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ORDER NO. 99

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

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

Periodic Reporting — Docket No. RM2008-2

NOTICE OF PROPOSED RULEMAKING ON COSTING METHODS USED IN PERIODIC REPORTING

(Issued August 18, 2008)

On August 11, 2008, the Commission received Request of the United States Postal Service for Commission Order Amending the Established Costing Methodologies for Purposes of Preparing the FY 2008 Annual Compliance Report (Request). In the Request, the Postal Service states that it has eight changes that it would like to make to the methods by which it compiles the FY 2008 version of the annual report that is required by 39 U.S.C. 3552 to provide to the Commission each year. It cites 39 U.S.C. 3652(a)(1), which gives the Commission the responsibility to prescribe methods that are used to produce the information that is compiled in the annual report. Request at 2. Among other things, the information supplied in the annual report is used by the Commission to prepare the Annual Compliance Determination (ACD) that is required by 39 U.S.C. 3653.

The Postal Service references pages 9-10 of the most recent Commission ACD. FY 2008 Annual Compliance Determination, March 27, 2007 (FY 2007 ACD). There, numerous commenters recommended that the Postal Service not change methods for collecting and analyzing cost data unless interested persons have had an opportunity to evaluate and comment on them. The Commission concurred, stating that it intended to issue regulations governing periodic reports generally (including the Postal Service's annual report) that would vet proposed changes in analytical methods through informal rulemakings in advance of the filing of the report. FY 2007 ACD at 10.

I. PROCEDURAL EXPEDITION

The Postal Service notes that it is already preparing its annual report for FY 2008. Given the lead time that is required, it observes that it is unlikely that the regulations that the Commission described in its FY 2007 ACD can be issued, and public scrutiny of particular changes in analytical methods could be completed under those regulations, in time to be incorporated in its FY 2008 annual report. It therefore asks that an alternative, expedited procedure be used to vet its proposed changes in analytical methods.

In the Postal Service's view, none of its proposed methodological changes "are of sufficient complexity to hinder relatively straightforward evaluation by both the parties and the Commission." Request at 2. It therefore proposes that its filing be treated as a rule 21 motion for a Commission order approving its proposed changes to current baseline methods used to analyze costs. *Id.*, n.2. The Postal Service notes that its Request includes the rationale for each of the eight methodological changes that it proposes, and estimates the impact of each change on the costs borne by mail classes. Equipped with this information, it suggests, the public could provide input in the form of answers supporting or opposing the motion. It recognizes, however, that the 7-day period that rule 21 allows for answers to motions should probably be lengthened. The Postal Service notes that if interested parties feel that more elaborate procedures for their input are needed, they can include those suggestions in their answers. *Id*. at 2.

As noted, the Postal Service's petition is followed by a description of each proposal, together with its background, objective, and supporting rationale.[1]

Although it does not have all of the changes to baseline analytical methods that it hopes to incorporate in its 2008 annual report ready to submit for public comment, the Postal Service observes that the process should begin. It notes that these proposed changes would be part of the core cost and revenue analysis process, which must be finalized before other changes, such as those from new special studies, can be added to its cost and revenue analysis. It says that other proposed changes will be submitted for public scrutiny as they are developed. *Id*. at 3.

The Commission agrees that the process of vetting proposed changes in the methods by which cost incurrence will be analyzed in the Postal Service's FY 2008 annual report should begin now with those proposals that are sufficiently refined to be submitted for public comment. The Request suggests that it should be procedurally sufficient for the Commission to adopt an order ruling on its proposed methodological changes. The Commission, however, prefers at least initially to interpret the definition of a "rule" in the Administrative Procedure Act (APA) to include analytical methods that affect the way costs or revenues are accounted for in a rate setting regulatory regime. The APA requires that notice be given in the *Federal Register* and an opportunity for public comment be provided before substantive rules take effect. *See* 5 U.S.C. 551(4) and 553. For this reason, the Commission will treat the Postal Service's August 11, 2008 filing as a petition to initiate an informal rulemaking consistent with section 553 of the APA.

