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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268–0001

PERIODIC REPORTING (PROPOSAL TWO)	Docket No. RM2017-6

PETITION OF THE UNITED STATES POSTAL SERVICE FOR THE INITIATION OF A PROCEEDING TO CONSIDER PROPOSED CHANGES IN ANALYTICAL PRINCIPLES (PROPOSAL TWO)
(June 8, 2017)

Pursuant to 39 C.F.R. § 3050.11, the Postal Service requests that the Commission initiate a rulemaking proceeding to consider a proposal to change analytical principles relating to the Postal Service's periodic reports. The proposal, relating to the format of the ICRA Report, is labeled Proposal Two and is discussed in detail in the attached text.

Proposal Two is presented in response to comments in the Fiscal Year 2016 Annual Compliance Determination (ACD) regarding revisions made to the FY 2016 ICRA over the course of the ACR proceeding. FY2016 ACD (March 28, 2017) at 63-65. Within those pages, the Commission linked the potential filing by the Postal Service of Proposal Two to discussion of certain other topics also affecting the costs reported for International Mail. *Id.* at 65. Those topics are discussed below, but the Postal Service notes that none of the issues raised by any of these topics directly relates to the merits of Proposal Two, and the Postal Service views consideration of Proposal Two as entirely independent of these other matters.

Four of the topics identified in the ACD can be grouped as International Service Center (ISC) issues:

- *The availability of International Service Center (ISC)-level Management Operating Data System data*
- *Machine productivity at ISC versus non-ISC facilities*
- *The proportion of sacked versus non-sacked mail arriving at ISCs*
- *The proportion of properly labeled versus improperly labeled mail arriving at ISCs*

In general, the In-Office Cost System (IOCS) accounts for these items. For instance, if ISC productivity differs from other plants due to the machines or mail preparation, those differences are reflected in the distribution keys.

Management Data Operating System (MODS) data are available for the ISCs, but the data quality is not well known as the Postal Service has not studied using MODS data for ISC cost pools. It should be noted that developing an appropriate set of ISC cost pools, MODS-based or otherwise, and implementing cost pools within the ISC group would be a significant research undertaking.

While MODS data could be used to compute productivity statistics (pieces handled per workhour) for some ISC operations, it is difficult to make direct comparisons between ISC versus non-ISC productivities. The ISC mail mix is quite different from that of domestic plants (e.g., P&DCs and NDCs), and international mail also can involve different handling steps than domestic mail. Relatedly, ISCs have operation mixes distinct from domestic facilities, and in some cases, equipment unique to the ISC system. As a result, there is no way at present to decompose any productivity differences into technical efficiency differences versus differences due to mail mix or unique international mail requirements.

In general, the In-Office Cost System (IOCS) data for ISCs will account for the effects of productivity differences and mail preparation issues on costs. Broadly speaking, the activity mix of tallies and the product proportions within any given activities will reflect the amount of labor actually used in working various products in the ISCs. For instance, if ISC productivity differs from other plants due to the machines or mail preparation, those differences will be reflected in the estimates of costs for ISC activities and/or the distribution key shares indicating the proportions of labor cost incurred by various products. Finally, the Postal Service also observes that variability of international mail cost estimates is not solely due to ISC costing. Rather, it is also caused by many international mail products incurring costs, but accounting for a small fraction of workload, in plants and post offices that primarily handle domestic mail—thus having small effective sample sizes outside of ISCs.

Another topic mentioned in the ACD is the number of IOCS tallies for International Mail products. FY2016 ACD at 65. What the Postal Service believes to be the tally number of interest is provided in an updated table presented as part of the instant Proposal. Please see the table presented as an attachment at the end of the Preface to USPS-RM2017-6/NP1.

Finally, another topic raised in the ACD is the ability to disaggregate the international mail cost pools between Market Dominant and Competitive products for the incremental cost calculation. *Id.* With respect to this topic, the Postal Service is still examining the host of issues relating to the unique structure of international product offerings that arise when attempting to calculate incremental costs.

The Postal Service respectfully requests that the Commission initiate a rulemaking proceeding to consider Proposal Two.

