in mail preparation during those years, including increasing carrier route bundles, applying the Intelligent Mail Barcode (IMB), producing labels upside-down to aid letter carriers, reducing sacks, increasing pallets, and expanding drop shipping to destination facilities. But the cost coverage figure for Periodicals had continued to fall. I shudder to think what the cost coverage would be today if the industry had not undertaken those initiatives.

Periodicals mailers hoped that cost coverage would finally improve in 2011 as the result of the elimination of “Hot 2-C Processing” as of July 1, 2011. Prior to this date, many USPS mail-processing facilities displayed signs which listed “Hot Publications.” Employees were instructed to take these titles to areas where they would receive manual bundle-processing and/or expedited handling. After July 1st, the signs were removed and employees were instructed to process all Periodicals on automated bundle-sorting equipment. Also, the Postal Service advanced the Critical Entry Time (CET) for Periodicals mail to ensure that it arrived

in time to be processed on the automated equipment, which required many publishers, including Time Inc., to make adjustments to their production, transportation, and, in some cases, editorial closing schedules. TIME Magazine had to advance its closing schedule by three hours to adjust for the earlier CETs, so that TIME's editors now have three fewer hours to cover late-breaking news. Such adjustments are not trivial, but publishers made them willingly in anticipation of cost coverage improvement. To say that we are disappointed with the failure of these changes to move the needle on cost coverage would be an understatement. We hope that in FY 2012, when the changes that were implemented last July will be in effect throughout the year and USPS will have had an additional year to eliminate the manual processing of Periodicals, we will see a positive effect on cost coverage.

Looking forward, Periodicals mailers are also hopeful about the prospect of further cost reductions resulting from the implementation of FSS and Network Consolidation. In FY 2011, the USPS completed its installation of 100 FSS machines and began increasing the number of zones processed on FSS. Unfortunately, growing pains are preventing these machines from realizing their full potential to reduce costs. At a recent meeting with USPS management, we were informed that FSS is now finalizing for delivery approximately 50% of the available volume in the FSS zones. This means that the other 50% of the available volume is being manually cased. While specific cost and mail-processing data are unavailable, it makes intuitive sense that having two systems processing mail for the same zones will add cost. Once again, Periodicals mailers are hopeful that the USPS will reduce mail-processing costs by increasing the FSS volumes in FY 2012 and eliminating the additional processing systems.

Network Consolidation, also in the early stages, did not realize significant savings in FY 2011. The USPS has stated that network consolidation could produce approximately \$3 billion in annual savings, and its current plans call for completion of network consolidation by the end of calendar year 2012. If the Postal Service is successful in meeting its schedule, network consolidation savings will begin to be realized in May to September of FY 2012 and continue to grow in FY 2013. Some of these savings should accrue to Periodicals Class mail and improve cost coverage over the next two years.

Cost coverage in 2011 was a bitter disappointment for Periodicals mailers, as Outside County cost coverage once again slightly declined—to 74.49%. However, Periodicals Class mailers are expecting to see improvements in cost coverage as the elimination of Hot 2C becomes standard practice, FSS is fully implemented, and the USPS network consolidation process is completed.

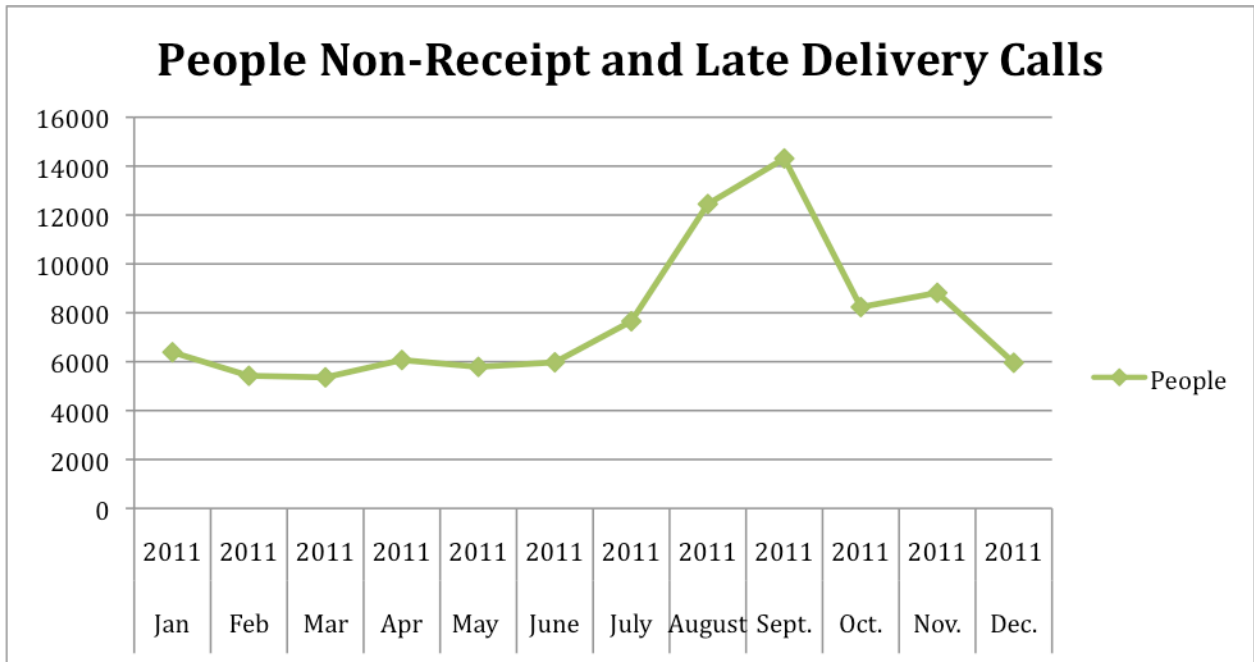
II. Service Performance

In FY 2011 the Postal Service fell significantly short of its Outside County service performance target of 91.0%, posting an on-time delivery score of 75.5%.¹ Although this may appear to be only a slight decline from its score of 76.7% in FY 2010,² beneath this statistic there is a disturbing trend of increasing non-receipt and late delivery complaints for Time Inc’s four weekly magazines. The reason that similar on-time delivery performance statistics may not reveal wide disparities in the frequency of such complaints is as follows.