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[1] Time Warner Inc. (Time Warner) has responded with a motion asking that the deadline for answers be extended to September 2, 2008. *See* Motion of Time Warner Inc. to Extend the Period for Response to Request of the United States Postal Service for Commission Order Amending the Established Costing Methodologies for Purposes of Preparing the FY 2008 Annual Compliance Report, August 14, 2008 (Motion). It argues that the substance of these proposals is not sufficiently simple and straightforward to be vetted in 7 days. It argues, further, that it needs more time to examine and comment on the alternative procedures that the Postal Service proposes, particularly if they are to become standard procedures for vetting methodological changes. Motion at 3-4. The rulemaking procedures and extended deadlines authorized in this Notice should meet Time Warner's procedural objections.

The Commission hereby grants the Postal Service's petition. Since time is of the essence in vetting these proposed methodological changes, the Commission is tentatively scheduling a technical conference in which Postal Service experts would be available to answer questions related to these proposals. The technical conference will be held on August 27, 2008 at 10:00 a.m. in the Commission's hearing room. The Postal Service should also arrange for the possibility that a follow-up technical conference could be held on the afternoon of September 3, 2008, if needed. Interested persons may file written comments on the Postal Service's proposals on or before September 8, 2008. Reply Comments may be filed on or before September 15, 2008.

II. SUBSTANCE OF POSTAL SERVICE PROPOSALS

The Postal Service proposals, *see* Request at 5 *et seq.*, are described below.

Proposal One

PROPOSED GROUP SPECIFIC COST CHANGE (COST SEGMENT 18)

OBJECTIVE:

A methodology change is proposed for the manner in which headquarters Finance Number (FN) Cost Segment 18 costs are categorized in the FY 2008 Cost & Revenue Analysis (CRA) Report.

BACKGROUND:

In FY 2007, and for years before, almost all Cost Segment 18 costs for headquarters Finance Numbers were treated as institutional costs. With the enactment of the Postal Act of 2006, however, there is a need to define a new category of cost — 'group-specific' cost. Group-specific costs are those costs which cannot be attributed to individual products, but which are caused by either the competitive or market-dominant products as a group. The remaining business sustaining or common fixed costs are ‘institutional'. An example of a competitive product group-specific cost would be a HQ organization unit that only supports competitive products. Pursuant to Commission Rule 3015.7(a), the Commission is currently using competitive products’ attributable costs, supplemented to include causally related, group-specific costs, to test for cross-subsidies.

Competitive products also must cover an ‘appropriate share’ of institutional cost. In addition to the identification of competitive product group-specific costs, the identification of market-dominant group-specific costs is also important, as the value of the institutional cost will be the residual of Postal costs that are not attributable to products and are not group-specific to either group. To the extent costs are group-specific costs, the remaining 'institutional cost' will be a smaller amount than it would be otherwise.

PROPOSAL:

The new taxonomy for costs places a new requirement to be able to identify group-specific HQ administrative and program costs for market-dominant and competitive product groups. The Postal Service captures costs for administrative activities and programs using a cost center designation of the “Finance Number”. Administrative organization units and programs are assigned a Finance Number and all expenses are charged to the Finance Number. Most Headquarters activities and programs support the entire enterprise or support all products. However, the cost in some Finance Numbers may be associated with either competitive or market-dominant product groups.

To facilitate the identification of group-specific costs in Headquarters, the Postal Service has created a new attribute for Finance Numbers called the Product Activity Attribute. The value of the Product Activity Attribute will indicate which of the following describes the activities and costs of the Headquarters Finance Number:

- *Market-Dominant*—Activity in Finance Number only supports Market-Dominant Products

- *Competitive*—Activity in Finance Number only supports Competitive Products
- *Common/Enterprise Sustaining*—Activity in Finance Number supports both groups of products, or supports the Enterprise as a whole.