Respectfully submitted,

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PROPOSAL TWO

Proposed Changes to the Reporting Methodology for Inbound Products (UPU Target and Transition Countries)

OBJECTIVE:

This proposal consists of two components. First, along the lines suggested when revising the International Cost and Revenue Analysis report (ICRA) during the course of the FY 2016 ACR process, the Postal Service proposes to change the costing methodology for the treatment of Inbound mail, including Letter Post, Parcel Post and EMS to adjust for the increasingly difficult task of maintaining the statistical reliability of reporting UPU Target and Transition countries separately.[1] Second, and closely related to the first component, the Postal Service proposes to more closely align the International Cost and Revenue Report (ICRA) reporting of Market Dominant Letter Post products with the Mail Classification Schedule (MCS). Specifically, the Postal Service proposes to collapse the reporting (cost and revenue) of the two separate Target System Countries at UPU Rates and Transition System Countries (at UPU rates) lines into a single Inbound Letter Post at UPU Rates line in the ICRA.

BACKGROUND:

In its FY 2016 Annual Compliance Determination (ACD), the Commission noted the ICRA procedures appeared to have changed in FY 2016 in response to shifting target/transition designations for a number of countries, and then stated:

[1] The Target and Transition Country distinction applies only to terminal dues rates paid for Letter Post items. The distinction has no application to Inbound Parcel Post or Inbound EMS; therefore, continuation of the Target and Transition calculations for Inbound Parcel Post and Inbound EMS has no basis. Therefore, this proposal seeks to discontinue the calculations to develop separate Target and Transition Country costs for Inbound Letter Post, Inbound Parcel Post and Inbound EMS in the ICRA.

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> When asked to explain the rationale for this change, the Postal Service presented a new methodology that aggregates costs and volumes from both systems to create a single unit cost for each type of inbound mail. Response to CHIR No. 5, question 3. The Postal Service justifies this methodology on the grounds that the number of IOCS tallies available to disaggregate target system and transition system costs is insufficient for purposes of statistical reliability. The Postal Service states that this new methodology improves the reliability of the cost estimates compared to the accepted methodology. Response to CHIR No. 12, question 1.
>
> Although the new methodology does appear to improve the accuracy of the cost estimates, the Commission did not previously approve this new methodology. The Postal Service knew which countries would join the target system in CY 2016, since this issue was decided at the 2012 UPU Congress. Accordingly, the Postal Service had ample time to develop an alternative methodology and propose a methodological change prior to the filing of the FY 2016 ACR. Although the Commission will use this methodology for assessing compliance in this ACD, the methodology must be reviewed by the Commission through a docketed proceeding before it can be used in future ACDs.

FY 2016 ACD at 64 (footnotes omitted)

The methodology developed in response to Chairman's Information Request (ChIR) No. 5, Question 3 in the FY2016 ACD, improves the statistical reliability of Inbound Letter Post cost estimates, and additional improvement is possible by replacing the reporting of two separate Target and Transition lines with one Inbound Letter Post at UPU Rates line in the ICRA. (The reporting lines will be Canada and Inbound Letter Post at UPU Rates.) The Universal Postal Union (UPU) has a goal of moving Transition system countries into the Target system with the ultimate aim of having all countries migrate to the Target system. As more designated operators shift into the Target system, there are fewer Transition Country operators, and those that remain in the Transition system tend to be low volume countries. As such, there are less data to estimate Inbound Transition Country costs and reporting can be improved by eliminating

the attempt to estimate costs separately for Target and Transition Countries. This proposal explains the rationale for the new costing methodology that was introduced in the response to ChIR 5, Question 3, and also explains why reporting Target and Transition Countries as a single Inbound Letter Post at UPU Rates line in the ICRA consistent with the MCS, is an additional improvement.

Historically, the ICRA has reported the inbound Market Dominant Letter Post products for Canada, Universal Postal Union (UPU) Target Country (Industrialized) and Transition Country (Developing and Least Developed Countries) groupings separately. Canada has had a longstanding bilateral with the Postal Service, which includes many presort worksharing arrangements and lower transportation costs. Canada represents such a large portion of International that it justified its own separate reporting, and that status will not change with this proposal. The UPU Target and Transition groupings, on the other hand, are based on the economic development of UPU countries, and the groupings change over time. As the UPU explains on its website:

> ***Target system***
>
> *Not all countries are at the same stage of development and there are significant variations in their mail volumes, postal tariffs and cost absorption. The aim is thus to progressively incorporate the developing and least developed countries into a target system that already applies to industrialized countries.*

Additionally, as explained in the January 2016 edition of the UPU Terminal Dues Statistics and Accounting Guide:

> ***Chapter I – Terminal dues rates and transit charges***
>
> ***1 The terminal dues system***

c. Any country in the transitional system may opt to be treated as a target country under the terminal dues provisions in the Convention and Letter Post Regulations (Convention article 29.13). Transition countries can volunteer to be treated as target countries (1.1, 1.2 or 2). Target countries from groups 1.2 and 2 can volunteer to be treated as group 1.1 countries. Target countries from group 2 can volunteer to be treated as group 1.2 countries.