Magazine readers come to expect to receive a weekly magazine on a certain day of the week. They are generally tolerant of some variation. For example, a PEOPLE magazine subscriber who normally receives the magazine on Friday will usually tolerate Saturday delivery and even an occasional Monday delivery. But when deliveries extend more than one or two days past the expected day, subscribers begin to complain, and, if it happens more than occasionally, to cancel their subscriptions. In 2011, Time Inc experienced a very sharp increase in delivery complaints between July and September, which is precisely the time when the new CETs were implemented and the FSS zones were expanded (see graph below).

¹ ACR 2011 USPS-LR-29 Annual Report on Service Performance for Market Dominant Products at 17.

² ACR 2010 USPS-LR-29 FY10_ACR_Periodicals.xls



Obviously, every automation program experiences startup problems, but if the problems continue, we will lose customers and the Postal Service will lose volume. Such volume losses will have a negative impact upon Periodicals cost coverage, but more importantly will affect the bottom line of the Postal Service as a periodical subscription cancellation also results in the loss of bills (First Class Mail), renewal notices (Standard Mail), and premiums (Parcel Mail). Neither Time Inc. nor the Postal Service can afford to lose these important revenue streams, especially in these difficult economic times.

While Time Inc is very concerned about the 2011 service levels, we are even more concerned about what lies ahead in 2012. As the Postal Service finalizes more volume on the FSS, will the result be further delivery delays? As the Postal Service consolidates over 250 facilities, will our subscribers experience shifts in delivery days and/or service failures? These questions remain unanswered. Time Inc. fervently hopes that the percentage of on-time delivery will improve in FY 2012.

III. Summary

In Library Reference 29, the Postal Service makes the following statement:³

Updated Periodical certification audits are ongoing to ensure compliance with standard operating procedures, adherence to critical entry times, proper identification of service commitments at Postal facilities and automation processing for Periodicals. Finally, Lean Six Sigma projects focusing on Periodicals have been initiated to identify “Best Methods” for upstream bundle operations, staging, signage, and sort program scheduling.

If the Postal Service is successful with these efforts, in addition to stabilizing and improving the FSS process, as well as successfully implementing network consolidation, Periodicals mail stands a fighting chance of seeing both cost coverage and service performance improve in 2012. We request that the Postal Regulatory Commission take these factors into consideration as it makes its Annual Compliance Determination.

Biographical Note

James O’Brien is the Vice President of Distribution & Postal Affairs for Time Incorporated, a division of Time Warner. He is the former Chairman of the Association for Postal Commerce (Postcom), and the former Chairman of the Magazine Publishers of America (MPA) Postal Committee, and currently serves on the board of directors of Postcom. He is a member of the Periodicals Operations Advisory Committee (POAC), MPA Postal Committee, and the MPA Government Affairs Committee. In 2004 he testified before the President’s Commission on the United States Postal Service. He was a member of the Periodicals Operations Review Team that focused on the cause of rapidly rising Periodicals Class costs in 1998, and as a result of his work on the Review Team, was a witness before the Postal Rate Commission in Docket No. R2000-1.

Mr. O’Brien holds a Bachelor of Science degree from the University of Illinois and is a graduate of the Program for Management Development at the Harvard Business School.

³ USPS-LR-29 Annual Report on Service Performance for Market Dominant Products at 21.

ATTACHMENT B

**COMMENTS OF HALSTEIN STRALBERG ON THE SERIOUS DEFICIENCIES OF
THE PROPOSAL EIGHTEEN/ACR2011 PERIODICALS FLATS MODEL**

COMMENTS OF HALSTEIN STRALBERG ON THE SERIOUS DEFICIENCIES OF THE PROPOSAL EIGHTEEN/ACR2011 PERIODICALS FLATS MODEL

My comments will focus on the FY2011 Periodicals flats model and the conclusions that may be drawn from that model. The Postal Service has filed three model versions that all attempt to represent the mail flows and costs related to FSS processing, which the model most recently approved by the Commission does not do. The first was filed as Proposal Eighteen in Docket No. RM2012-2. The two other versions are variants of the Proposal Eighteen model and were filed in ACR2011. One of these includes only the modification related to FSS, while the “alternate” model also incorporates some other Proposal Eighteen modifications on which the Commission has not yet ruled. See ACR2011 at 7.