In the analysis to support the Annual Compliance Report beginning in FY 2008, the Postal Service proposes to use the value of the Product Activity Attribute for Headquarters Finance Numbers to help identify group-specific costs (and possibly some product-specific costs) for competitive and market-dominant products. That is, expenses in Finance Numbers deemed “Market-Dominant” would be candidates for market-dominant group-specific costs and expenses in Finance Numbers deemed “Competitive” would be candidates for competitive product group-specific costs. Costs in Finance Numbers deemed “Common/Enterprise Sustaining” would be candidates for Institutional Cost. The analysis of group-specific costs by Finance Number would not replace, but rather would supplement, existing volume-variable and product-specific analysis of expenses in Headquarters Finance Numbers.

Approach to Determine Value of the Product Activity Attribute

A. Existing Finance Numbers:

The Postal Service is conducting a survey of the owners of the Headquarters Finance numbers to obtain information on the type of activity or program performed in the Finance Number. Responses to the survey will be used to help ascertain whether the activity supports a specific product group or is Common/Enterprise Sustaining. The Cost Attribution unit in Corporate Financial Planning will analyze the results of the survey and conduct further research as necessary to determine the appropriate value of the Product Activity Attribute for each Finance Number. The value of the Product Activity Attribute will be populated in the Finance Number Control Master File.

B. New Finance Numbers:

The Postal Service will modify its current business process for the creation of new Finance Numbers to include a step for the requestor of the new Finance Number to respond to the Product Activity Survey Questions. The Cost Attribution unit in Corporate Financial Planning will serve as the gate-keeper for review and approval of the value of the Product Activity Attribute in the official Finance Number Control Master File.

IMPACT:

The proposed approach is designed to position the Postal Service to identify group-specific costs as the organization and strategies for Mailing Services (i.e., Market-dominant products) and Shipping Services (i.e., Competitive products) evolve. The Postal Service does not have survey data to estimate the impact of the proposed approach on FY 2007 costs and, because of the substantial amount of HQ organizational restructuring which has taken place this fiscal year, believes that historical information from FY 2007 would have limited value in projecting future group-specific costs. The typical FN at headquarters usually contains several million dollars, however, so depending on the numbers of FNs determined to be Market Dominant or Competitive Product, something between tens of millions to perhaps as much as several hundreds of millions of dollars would be expected to move out of institutional costs and into group specific costs.

Proposal Two

PROPOSED GROUP SPECIFIC COST CHANGE (COST SEGMENT 16)

OBJECTIVE:

A methodology change is proposed for the manner in which advertising costs (Cost Segment 16) for Click-N-Ship and Carrier Pickup are assigned in the FY 2008 Cost & Revenue Analysis (CRA) Report.

BACKGROUND:

In the FY 2007 CRA, the advertising costs for Click-N-Ship and Carrier Pickup were treated as institutional, even though these costs related to specific products (Express Mail, Priority Mail, International packages, International Express Mail, and International Priority Mail), all of which are Competitive Products.

PROPOSAL:

In FY 2008, we propose that advertising costs for Click-N-Ship and Carrier pickup be assigned as a group specific cost to competitive products, as the advertising for these services relates specifically to products that are competitive.

IMPACT:

In FY 2007, approximately $40 million was spent on advertising for Click-N-Ship and Carrier Pickup, together. Therefore, a similar amount of group specific costs to competitive products might be expected in FY 2008.

Proposal Three

PROPOSED IN-OFFICE COST SYSTEM (IOCS) MIXED MAIL CODING CHANGES

OBJECTIVE:

Changes are proposed to the IOCS coding of mixed mail that better support shape-based costing by the Postal Service.

BACKGROUND:

Currently, readings observed on employees handling wheeled containers, pallets and empty containers are assigned mixed mail activity codes that depend only on the operation where the sampled employee was assigned. While this approach works well for employees in operations that handle a single shape of mail, it is fairly imprecise for allied operations such as platform.