The UPU Target and Transition Country groupings change as the UPU moves towards its goal of incorporating developing and least developed countries into the Target system, and as Transition Countries opt into the Target Country group. Appendix C of the UPU Terminal Dues Statistics and Accounting guide shows the changes from Transition to Target Countries through 2016:

Appendix C – Country classification

Group 1.2 – List of countries and territories that joined the target system in 2010 – [13 countries added]

Group 2 – List of countries and territories that joined the target system in 2012 – [25 countries added]

Group 3 – List of countries and territories that apply the transition system provisions up to 2015 and the new target provisions as of 2016, that benefit from and contribute to the QSF as provided for in article 32 of the Convention – [39 countries added]

As countries shift to the Target System, the only change is an accounting change from Transition settlement rates to Target Country settlement rates. There are no operational changes. The treatment of Inbound mail does not change when a country shifts from a Transition Country to a Target Country. As such, developing separate Inbound Target and Transition Country cost estimates in the ICRA does not produce meaningful cost estimates, and certainly does not allow for comparison of Target

Country year-to-year costs as the country classifications change as a result of UPU Congress decisions.

Moreover, the separation of costs into Target and Transition Countries results in statistically less reliable cost estimates and inferior reporting quality for Transition Countries, as its list continues to grow smaller as the UPU continues to move towards only Target system countries.

In its reply to Question 1 of Chairman's Information Request No. 12, (February 6, 2017), the Postal Service highlighted the problem for Inbound Letter Post:

> The CV for Air Letter Post is under 10 percent, and has been for many years. However, while the number of tallies for DC had been a significant percentage of total Air Letter Post tallies until FY16, it fell dramatically in FY16, dropping from 58 percent in FY15 to 18 percent in FY16. Because quarter 1 of FY16 had DC tallies that have since moved to IC, it is anticipated that the percentage of DC tallies will drop further in FY17, to about 5 percent. The CV for an estimate based on so few tallies will exceed 10 percent.

An attachment appearing at the end of the Preface to USPS-RM2017-6/NP1, filed under seal, updates Table 2 of the reply to ChIR 12, Question 1 (also filed under seal), to reflect the cost changes resulting from this proposal.

Problems arising from the decreasing number of Transition tallies and the resulting increased volatility are remedied by combining Target and Transition Country reporting into the single Inbound Letter Post at UPU Ratesline. Less variability of Inbound Letter Post at UPU Rates Inbound Air and Surface Letter Post will provide better cost estimates for year-to-year analysis.

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PROPOSAL:

The proposal would implement the costing methodology used in the response to CHIR 12, question 1, and consolidate the cost estimates for Target and Transition Countries. It would, as well, combine Inbound Letter Post from Target and Transition Countries at UPU rates reporting into a single ICRA Inbound Letter Post at UPU rates line separate from Canada. There would no longer be a need for the IOCS analysis to separate costs into Target and Transition Countries in the CRA Cost Segments tab of the Inputs file. (The Canada and UPU separation remains in place.)

RATIONALE:

Continuing the Target County and Transition Country distinction is not consistent with the current MCS, and produces increasingly unreliable or misleading cost estimates due to the shrinking Transition Country classification.

Section 1130.1of the MCS makes no distinction between Target and Transition Countries regarding Inbound Letter Post:

1130.1 Description

a. Inbound Letter Post consists of inbound International pieces (originating outside of the United States and destined for delivery inside of the United States) that are subject to the provisions of the Universal Postal Convention of the Universal Postal Union and encompasses letters, packages, postcards, printed matter, and small packets, up to 2 kilograms. Letter Post items in transit through the United States from a foreign origin for delivery to a foreign destination are included in the Inbound Letter Post Grouping.

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The current MCS classification is consistent with the fact that there is no costing reason to maintain a distinction between Target and Transition Counties. The UPU Target and Transition Country classifications depend on the economic development of countries, unrelated to the cost causing characteristics that should be reported. Additionally, the classifications continue to change as the UPU continues to move towards an all-Target System arrangement.

Moreover, operationally, inbound mail under default UPU terminal dues is not treated separately based on its origin country. Processing varies because of the mail characteristics (e.g., shape, weight) and because of where the mail enters the country. There is no essential cost difference between mail from Target Countries and Transition Countries. Splitting the products by origin country group also reduces the precision of the estimates for each group relative to consolidated Inbound Letter Post. Since many of the international products are small and have high sampling variability, combining the mail from Target and Transition countries will reduce coefficients of variation (CVs) and improve the precision of estimates.