My comments below address specifically the “alternate” model filed with the ACR, but could also be applied, with very minor numeric changes, to the other two versions. In order to illustrate my comments and proposed changes, I have prepared a revised version of the “alternate” model.¹ My comments identify errors that should be corrected before any conclusions are drawn based on the Proposal Eighteen model. They also raise questions that I hope the Postal Service will address. They are organized as follows:

1. An apparent formulaic error has the effect of substantially lowering the estimated cost of FSS processing.
2. The under 90% FSS acceptance rate, much lower than the corresponding AFSM rate, suggests that large numbers of FSS flats were not finalized to DPS on the FSS and must have been diverted to manual processing.
3. The corrected model results indicate that, in FY2011, FSS processing was in fact

¹ My revised “alternate” model will shortly be filed as Time Inc. Library Reference TI LR-1 in Docket No. ACR2011.

very costly and most likely made Periodicals costs higher than they would have been without FSS.

4. The model in its proposed form has the effect of hiding some of the cost differential between carrier route and 5-digit presort in non-FSS zones.
5. As in previous years, but even more so, the proposed FY2011 model appears to understate the true cost of piece sorting and overstate the costs of bundle, sack and pallet handlings.

1. AN APPARENT FORMULAIC ERROR HAS THE EFFECT OF SUBSTANTIALLY LOWERING THE ESTIMATED COST OF FSS PROCESSING

All Proposal Eighteen model versions include a new sheet, named "FSS," designed to track the piece related costs of flats that have been presorted into FSS scheme bundles. The flow of such flats, and the corresponding costs, are tracked separately for the four categories of machinable/non-machinable and barcoded/non-barcoded flats. For each piece category, 10,000 pieces are tracked and the costs incurred are accumulated. Dividing by 10,000 will then give the unit piece related costs (before certain adjustments, e.g., the CRA adjustment) of pieces in FSS bundles.

Cells K193 and K194 contain the calculated direct piece related unit costs for machinable barcoded flats sorted on FSS. As can be verified by inspecting the formulas in those cells, instead of dividing by 10,000 as described above, there is a division by 20,000, cutting the costs in half.² The same applies to the formulas in cells W193-W194, which are supposed to calculate the corresponding costs for machinable non-barcoded flats, and in cells AI193-194 and AU193-194, which calculate the costs for non-machinable flats.

There is a corresponding problem in the sheet called "5D," which calculates the piece

² To be precise, there is a division by the contents of cell G6, whose value happens to be 20,000.

related costs of flats that arrive in 5-digit bundles. Added to that sheet this year are calculations of the costs of 5-d flats that end up being processed on FSS machines. In the cells corresponding to those above, the costs of 5-d flats processed on FSS are divided by 40,000 rather than 10,000, cutting those costs to only one fourth.

There does not seem to be any similar problem with the calculation of so-called "allied" piece costs. Nor does the problem appear in the other sheets ("MADC," "ADC" or "CR") that calculate piece costs for other presort levels.³

This error is, fortunately, easy to correct. If uncorrected, it severely distorts the relationship between the costs of different presort levels, whose measurement is, I believe, the model's most important purpose.

The TI LR-1 model version has a new "switch," similar to the several switches created by the Postal Service. When the "switch" in cell D38 on model sheet "Switches" is set to "ON," the correction proposed above is applied. Comparing the results on the "SUMMARY" sheet with the switch turned on and off will show the importance of this correction. For example:

- a. Cell G15 on the summary sheet gives the estimated unit piece processing cost of machinable barcoded flats entered in FSS scheme bundles. That cost increases from 9.36 to 16.35 cents per piece, or 75%, when the correction is applied.⁴

³ It is possible that the errors described above were introduced by inappropriately copying certain cell formulas from either the First Class or Standard flats model versions. It so happens that in those models the value of cell G6 on the sheets that calculate piece processing costs is always 10,000. In the Periodicals model, the only legitimate function of cell G6 is for the model developer to assure that all the flats entered into the flowcharts below have been accounted for.

⁴ Only a small portion of the flats handled at the FSS in FY2011 were in FSS scheme bundles. Most were in fact in carrier route or 5-digit bundles. But because the estimated FSS unit costs have been derived using an average FSS productivity rate, the unit cost can be seen as an average for all flats processed on the FSS.

b. The calculated "CRA adjustment factor" is reduced from 1.2134 to 1.1958, causing somewhat lower unit costs of all bundles, sacks and pallets. But as discussed in a later section, there is reason to believe that the model may still be exaggerating those unit costs.

c. The estimated unit cost for machinable flats in 5-digit bundles increases by about 0.7 cents. The cost passthrough factor for the price differential between carrier route presorted and 5-digit flats, as shown in USPS-FY11-3, drops to 69.9%, versus an uncorrected 73.3%.

2. THE UNDER 90% FSS ACCEPTANCE RATE, MUCH LOWER THAN THE CORRESPONDING AFSM RATE, SUGGESTS THAT LARGE NUMBERS OF FSS FLATS WERE NOT FINALIZED TO DPS ON THE FSS AND MUST HAVE BEEN DIVERTED TO MANUAL PROCESSING

The FY2011 MODS data indicate that only 89.39% of the pieces fed into the FSS (TPF) actually were finalized to DPS on the FSS (TPH).⁵ The Proposal Eighteen model fails to account for this large discrepancy, which must have caused costs in addition to those the model indicates. The failure is partly caused by the model's reliance on AFSM acceptance rates, which are much higher than those apparently achieved on the FSS, and partly caused by the fact that it does not provide flow paths corresponding to events that must occur when pieces are rejected from the FSS.

I understand that FY2011 was the year in which most of the FSS were deployed , that there were many start-up problems, and that the Postal Service may not have all the data required to fully explain exactly why the TPH were so much lower than the TPF. Nevertheless, it may be useful and even necessary to have a more in-depth discussion of these issues than the Postal Service so far has provided.