PROPOSAL:

For FY2008, we propose to use additional information on the shape (letter, flat or parcel) of the contents in a wheeled container or pallet when assigning IOCS mixed mail codes. If the contents are all of the same shape (for example, all loose letter-shaped mail and letter trays), we propose to assign the mixed mail code to the corresponding shape. For empty equipment, we propose to assign a shape-based mixed mail code that corresponds to the equipment type; for example empty letter trays would be assigned a letter-shape code. Containers that contain multiple shapes or no shape information would continue to be assigned as they are now.

IMPACT:

There would be a decrease in the IOCS dollar-weighted tallies associated with IOCS activity codes for mixed mail all shapes and empty equipment of approximately 28 percent, and a corresponding increase in shape-specific mixed mail codes of 86 percent. These changes, when incorporated in the mail processing model, would slightly increase unit costs for parcel-shape mail, slightly decrease them for letter-shape mail, and leave costs for flat-shape almost unchanged.

Proposal Four

PROPOSED CITY CARRIER COLLECTION COST CHANGE

OBJECTIVE:

A change is proposed to identify an additional $60 million of First-Class Mail product specific cost in collection costs for city delivery carriers.

BACKGROUND:

In the FY 2007 CRA, the Postal Service attributed the nonvolume variable portion ($60 million) of the city carrier time, associated with picking up mail in blue collection boxes, to First-Class single piece letters. However, in the Commission's FY 2007 Annual Compliance Determination Report, the Commission rejected this treatment.

PROPOSAL:

For FY 2008, the Postal Service again proposes that this $60 million be attributed to First-Class Single piece letters. These costs represent a portion of the labor costs for collecting mail at "blue" collection boxes. The Commission correctly noted in their FY 2007 Annual Compliance Determination that the boxes do not state that their use is solely for the collection of First-Class single-piece letters. Still, over 90 percent of collection box mail is First-Class single piece letters. (Moreover, in the new regime, single-piece letters and single-piece cards are now both components of the same MCS "product" to which these costs will be treated as product-specific, which is a change from the old regime in which cards and letters were separate subclasses.) Collection boxes are put into service for collecting First-Class Single Piece letters, though a small amount of other products are sometimes deposited there. Furthermore, as of July 2007, the Postal Service prohibited stamped mail over 13 ounces from being deposited in these collection boxes, for security reasons. This would exclude some classes of mail that would have been there previously. Finally, with Carrier Pickup, competitive products such as Express and Priority Mail now have an alternative to using collection boxes. Therefore, the non-volume variable labor costs of sweeping collection boxes are reasonably treated as product specific to First-Class Single Piece letters. Of course, to the limited extent that other types of mail are deposited in collection boxes, they will continue to get a proportionate distribution of the volume-variable costs, based on the existing distribution key.

IMPACT:

The impact is $60 million of attributable cost for First-Class Single Piece letters, which would be institutional otherwise.

Proposal Five

PROPOSED EXPRESS MAIL PROCESSING CHANGES

OBJECTIVE:

The purpose of this document is to propose addressing and implementing the changes recommended in the Commission's FY 2007 Annual Compliance Determination Report for (a) the distribution key for the costs of the mail processing activity called "out of office, delivering Express Mail" and (b) the treatment of the non-volume variable portion of the cost for the same mail processing activity.

BACKGROUND:

(a) In the FY 2007 CRA, the distribution key used for the costs of the mail processing activity called "out of office, delivering Express Mail", were the costs of the mail processing activities that the clerks were performing when they were "in office". However, in the Commission's FY 2007 Annual Compliance Determination Report, the Commission suggested using RPW volumes of domestic and international Express to distribute the "out of office, delivering Express Mail" costs. Thus, we are proposing adoption of the Commission's suggestion.

(b) In the FY 2007 CRA, the non-volume variable portion (57 percent) of the costs for the "out of office, delivering Express Mail" activity was treated as institutional. In the Commission's FY 2007 Annual Compliance Determination Report, the Commission suggested we review this variability/treatment and return with further suggestions.

PROPOSAL:

(a) For FY 2008, we propose adopting the Commission's suggestion to use the relative RPW volumes of domestic and international Express Mail to form the distribution key.