IMPACT:

The differences that arise from the modifications discussed below in the Mechanics section are presented in the non-public Excel file "Attachment 1.xls" filed under seal as USPS-RM2016-7/NP1. Attachment 1 consists of 30 tabs: three versions of the ICRA summary tables, as well as two sets of differences relative to the results filed in USPS-FY16-NP2. Three versions are necessary for comparison purposes in this instance because, in addition to the "proposed" version, there are in some sense

two versions of the "status quo." The "old status quo" represents what might be considered the previously accepted methodology, which is consistent with the way tallies were counted across calendar years 2015 and 2016. The "new status quo" represents the methodology used in the revisions to the ICRA filed in February of this year (provisionally used by the Commission in the FY 2016 ACD), which differs from the "proposed" version in that certain refinements and corrections have been made (although the same conceptual approach underlies both the "proposed version" and the "new status quo"). The three sets of ICRA alternatives are labeled as follows with each set preceded by a brief separator tab with a short explanation: the "new status quo" is represented by the Summary and A and B Pages from Reports (Unified) as filed in USPS-FY16-NP2 (as revised on 2/3/17) (tab names consisting of report name appended with " ACR"); the "old status quo" is represented by the corresponding A and B Pages arising from the ACR adjusted to reinstitute the tally analysis splits between target and transition countries for foreign origin mail (tab names consisting of report name appended with " Rev. Baseline"); and the "proposed" scenario is represented by corresponding A and B Pages arising from the current proposal (tab names consisting of report name appended with " Proposed");

Two sets of tabs show the cell-by-cell differences between the reports (tab names appended by "Diff1" representing differences between the Revised Baseline[2]

[2] One might expect that the baseline would be what was originally filed in the ACR on December 29, 2016, but as the Commission noted in the ACD, that version did not fully reflect the mid-year shifts in status by some countries, nor did it incorporate the other revisions of 1/19/17 and 2/3/17. Therefore, the baseline version herein is referred to as the Revised Baseline, in order to clarify that this version has been revised from what was filed in the original ACR to incorporate those revisions while maintaining the tally analysis to allow for a clearer comparison between 1) the tally analysis, and 2) removing the tally analysis and combining Target and Transition Countries for reporting purposes.

and the (revised) ACR; and tab names appended by " Diff2" representing differences between the Proposed methodology and the ACR).

MECHANICS:

Revised Domestic Processing Model (DPM): The DPM filed as USPS-FY16-NP4 (Revised 2/2/17) is revised to incorporate the new Canada versus ROW separation. As filed, USPS-FY16-NP4 included the following Inbound Letter Post categories:

Foreign Origin – Surface	
LC/AO	182
Foreign Origin – Air	
LC/AO	187.

Class number 182 is reused as Foreign Origin Surface LC/AO ROW, class number 187 is reused as Foreign Origin Air LC/AO ROW and two new class numbers, 72 and 77, are introduced for Canada Surface and Air, respectively:

Foreign Origin – Surface	
LC/AO Canada	72
LC/AO ROW	182
Foreign Origin – Air	
LC/AO Canada	77
LC/AO ROW	187

Neither the previous tally analysis nor the response to ChIR No. 12, question 1 was correct, because only IOCS-related costs were adjusted in Cost Segments 2, 3 and 6. As a result, changes to non-IOCS costs and piggyback costs were not included in the analysis. Although inclusion of the piggybacks is a correction, it is included in this

proposal to remedy the previous oversight by incorporating the non-IOCS and piggybacks impacts by completely running the DPM. New inputs using the proposed format are provided in ICRA16PRC-Target-Trans.xls, ICRAEQUIP.FLAT16CANROW and DPM RPW 16 Target Trans.xls. The changes are highlighted in yellow in ICRA16PRC-Target-Trans.xls and in the first row of the individual columns that changed in those tabs. Those highlights are contrasted with the blue highlighted tabs and columns that did not change. Although most of the tabs changed, the impact is limited because the class lines that changed are common to most of the spreadsheets.

The DPM was run using the new formats and inputs to generate the usual I, A, B, F, K and C files and reports files. The new C Report was used to run the proposed ICRA model as the new tab, CRA Cost Segments, in the Inputs.xls file described in the next section.

Revised ICRA Model: Preparing the necessary exhibits for this Proposed UPU Target and Transition Country Classification Aggregation involves setting up two versions for comparing against the ACR.