A difference between TPF and TPH must be due to some pieces being fed into the machine without completing the process of being sorted and put into DPS sequence.

For example, a piece may be physically ejected, or removed by an operator, or sent to some reject bin.⁶ When that happens, there are, essentially three possibilities:

- (1) the piece may be fed back into the machine, which would cause an extra count of the TPF;
- (2) the piece may be diverted to another line of processing, most likely a manual sort to carrier route followed by a manual sequencing by the carrier, in which the TPH is reduced; or
- (3) the piece is destroyed, has disappeared or for some other reason ends up never being delivered, again reducing the TPH.

That magazine copies would end up not being delivered at all is of course unacceptable, yet it happened many times in FY2011.⁷ I assume in the following that the total number of such occurrences was small and that the problem by now is solved. I will therefore focus only on the first two alternatives listed above.

⁵ See USPS-FY11-23, or the model sheet "MODS Data E23.

⁶ I understand that in some circumstances, the FSS may have bins dedicated to holding out flats for mail recipients who pick up their own mail, and that flats addressed to those recipients would only receive a Pass 1 sort on the FSS and not be put into DPS sequence. It seems unlikely, however, that these flats would account for more than a very small portion of the TPF versus TPH discrepancy reported for FY2011. I believe the Postal Service may be able to determine exactly how many flats are held out by the FSS in this manner. I suggest that this percentage be included in future model versions. If some flats go from FSS Pass 1 to a box section, then the percentage of such flats and the box section costs should be included in the model.

⁷ This is confirmed by my personal experience. I live in an FSS designated Zip code. Twice, around July/August 2011, copies of a weekly magazine (not from Time Inc.) that I subscribe to simply never arrived. In both cases I called the publisher, who used First Class mail to send me replacement copies. I was told, essentially: "there have been many complaints like yours. The Postal Service told us recently to change the way that we prepare our mail and we are doing the best we can."

I have also been informed that Time Inc. has received many similar complaints from customers living in FSS zones. In one case, a subscriber to three Time Inc. weeklies reported that none of them had arrived in a given week. The Postal Service could not explain, but when provided with the IMB codes for the three copies, they could confirm that all three had been read into the first FSS pass, but none had made it to the second pass.

The Proposal Eighteen model does provide a flow-path for the first alternative, i.e., that rejected pieces may be re-fed into the machine. However, it uses a re-fed rate of only 0.66%, which is taken from the AFSM. Let us assume as an extreme case that the full 10.61% TPF versus TPH difference was caused by pieces subsequently re-fed in this manner. That would require a “re-fed” rate of $1/0.8939-1=11.87\%$. I created a separate switch in the TI LR-1 model, at cell D46 on sheet “Switches,” to replace the 0.66% rate with an 11.87% rate. Turning that switch to ON can be seen to raise estimated FSS costs further from 16.35 cents to 17.8 cents per piece, or 8.9%.

However, it is very unlikely that most of the rejected pieces were re-fed into the FSS. For reasons explained below, I believe it is much more likely that most of them were diverted to manual processing, which must have added even more costs.

The model does not seem to presently allow for the possibility that any flats pieces rejected by the FSS might be diverted to manual processing, except in the case where: (a) a flat’s image was sent to a manual encoding clerk, and (b) the encoding clerk was either unable to code it or took too long time to respond. Out of 10,000 machinable barcoded FSS pieces, the model shows eleven, or 0.11 percent, as meeting these conditions and therefore being diverted to manual sorting meeting. For non-barcoded flats, the figure is 49, or 0.49% of all flats.⁸ There does not appear to be any other provision for pieces being diverted to manual sorting. I believe there should be and that the Postal Service in the future must determine the percentage of rejected pieces that are diverted to manual.

It is also not clear that pieces which are diverted from the FSS can simply be sent to a manual incoming secondary sort, as the model flowchart suggests. Many FSS schemes are combinations of more than one 5-digit Zip code. In some cases, mail for

⁸ On model sheet “FSS,” cells A96-A99 show the numbers of pieces, out of 10,000, for each piece type, that are sent to remote encoding. Cells D94-D97 show the number of such pieces that could not be encoded and therefore were sent to manual sorting.

this scheme may not be suitable for sorting on a manual scheme designed for only one Zip code. That could lead to a more costly manual sorting process where some flats might need to be sorted twice.

One reason it is likely that most rejected pieces were diverted to manual, rather than being re-fed, is that unlike on an AFSM, pieces entered on an FSS are sorted in two passes, each pass requiring that pieces be fed through a mechanical reader and subsequently read by an OCR or barcode reader. That means not only that there are twice as many opportunities for each piece to be rejected. If a piece is rejected, for whatever reason, in the second pass, it is already too late for it to be entered into Pass 1 for that particular zone on that day. I don't know if it is even possible for the piece to be re-fed into the Pass 2 process. I don't believe so, and in any case that would not affect the TPF count, which presumably is the number of pieces fed during Pass 1.⁹

Regarding pieces whose images were sent to remote encoding, the model presently assumes that this happens with frequencies measured on AFSM machines. However, since FSS pieces must be read both on the first and second pass, it might appear that they would have a higher probability of needing REC intervention. That is, unless the machine somehow is able to remember that a given piece already was read by the REC operator in the first pass. Hopefully, the Postal Service will clarify this.¹⁰

To summarize, it appears most likely that the majority of the flats that were rejected in some way by the FSS during FY2011 were diverted to manual processing. Note that this would require not only manual sorting to carrier route, but also manual sequencing by the carrier. And considering that the majority of flats processed by FSS are flats that

⁹ As I understand it, in FSS Pass 2, all the pieces that will be delivered to the first address on their respective carrier routes are first sorted to carrier route, then all the pieces to second addresses are sorted, etc. If a piece is rejected during this process, it would seem to have to be re-fed very quickly, or else it would end up in the wrong sequence. The Postal Service may be able to clarify this issue.