(b) For FY 2008, since we do not have a new study to update the variability, we propose continuing with the 43 percent variability (with the remaining 57 percent non-volume variable), and we also propose to treat the 57 percent non-volume variable amount as Group Specific to Competitive Products, as these costs are solely for domestic and international Express Mail, which are both Competitive Products.

IMPACT:

(a) Using the RPW volume of domestic and international Express Mail shifts about $4.346 million away from domestic Express Mail and into international Express Mail (using FY 2007 cost information in C/S 3.1 inputs to the spreadsheets).

(b) Treating the 57 percent non-volume variable costs as Group Specific to Competitive Products shifts about $33.882 million from Institutional Costs to Attributable Competitive Group Specific (using FY 2007 cost information).

Proposal Six

PROPOSED CHANGE TO DISTRIBUTION OF EMPTY EQUIPMENT COSTS

OBJECTIVE:

For FY 2008, the Postal Service proposes a change in the methodology by which attributable empty equipment Cost Segment 14 (Purchased Transportation) costs are distributed to products.

BACKGROUND:

Accrued purchased transportation empty equipment costs are contained in two general ledger accounts, 53191 and 53192, for highway and rail empty equipment costs, respectively. Empty equipment costs are generally incurred when empty equipment items, i.e. letter trays, flat tubs, sacks, rolling stock etc, are transported between mail processing facilities and Mail Transport Equipment Service Centers (MTESC), or from MTESC directly to large mailers.

The attributable costs are computed by applying the variability factor to the accrued costs. The variability for transporting empty equipment by highway is the average cost weighted variability from all contracted highway transportation (approximately 80 percent). The variability for transporting empty equipment by rail is equal to the freight rail variability (approximately 99 percent). The Postal Service is not proposing any change in the variability factor applied to either highway or rail accrued empty equipment costs.

Currently, after the highway and rail attributable empty equipment costs are computed, they are distributed to products in the same proportions as the aggregate of all non-amphibious (that is, with the exception of inland and offshore water) cost segment 14 costs, using a simple three-step process. First, all other attributable cost segment 14 costs are distributed to products, based on the distribution keys and distribution factors for the various other cost segment 14 components. Second, based on the results of the first step, the cumulative proportion of all non-amphibious cost segment 14 costs that have been distributed to each product is calculated. Third, each product then receives the same proportion of empty equipment costs as it received of total of all non-amphibious cost segment 14 costs. This methodology has been utilized in PRC versions of the CRA since FY2000.

PROPOSAL:

In the second step of the distribution process described above, the Postal Service is proposing to exclude a portion of Cost Segment 14 costs mapped to component 828 (Total International) when calculating the cumulative distribution factors used to distribute highway and rail empty equipment attributable costs to products. Specifically, we propose to exclude costs from accounts 53261, 53262, 53263, and 53268 before calculating the distribution key that attributes empty equipment costs to products. In FY07, those four accounts totaled $472.4 million.

RATIONALE:

The Postal Service believes the current method of allocating attributable empty equipment costs to products should be refined to compute the distribution factors after excluding the portion of costs mapped to component 828 (Total International) that are not transportation related. The accounts recommended to be excluded from the distribution factor calculation are for terminal dues (accounts 53262, 53263, 53268) and for internal conveyance charges (account 53261). These costs are largely the result of settling foreign postal transactions, and are not transportation-related. Since there is no apparent causal relationship between variations in non-transportation component 828 costs and empty equipment costs, these non-transportation costs should be eliminated from the distribution factor calculation.

In the current domestic cost segment 14 model, all component 828 costs are mapped to the International Mail product group. As a result, including all component 828 costs (transportation and non-transportation) in computing the empty equipment distribution factors causes International Products to be assigned an inequitable proportion of empty equipment costs. Computing the distribution factors after excluding the non-transportation related portion of component 828 costs will result in a fairer distribution of highway and rail empty equipment costs to products. Of course, international mail products are sampled as they travel via the various modes of domestic transportation, and they will therefore continue to be assigned an appropriate share of empty equipment costs on that basis.