Revised Baseline: The first step for examining the impacts is to prepare a version of the ICRA which is consistent with the way tallies were counted across calendar years 2015 and 2016 – the Revised Baseline Incorporating Target / Transition Data by Calendar Year Consistent with the Inbound Tally Analysis. (To be done properly, however, note that this step must reflect the “revisions” made to the version of the ICRA filed in the ACR to correct mistakes fixed in the errata filed on January 19, 2017, and February 3, 2017, rather than using as a baseline the version of the ICRA filed originally on December 29, 2016.) This is accomplished in the Inbound Calcs.xls

workbook on the tabs Vol1 and Vol2 combined with the inbound cost data in Reports (Unified).xls. New blocks of calculations begin in column P of both sheets. Vol1 represents the data for calendar year 2015 and Vol2 represents the data for calendar year 2016. Volumes are staged at the bottom of each of the sheets, distinguished by the 2015 and 2016 UPU country classifications which are used in Reports (Unified).xls to separately calculate target and transition country unit costs from the total costs of countries and products thus classified based on the Tally Analysis. These unit costs are reapplied in Inbound Calcs.xls for mail processing and delivery costs.

Column P of Inbound Calcs.xls shows the UPU target and transition country codes for FY2015 in the Vol1 sheet, and in the Vol2 sheet column P shows the 2016 UPU codes. Mail processing costs are calculated in columns S through AG in both sheets, and delivery costs in columns AI through AW. The Vol1 sheet also aggregates the 2015 and 2016 mail processing and delivery costs in columns AZ through CD for transferring to the Intermediate (database) sheet of Reports (Unified).xls (see cells V1316 through AJ1782 for the formulas in the Intermediate sheet that accomplish the transfer). With these new calculations included into the ICRA, the target and transition country costs are separated consistently with the tally counts input into the ICRA.

Proposed Approach: Reporting of Target and Transition Countries as the single Inbound Letter Post at UPU Rates line begins with the distribution key inputs to the Domestic Processing Model (DPM), USPS-FY16-NP4 (Revised February 2, 2017). The former class lines, Inbound Foreign Origin-Surface LC/AO class 182 and Inbound Foreign Origin-Air LC/AO class 187, are replaced with the following:

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Foreign Origin – Surface
LC/AO Canada - 72
LC/AO ROW - 182

Foreign Origin – Air
LC/AO Canada - 77
LC/AO ROW - 187

The Rest of World mail classes 182 and 187 are the combined Target and Transition Countries. The FY16 distribution key inputs, DPM formats and DPM reports are changed to reflect the proposed format and the DPM is run to produce an FY16 International Cost Segments and Components Report for use in the ICRA Inputs file. The only difference in the new format is that lines 182 and 187 are split between Canada and Rest of World. All subtotals and totals remain unchanged from what was filed in USPS-FY16-NP4 (Revised February 2, 2017).

The next step is to develop the Proposed UPU Target and Transition Country Classification Aggregation. Numerically, the proposed approach is the same as what was filed in the ACR, USPS-FY16-NP2 reference. Operationally, calculations related to the Tally Analysis have been removed, which streamline the use of the data in Inputs.xls under the CRA Cost Segments tab. The new data explained in the Revised Domestic Processing Model (DPM) section separate Canada Letter Post mail from other UPU countries (see rows 37, 38, 42, 43). These lines will be used in lieu of the previous approach which made calculations based on the Tally Analysis to spit costs between Canada, ICs (target) and DCs (transition) countries. Note that the Tally Analysis did not affect Canada versus the rest of the UPU countries for either parcels or EMS since separate rows are already provided in the input table for Canada as

Expedited Parcels-USA (class 186) and Xpresspost-USA (class 181). For parcels and express, the Tally Analysis was only used to distinguish ICs from DCs for countries other than Canada. The streamlining is shown at the bottom of the CRA Cost Segments input table in cells C66 through U220 which have been cleared of their contents and cross-hatched to show that the data and calculations will be eliminated from future ICRAs under this proposal.

The data from the CRA Cost Segments input table are utilized in Reports (Unified).xls. The cross-hatching convention is used in this workbook. On the CRA Staging sheet, several areas have been cleared and cross-hatched indicating their removal under the Proposed approach -- the staged Foreign Origin unit cost table staged beginning at cell G3, staged cost data block from the Tally Analysis beginning at cell E87, and several areas in the unit cost calculation table in the area covered by cells AO56 through AZ114. In addition, the Group3Pivot and Group3Countries tabs added for ICRA 2016 to properly reflect the shifts in UPU Group 3 countries from transition to target in 2016, as well as tabs Inbound Mail by TD Group and Pivot1b, are no longer needed since target and transition reporting lines are not maintained in the Proposed Approach. These tabs have also been shaded in red to indicate their ultimate removal.