¹⁰ Each time remote encoding is successfully performed on an FSS piece, some costs will have been incurred, but there should, as I understand it, be no effect on either the TPF or TPH counts.

without FSS would have been carrier route presorted, the flats that are diverted to manual from FSS will experience higher delivery costs, as well as much higher processing costs, than they would had they simply remained as carrier route presorted flats going directly to the carriers.¹¹

It is therefore clear that, due to the high reject rates, FSS processing costs in FY2011 were considerably higher than the Proposal Eighteen model shows, even after the model correction described in Section 1 above has been applied. Exactly how much higher the costs were is impossible to determine until the Postal Service provides more data, and until the model is modified to be able to represent the flow of rejected FSS pieces.

3. THE CORRECTED MODEL RESULTS INDICATE THAT, IN FY2011, FSS PROCESSING WAS IN FACT VERY COSTLY AND MOST LIKELY MADE PERIODICALS COSTS HIGHER THAN THEY WOULD HAVE BEEN WITHOUT FSS

The FSS has at times been seen as the technological fix that would reduce flats costs and significantly raise the Periodicals cost coverage. But considering the FSS low performance and high unit costs in FY2011, the only good news may be that there is plenty of room for improvement. In FY2011, far too many flats were rejected from the FSS, and some either disappeared or had unacceptable delays. Additionally, relative to the volumes sorted by the FSS, there must have been far too many manhours spent on a system that was supposed to be highly automated.

Let us compare FSS costs with the piece sorting and delivery costs incurred by carrier route (CR) sorted flats in non-FSS zones. If both the switches described in Sections 1 and 2 above are turned "ON," the carrier route piece sorting costs given by the model

¹¹ Over 60% of Outside County flats were carrier route presorted in FY2011. Additionally, the zones selected for FSS have tended to be those with the highest density and therefore the highest percentage of carrier route presorted flats. With Time Inc.'s weekly titles, for example, an analysis showed that as much as 30% of its carrier route presorted flats were to FSS zones, while only about 10% of its 5-digit presorted flats and even less of those with lower presort were to FSS zones.

are 1.58 cents per piece. According to USPS-FY11-3, the CR delivery costs are 11.06 cents per piece, for a total of 12.64 cents.¹²

For FSS flats, as shown in Section 2, the modeled piece handling costs are 17.8 cents per piece, if one assumes that none of the rejected pieces were diverted to manual sorting. If on the other hand, as seems likely, rejected pieces were diverted to manual processing, the costs must be even higher. And although the FSS preparation avoids some delivery costs, the DPS'd flats still require street delivery. According to USPS-FY11-19, the unit city carrier street time costs for Periodicals flats were 2.61 cents, to which one should also add rural carrier street time costs. I do not know the latter, but the above means that FSS combined piece handling and delivery costs were at least $17.8+2.6 = 20.4$ cents, or almost eight cents per piece more than for carrier route sorted pieces in non-FSS zones.¹³

Since the true differential is likely to be even larger, and since most of the Periodicals flats that were sent to FSS in FY2011 were flats that otherwise would have been carrier route presorted, I believe it is safe to conclude that the FSS experiment in FY2011 must have added to Periodicals costs, rather than reducing them.

It was claimed before the actual deployment of the FSS that carrier route flats converted to FSS would have total costs less, or at least not more, than before. That was not true

¹² Note also that this exaggerates the CR costs in non-FSS zones, because most of the piece handling costs that the model shows for CR flats is due to the portion of CR flats that are routed to the FSS. In FY2010, before the FSS were introduced in the model, the CR piece handling costs were modeled to be only 0.22 cents per piece, and the combined delivery and piece handling costs for CR were 11.04 cents per piece.

¹³ It is of course possible that CR bundles in non-FSS zones may incur higher bundle sorting costs than bundles sent to FSS. But that difference is not large enough to invalidate the conclusion that CR flats sent to the FSS ended up costing more. For example, according to USPS-FY11-3, a carrier route flats bundle on a 3-digit pallet costs the Postal Service 59.4 cents. It is actually slightly less after the model modifications described above. From the "Model Volumes" sheet in the Periodicals model it can be seen that an average carrier route bundle had 13.3 pieces in FY2011. Dividing the bundle cost by 13.3 gives a per-piece bundle cost equal to 4.47 cents, which is less than the cost differential between CR and FSS costs derived above. And there are of course bundle costs associated with FSS pieces also.

in FY2011, when FSS pieces cost considerably more than non-FSS carrier route presorted pieces. If the Postal Service can overcome this problem, by making FSS processing more efficient, then there may be hope for a significant future improvement in Periodicals cost coverage.

4. THE MODEL IN ITS PROPOSED FORM HAS THE EFFECT OF HIDING SOME OF THE COST DIFFERENTIAL BETWEEN CARRIER ROUTE AND 5-DIGIT PRESORT IN NON-FSS ZONES

With the deployment of the FSS, flats mailers are asked to perform two quite different forms of mail preparation. To non-FSS zones, the preparation is essentially as before. But to FSS zones, although the Postal Service so far allows mail preparation as in the past, it clearly prefers that mailers with enough density to do so prepare their flats in FSS scheme bundles placed on FSS scheme or FSS facility pallets.