IMPACT:

Attached is a table which shows the impact of the proposed change on products (using FY07 mail categories and costs). The proposed methodology results in International Products receiving $9 million less in empty equipment costs, while First Class Mail and Priority Mail each receive $3 million in additional highway and rail empty equipment costs, respectively.

FY2007 CLASS, SUBCLASS, OR SPECIAL SERVICE	FY2007 HIGHWAY EMPTY EQUIPMENT COSTS	FY2007 PROPOSED HIGHWAY EMPTY EQUIPMENT COSTS	HIGHWAY DIFFERENCE (PROPOSED-CURRENT)	FY2007 RAIL EMPTY EQUIPMENT COSTS	FY2007 PROPOSED RAIL EMPTY EQUIPMENT COSTS	RAIL DIFFERENCE (PROPOSED-CURRENT)	HIGHWAY + RAIL DIFFERENCE (PROPOSED-CURRENT)
FIRST-CLASS MAIL:							
SINGLE-PIECE LETTERS	10,259	11,193	934	4,839	5 ,272	4 33	1 ,368
PRESORT LETTERS	9,863	10,750	887	4,676	5 ,090	4 14	1 ,301
SINGLE-PIECE CARDS	126	137	11	61	66	5	16
PRESORT CARDS	297	324	27	143	156	13	40
TOTAL FIRST-CLASS	20,545	22,405	1 ,860	9,719	10,584	8 65	2 ,725
PRIORITY MAIL	24,157	26,393	2 ,236	11,156	12,169	1 ,012	3 ,248
EXPRESS MAIL	1,799	1,964	165	837	912	75	240
IN-COUNTY	2	2	0	1	1	0	0
OUTSIDE COUNTY	3,633	3,963	330	1,716	1 ,870	153	483
TOTAL PERIODICALS	3,635	3,965	330	1,717	1,870	153	484
ENHANCED CARR RTE	1,361	1,485	124	636	693	57	181
REGULAR	6,591	7,183	593	3,125	3,402	277	869
TOTAL STANDARD MAIL	7,951	8,668	717	3,761	4,094	334	1,050
PACKAGE SERVICES:							
PARCEL POST	5,045	5,508	462	2,355	2,567	212	674
BOUND PRINTED MATTER	1,197	1,305	108	568	618	50	159
MEDIA MAIL	1,695	1,849	154	806	878	72	226
TOTAL PACKAGE SERVICES	7,938	8,662	724	3,729	4,064	334	1,059
US POSTAL SERVICE	567	620	53	265	289	24	77
FREE MAIL	79	86	7	38	41	3	10
INTERNATIONAL MAIL	14,409	8,318	(6,091)	6,732	3,930	(2,802)	(8,893)
TOTAL VOLUME VARIABLE	81,079	81,079	(0)	37,953	37,953	(0)	(0)

Proposal Seven

PROPOSED CHANGE IN DISTRIBUTION KEY FOR VSD COSTS

OBJECTIVE:

A methodology change is proposed for FY2008 in the distribution key for Cost Segment 8 (Vehicle Service Drivers) costs.

BACKGROUND:

Cost Segment 8 includes the salaries, benefits, and related costs of vehicle service driver (VSD) labor. VSD workload involves transporting mail using postalowned and leased vehicles. Transportation runs are made between post offices, branches, Processing and Distribution Centers/Facilities, Air Mail Centers/Air Mail Facilities, Bulk Mail Centers, depots, and certain customer locations.

The attributable costs are calculated by applying the variability factor of 60.44 percent to the accrued costs (approximately $660 million in FY2007). The volume variability factor was developed in R97-1 (USPS-T-20, Exhibit 2 Revised, page 22). This proposal does not address changing the volume variability factor. In FY2007, there were approximately $400 million in VSD attributable costs. Currently, after the attributable costs are calculated, they are distributed to products in the same proportions as cubic feet of originating mail obtained from Revenue, Pieces and Weight (RPW) Statistics.

PROPOSAL:

The Postal Service is proposing to distribute the attributable costs to products in the same proportions as the estimated cubic-foot miles of mail sampled on INTRA-SCF routes. The relevant proportions are developed through the Transportation Cost System (TRACS).

RATIONALE:

The Postal Service submits that the current method of distributing attributable costs to products incorrectly assigns Vehicle Service Driver labor costs to mail that originates at the Destination Delivery Unit (DDU). Presumably, this mail is entered at the DDU for delivery on routes from that office, and thus avoids VSD costs. The current methodology, however, treats all originating mail, regardless of entry point, as incurring the same amount of these labor costs. Absent a specific VSD distribution key, the Postal Service takes the view that a distribution key consisting of the cubic foot mile proportions on INTRA-SCF runs provides a reasonable proxy for distributing attributable VSD costs to products. Relative proportions of mail transported by Intra-SCF contracts are much more likely to be representative of VSD mail than relative proportions of originating cube, which necessarily include DDU mail that VSD drivers are unlikely to transport. Intra-SCF highway contracts, by definition, provide local transportation and include some trips from mail processing facilities to delivery units.

IMPACT:

Attached is a table which shows the impact of the proposed change on products (using FY07 costs).

FY2007 CLASS, SUBCLASS, OR SPECIAL SERVICE	HIGHWAY INTRASCF HIGHWAY	HIGHWAY CUBIC FEET	CURRENT HIGHWAY 2007 CS8 COSTS	PROPOSED FY2007 RAIL COSTS USING INTRA-SCF	PROPOSED MINUS PROPOSED RAIL CURRENT COSTS	CURRENT PERCENT	RAIL PROPOSED PERCENT
FIRST-CLASS MAIL:							
SINGLE-PIECE LETTERS	$ 145,729	109,232	$ 23,408	$ 69,963	$ 46,555	5.89%	17.60%
PRESORT LETTERS	$ 56,127	129,637	$ 27,781	$ 26,946	$ (835)	6.99%	6.78%
SINGLE-PIECE CARDS	$ 2,718	971	$ 208	$ 1,305	$ 1,097	0.05%	0.33%
PRESORT CARDS	$ 4,857	2,852	$ 611	$ 2,332	$ 1,721	0.15%	0.59%
TOTAL FIRST-CLASS	$ 209,431	242,692	$ 52,008	$ 100,546	$ 48,538	13.08%	25.29%
PRIORITY MAIL	$ 216,478	398,040	$ 85,298	$ 103,929	$ 18,631	21.46%	26.15%
EXPRESS MAIL	$ 11,041	8,334	$ 1,786	$ 5,301	$ 3,515	0.45%	1.33%
IN-COUNTY	$ 112	10,277	$ 2,202	$ 54	$ (2,148)	0.55%	0.01%
REGULAR	$ 90,696	145,187	$ 31,113	$ 43,542	$ 12,429	7,83%	10.95%
TOTAL PERIODICALS	$ 90,807	155,464	$ 33,315	$ 43,596	$ 10,281	8.38%	10.97%
ENHANCED CARR RTE	$ 50,7261	226,200	$ 48,473	$ 24,353	$ (24,120)	12.19%	6.13%
REGULAR	$ 116,008	263,241	$ 56,411	$ 55,694	$ (717)	14.19%	14.01%
TOTAL STANDARD MAIL	$ 166,734	489,441	$ 104,884	$ 80,047	$ (24,837)	26.39%	20.14%
PACKAGE SERVICES:							
PARCEL POST	$ 70,2365	302,504	$ 64,825	$ 33,720	$ (31,105)	16.31%	8.48%
BOUND PRINTED MATTER	$ 24,648	149,015	$ 31,933	$ 11,833	$ (20,100)	8.03%	2.98%
MEDIA MAIL	$ 16,447	47,026	$ 10,077	$ 7,896	$ (2,181)	2.54%	1.99%
TOTAL PACKAGE SERVICES	$ 111,331	498,545	$ 106,835	$ 53,449	$ (53,386)	26,88%	13.45%
US POSTAL SERVICE	$ 8,352	21,612	$ 4,631	$ 4,010	$ (621)	1.17%	1.01%
FREE MAIL	$ 1,808	3,024	$ 648	$ 868	$ 220	0.16%	0.22%
INTERNATIONAL MAIL	$ 11,985	37,770	$ 8,094	$ 5,754	$ (2,340)	2.04%	1.45%
TOTAL VOLUME VARIABLE	$ 827,968	1,854,922	$ 397,499	$ 397,499	$ -	100.00%	100.00%