In non-FSS zones, carrier route preparation continues to be by far the most efficient. To encourage such preparation, which through comailing today is possible for many more mailers than in the past, the rate differential between carrier route and 5-digit preparation in non-FSS zones should, ideally, correspond to the cost differential between the two types of preparation in non-FSS zones. The same applies to the rate and cost differentials between 5-digit and 3-digit preparation, etc.

However, the Proposal Eighteen model only shows average costs over all zones, including FSS zones. Because cost differentials between presort levels (e.g., carrier route vs. 5-digit) disappear in FSS zones, the average costs the model produces will understate the cost differentials that continue to exist in non-FSS zones.

For example, the model assumes that 7.72% of Carrier route and 7.72% of 5-digit, and somewhat smaller percentages of 3-digit and ADC presorted flats, end up at the FSS. Because the FSS costs are the same for all, the differentials that exist in non-FSS

zones are effectively reduced in the corresponding average costs.¹⁴

In FY2012, the portions of mail at each presort level that are routed to FSS are expected to be much higher. That will increase the distortion of the true cost relationships in non-FSS zones.

For the above reasons, the model should include tables that show costs associated with different types of mail preparation in non-FSS zones, as well as in FSS zones. That will make it possible to assure that Periodicals rates are, as much as possible, based on costs. It will also facilitate a direct comparison of mail processing costs incurred in FSS and non-FSS zones.

5. AS IN PREVIOUS YEARS, BUT EVEN MORE SO, THE PROPOSED FY2011 MODEL APPEARS TO UNDERSTATE THE TRUE COST OF PIECE SORTING AND TO OVERSTATE THE COSTS OF BUNDLE, SACK AND PALLET HANDLINGS

I have on previous occasions, most recently in an addendum to Time Inc.'s comments in Docket No. ACR2010, pointed to an apparent discrepancy between the Periodicals piece sorting costs reported by the CRA and the considerably lower piece sorting costs suggested by the flats mail flow model. I have further suggested that this must mean that there is more manual sorting of Periodicals flats than reflected by the model.¹⁵

The Postal Service clearly does not agree with this viewpoint and included a long rebuttal in its ACR2010 reply comments.¹⁶ Yet, I believe it would be appropriate to point out that in FY2011, the discrepancy between CRA reported piece sorting costs and modeled piece sorting costs is larger than ever. This is true despite evidence of some

¹⁴ It is possible that in reality all presort levels do not incur the same cost in FSS zones, e.g., flats in FSS bundles may actually cost less because they require less allied labor. But the present model does not reflect any such differences and applies the same assumed productivity rate to all flats processed by the FSS.

¹⁵ See Initial Comments of Time Inc. on the United States Postal Service FY 2010 Annual Compliance Report (filed February 2, 2011; errata filed February 18, 2011), Addendum: Comments on the Postal Service's ACR2010 Filing, by Halstein Stralberg

real progress in avoiding manual flats sorting in delivery units, as described below.

By the term “CRA piece sorting costs” I mean the sum of CRA costs attributed to Outside County flats at cost pools that are dedicated to piece handling. In FY2011, this sum comes to 8.395 cents per piece, or \$533.781 million after multiplying with the Outside County flats volume.¹⁷

On the other hand, before applying any of the corrections suggested in previous sections, the modeled piece sorting costs are only \$296.187 million. Dividing CRA piece sorting costs with modeled piece sorting costs gives a ratio of 1.802, which is much higher than in any recent year.¹⁸

Applying the correction described in Section 1 increases the modeled costs and reduces the ratio between CRA and modeled piece costs to 1.7282. It also reduces the overall CRA adjustment factor that the Postal Service prefers to apply from 1.2134 to 1.1958.¹⁹ Applying also the model “switch” described in Section 2 reduces the ratio a little more, but in any case the ratio between CRA and modeled piece costs would be higher than in any recent year.

¹⁶ See Reply Comments of the United States Postal Service (filed February 17, 2011), at 18-39.

¹⁷ The unit costs for outside County flats at each cost pool are shown in Column E, rows 15-83, on model sheet “CRA Flats.” A 1.0 in column F on the same sheet indicates that a given cost pool is piece sorting related. Note, however, that one cost pool I believe is piece sorting related is not so identified in the Proposal Eighteen model. It is the cost pool named “FSS” under the Network Distribution Center (NDC) facility group. I assume the existence of this pool means that at least one FSS machine has been located at an NDC, where, like other FSS machines, it is being used to put flats in DPS sequence. If this cost pool is what its name suggests it is, then it should be classified as piece sorting related. To change its classification to piece related, a value of 1.0 should be inserted in cell F62 on the “CRA Flats” model sheet, while erasing the 1.0 value in cell G62. I made this correction in deriving the above estimate of CRA piece sorting costs.

¹⁸ See Table 1 on page 5 of my addendum to Time Inc.’s ACR2010 initial comments. The highest ratio since the establishment of the current type of flats model was in FY2009, when it reached 1.6163, dropping to 1.5816 in FY2010.

¹⁹ The overall CRA factor divides the sum of CRA costs at all modeled cost pools (including platforms, other container handling operations and opening units) by all modeled costs.

Regarding the problem of too much manual flats sorting, there is one sign of real progress having been made the last two years.

At NonMODS post offices, the extent of manual flats sorting has dropped considerably, according to the CRA data. In FY2009, the NonMODS cost pool MANF (Manual flats) showed 2.552 cents per piece attributed to Outside County flats. In 2010 this had dropped to 2.05 cents per piece, and in FY2011 it was only 1.69 cents per piece.