Proposal Eight

PROPOSED CHANGES TO FIRST-CLASS MAIL AUTOMATION FLATS MAPPING

OBJECTIVE:

A change in Mail Characteristics Study methodology is proposed to correct an error in the procedure used to map First-Class Mail Automation flats pieces to rate elements in the FY2007 ACR and the two previous rate cases (Docket Nos. R2006-1 and R2005-1).

BACKGROUND:

The methodology used for mapping preparation characteristic to rate element for First- Class Mail Automation flats in R2005-1, R2006-1, and the 2007 ACR was incorrect. These previous Mail Characteristics Studies (e.g., in the 2007 ACR, FY07-14) included a scheme to map automation flats pieces from preparation characteristic to rate element that used a container-based mapping. In fact, however, a bundle-based mapping should apply for automation flats. For example, an automation piece in a 5-Digit bundle that is placed in a 3-Digit container is assessed the 5-Digit rate, and not the 3-Digit rate that would be consistent with the presort level of the container. (To give a slightly more complete background, the current container-based mapping scheme was appropriate when designed in anticipation of adoption of a container-based rate structure. The error, so to speak, occurred when the container-based rate structure was never implemented, but, through oversight, the container-based mapped scheme was nonetheless maintained in the spreadsheets, rather than being adapted to a bundle-based mapping scheme to reflect the actual bundle-based rate structure. The intent of this proposal is to correct that oversight.)

RATIONALE:

The bundle-based rates are in effect for automation First-Class Mail flats. Pieces are assessed postage based on the presort level of the bundle, not the presort level of the container.

IMPACT:

The correction of the mapping of preparation characteristic does not alter the aggregate volume of pieces by rate element because RPW rate element volumes are used as control values. The correction, however, will alter the distribution of pieces across preparation characteristic within rate elements.

The effect of the correction will increase the modeled cost for all First-Class Mail Automation flats rate elements. The costs for 5-Digit automation pieces increase because the 5-Digit rate element includes pieces in 5-Digit bundles that have been placed in MADC, ADC or 3-Digit tubs and incur additional bundle sorts. In the incorrect versions, the 5-Digit automation rate element only included pieces in 5-Digit trays, which do not incur bundle sorting costs. The costs of 3-Digit automation, ADC automation, and MADC automation pieces increase because these rate elements previously included the relatively lower cost pieces in bundles with a finer bundle presort than the container sort. For example, the 3-Digit automation modeled costs included the modeled costs of 5-Digit bundles that do not incur as many piece-sorts as pieces in 3-Digit bundles. The increase in the modeled costs for each rate element decreases the CRA adjustment factor. As a result of a decrease in the CRA adjustment factor, the nonauto presort rate category costs go down. The effect on the avoided costs is indeterminate, because the avoided costs depend on the estimated distribution of pieces across preparation characteristic.

It is Ordered:

1. Docket No. RM2008-2 is established for the purpose of considering the Request of the United States Postal Service for Commission Order Amending the established Costing Methodologies for Purposes of Preparing the FY 2008 Annual Compliance Report, filed August 11, 2008.

2. An informal technical conference to explore and clarify proposals is scheduled for August 27, 2008 at 10:00 a.m. in the Commission's hearing room.

3. Interested persons may file initial comments on or before September 8, 2008.

4. Reply comments may be filed on or before September 15, 2008.

5. William C. Miller is designated as the Public Representative representing the interests of the general public in this proceeding.

6. The Secretary shall arrange for publication of this Notice in *the Federal Register.*

By the Commission.

Judith M. Grady
Acting Secretary