While costs at individual cost pools may vary from year to year due simply to random variations in IOCS tallies, the trend described above seems to indicate some real progress. The percentage of Outside County flats being sorted manually in NonMODS post offices must have been reduced a great deal in the last couple of years. This could be due to many different factors, including:

- Postal Service efforts to change the practices of manually sorting Periodicals flats in some post offices, including the order to eliminate “Hot 2C” signs;²⁰
- diversion of flats previously being sorted manually to FSS processing;
- increased carrier route presorting, reducing the need for incoming secondary sorting;
- additional NonMODS cost pools being added under Proposal Six in Docket No. RM2011-12, which could conceivably have diverted some costs from the MANF pool.

Why then, despite this undeniable progress, are CRA costs for Periodicals piece sorting so much higher than the modeled costs, in fact higher by a greater ratio than ever before? And why did the progress that was achieved in this area not help to raise the Periodicals cost coverage? I hope the Postal Service will address these questions. I

²⁰ The order to eliminate “Hot 2C” practices only took effect in the last quarter of FY2011, and one
[footnote continues]

can offer the following additional observations.

First, it is worth noting that while CRA costs of manual flats sorting in NonMODS post offices have gone down, the same does not apply to other piece costs. For example, the per piece costs incurred by Periodicals in AFSM sorting were actually higher in FY2011 (2.85 cents per piece) than in FY2010 (2.8 cents). Similarly, the costs of manual flats sorting in MODS offices increased (to 1.01 from 0.96 cents per piece). If 8.6 percent of the flats that previously would have been sorted on AFSM machines were diverted to FSS processing in FY2011, should not AFSM costs then have gone down?

At least a partial answer to the last question is simply that the vast majority of flats diverted to FSS were flats that had been carrier route presorted.²¹

If mostly carrier route flats were diverted to FSS, the FSS would have reduced few previously existing piece sorting costs, while adding a great deal of new piece costs, i.e., for FSS sorting. But the model does not recognize this. The percentage of carrier route flats that it sends to the FSS is exactly the same as the percentage of 5-digit flats. That causes the model to understate the total piece sorting costs and is another contributor to the large discrepancy between CRA and modeled piece costs. I am not suggesting a specific model correction in this area, because I do not have enough data on which to base such a correction. But the Postal Service, using the mail.dat files it has collected, ought to be able to determine, in each FSS zone, what percentage of the flats to that zone was previously in CR bundles, what percentage was in 5-d bundles, etc.

might hope to see a bigger impact of this change in FY2012.

²¹ As mentioned above (see note 11), the zones selected for FSS deployment were generally the zones with the highest density, where mailers are most likely to be able to produce carrier route bundles. Overall, the carrier route percentage for Outside County flats in FY11 reached over 61%. But in FSS zones, the percentage is likely to be considerably higher, as I have verified in the case of Time Inc.'s publications.

The Postal Service has made clear its distaste for the idea of applying separate CRA adjustments for piece sorting and other processing costs, an idea I have promoted in the past. I believe, however, that major discrepancies between CRA and modeled costs at individual cost pools or groups of cost pools ought in the future to at least be analyzed carefully, both to understand better why Periodicals costs are so hard to control, and possibly to identify flaws in the model itself.²²

The modeled costs of bundles, sacks and pallets in this year's model are about 10 percent higher than the CRA costs at operations where bundles, sacks and pallets are handled and sorted. A separate CRA adjustment applied for bundles, sacks and pallets would in FY2011 be equal to 0.904.²³ But with an overall CRA adjustment, as the Postal Service prefers, which must include the large piece cost discrepancy, the factor applied becomes instead 1.2134 in the unadjusted model. After the correction described in Section 1, it is 1.1958.

6. CONCLUSIONS

The Proposal Eighteen model should not be relied upon for conclusions about costs of FSS processing or approved for future use in periodic reporting unless the error described in Section 1 is corrected. That alone will bring the model much closer to representing the reality of Periodicals flats costs in the FSS era.

In subsequent sections above, I have posed questions that the Postal Service eventually will need to answer and have suggested further model improvements that will be possible only when the Postal Service provides more complete data.

As described in Section 2, the Postal Service also needs to describe fully why flats are rejected from the FSS and what exactly happens to the flats that are rejected,

²² It was the realization that modeled FSS costs were very different from the CRA FSS costs that led me to discover the error described in Section 1 above.

²³ This value is derived in cell E105 on sheet "CRA Flats" in the TI LR-1 spreadsheet.

particularly when flats are rejected during Pass 2 of the FSS preparation.

As described in Section 3, most of the flats sorted on the FSS had previously been carrier route sorted and, the mail processing costs added to those flats by the FSS were in excess of the delivery costs that the FSS helped to avoid. One consequence appears to have been that, despite progress achieved in reducing manual flats sorting, as noted in Section 5, there was no progress at all, in fact a small step backward, in the effort to raise the Periodicals cost coverage. The FSS in FY2011 were very far from producing the cost savings that the Postal Service had hoped the machines would produce.

To improve on this situation, the Postal Service needs not only to achieve much higher acceptance rates for the FSS machines to realize their cost savings potential. It also needs to find ways to run these supposedly fully automated machines with fewer workers, i.e., to achieve higher productivity rates than those achieved in FY2011.

For the foreseeable future, the majority of flats will continue to go to non-FSS zones and mailers should continue to have incentives to prepare those flats in the most efficient manner possible. For this reason, as discussed in Section 4, the model should continue to show the true cost differentials, in non-FSS zones, between different levels of presort.

BIOGRAPHICAL NOTE

Halstein Stralberg is a consultant to Time Inc. on issues related to distribution of magazines through the postal system. Until June 1999 he was a principal at Universal Analytics, Inc. (UAI), a management consulting firm in Torrance, California, and manager of its Operations Research Division.

His academic background is in mathematics, with a master's degree from the University of Oslo, Norway in 1963. He received a bachelor's degree in mathematics, physics and astronomy at the University of Oslo in 1961. Most of his professional experience is in the area of management science and operations research. He has directed and performed almost 40 years of postal related studies as well as management studies for other clients in government and private industry, including production scheduling and control, corporate planning and finance, investment analysis, design and optimization of transportation systems, health care and computer system design.

Since the passage of the Postal Accountability and Enhancement Act of 2006, Stralberg has prepared a number of studies of Periodicals costs and rate design for Time Inc. which have been filed with the Commission. See Comments on the Postal Services ACR2010 Filing;²⁴ Comments On Reasons Why the Large Periodicals Rate Increase Proposed in Docket R2010-4 Should be Denied;²⁵ A Tour of Post Offices Handling Periodicals Mail in Northern Virginia;²⁶ Comments On Costing Proposal No. 29;²⁷ The High Costs of Manual Flats Sorting;²⁸ Estimates Of Worksharing Related Cost Avoidances For Periodicals Flats,²⁹ and Recommendations For Improving The Periodicals Class.³⁰

Stralberg addressed both the 2003 and 2007 Flats Summits organized by the Postal Service and the Mailers Technical Advisory Committees regarding the likely cost impact of the FSS deployment.

Prior to the passage of the PAEA, Stralberg presented 22 pieces of testimony before the Postal Rate Commission on a variety of postal costing and rate design issues on behalf of Time Inc. and of the United States Postal Service. Since 1987, he has worked in support of Time Inc.'s participation in postal rate cases . He has directed the development of computer models for analysis of postal costs and rate design, participated actively as a member of the joint industry/USPS Periodicals Review Team, as an industry representative in an MTAC data collection on bundle breakage, and in a USPS/Time Warner task force to evaluate the feasibility of tailoring the preparation of Periodicals mailings to the processing methods and sort schemes used in each postal facility.

Stralberg has made extensive visits, including many multiple repeat visits, to over 40

²⁴ Docket No. ACR2010, Initial Comments of Time Inc. on USPS FY 2010 Annual Compliance Report (February 2, 2011), Addendum.

²⁵ Docket No. R2010-4, Comments of Halstein Stralberg in Behalf of Time Warner Inc. on Reasons Why the Large Periodicals Rate Increase Proposed in Docket R2010-4 Should be Denied (August 17, 2010).

²⁶ Docket No. ACR2009, Initial Comments of Time Inc. on ACR2009 Pursuant to Order 380 (February 1, 2010). Addendum.

²⁷ Docket No. RM2010-6, Initial Comments of Time Warner Inc. in Response to Order No. 363 (January 11, 2010), Appendix.

²⁸ Docket No. RM2009-10, Initial Comments of Time Warner Inc. in Response to Order No.269 (August 20, 2009), Appendix.

²⁹ Docket No. ARC2008, Initial Comments of Time Warner Inc. on ACR2008 in Response to Order No. 161 (January 30, 2009), Addendum.

³⁰ Docket No. RM2008-2, Initial Comments of Time Warner Inc. in Response to Order No. 99 (September 8, 2008), Addendum.

USPS mail processing facilities and has observed all aspects of mail processing operations on all tours, as well as methods of mail collection, acceptance and transportation, and various ongoing postal data collection systems. He estimates that in total he has spent more than 2000 hours on site in postal facilities. In late 2009 and early 2010 he joined, as the only industry representative, a task force of USPS and Postal Regulatory Commission personnel touring postal and mailer facilities to review the preparation and processing of Periodicals.

From 1973 until 1987, he directed UAI's efforts under several contracts with the U.S. Postal Service. His activities under these contracts included:

- Design and development of the Mail Processing Cost Model (MPCM), a weekly staffing and scheduling computer program for postal facilities, with an annualized extension (AMPCM), using linear programming for long term staffing planning in a postal facility.
- An extensive data collection in 18 postal facilities designed to (1) establish a Postal Service data base on mail arrival rates and mail attributes affecting costs (subclass, shape, indicia, presort, container method, etc.), and (2) develop the model input data needed to apply MPCM for each facility.
- The "Study of Commercial Mailing Programs" under the Long Range Classification Study Program. This study involved a detailed cost and market evaluation of several rate and classification concepts, including various presort concepts, destinating SCF discounts for second class, plant loading and barcoding of preprinted envelopes.
- A BMC cost analysis which resulted in the establishment of the Inter/Intra-BMC parcel post rate differential in R80-1.
- Numerous simulation studies requested by USPS management.

Before joining UAI Stralberg was an Operations Research Analyst at the Service Bureau Corporation (IBM), where he performed several large-scale simulation studies, including a design analysis of the Dallas/Fort Worth Airport's people mover system and simulations to improve design and response time in large interactive computer systems.

As Operations Research Analyst at Norsk Hydro, a Norwegian petrochemical company, his work included design, development and implementation of factory production scheduling systems, studies of transportation and distribution systems and risk analysis of investment decisions.

For three years he was assistant Professor of Mathematics at the University of Oslo.