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POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

PERIODIC REPORTING RULES	Docket No. RM2008-4

INITIAL COMMENTS OF THE UNITED STATES POSTAL SERVICE IN RESPONSE TO ORDER NO. 104
(October 16, 2008)

On August 22, 2008, the Commission issued Order No. 104, seeking comments on proposed new rules regarding periodic reporting and the Annual Compliance Report (ACR). Order No. 104 set October 16th as the date for initial comments, and November 14th as the date for reply comments. The Postal Service hereby submits its initial comments on the proposed rules.

The proposed rules represent the next step in the evolutionary process from the former regime under the Postal Reorganization Act (PRA), in which the primary conduits of cost, volume, and revenue information from the Postal Service to the Commission were omnibus rate proceedings, to the new regime under the Postal Accountability and Enhancement Act (PAEA), in which the primary conduits of comparable information necessary for transparency and regulation are the Annual Compliance Reports. Other periodic reporting played an important role under the old regime. Although the periodic reports needed under the new regime may be different, and the primary focus has shifted from rate cases to the ACR process, periodic reporting will continue to play an important role in the new regulatory regime. Last year, the Postal Service filed its initial ACR, despite the fact that the data systems in place for FY07 were geared to

subclasses of mail, rather than “products,” and despite the fact that the Commission had not yet issued rules to guide ACR preparation. The Postal Service is pleased that the rules proposed now do not appear to require any massive alteration in structure, relative to what was filed last year. The fundamental building blocks of cost reporting will remain the same, including separation of accrued costs into segments; application of variability studies and data collection systems to create cost pools and distribute variable costs to products; use of special cost studies to develop models of worksharing costs and costs associated with different types of mail; and aggregation of most of this information into the Cost and Revenue Analysis (CRA) report and the Cost Segments and Components Report. Quite sensibly, in other words, the proposed rules build on what has worked well in the past, and do not attempt to reinvent the wheel.

Moreover, Order No. 104 shows apt recognition of the transitional status of data reporting at this time. *See, e.g.,* Order No. 104 at pages 16-17. The reporting unit is changing from “subclass” to “product,” international mail products have become commensurate with domestic mail products, and data regarding Negotiated Service Agreements (NSAs) have to be better integrated into broader reporting formats. The Commission appears to understand that each of these transitions presents challenges, and that the Postal Service’s ability to meet such challenges should be improving over time. Nonetheless, some flexibility will be required of all participants as the process moves forward, and the Postal Service appreciates that the general approach reflected in Order No. 104 appears to be a fundamentally pragmatic one.

Overall, therefore, the Postal Service views the proposed new rules as establishing a workable framework for the ACR and other periodic reporting. There are,

however, certain aspects of the proposed rules which raise concerns. The Postal Service's focus on such concerns in these comments should not be misinterpreted as a broader objection to pursuit of the objectives which the new rules appear to be designed to accomplish. Rather, the Postal Service believes that generally sound proposals can be and should be improved in certain discrete respects.

Before offering specific suggestions on the proposed rules, the Postal Service understands that section 3652(e) grants the Commission the authority to prescribe the content and form of the public report required under section 3652. In doing so, the Commission is directed to balance competing factors:

> "[T]he Commission shall give due consideration to---
> (A) providing the public with timely, adequate information to assess the lawfulness of rates charged;
> (B) avoiding unnecessary or unwarranted administrative effort and expense on the part of the Postal Service; and
> (C) protecting the confidentiality of commercially sensitive information."

39 U.S.C. § 3652(e)(1).[1]

In balancing these elements, the Postal Service also encourages the Commission to be mindful of the increasingly competitive environment in which the Postal Service operates for all classes of mail, the significant economic burdens the Postal Service is facing at the present time, and the fact that the Postal Service must eliminate all unnecessary costs as quickly as possible now and in the future. In particular, the Postal Service must limit its staff size to control its costs, and staff must be focused on only what is absolutely necessary to enable the Postal Service to maintain high quality service and otherwise continue to fulfill its universal service

[1] Although Order No. 104 does not specifically address these considerations, it seems reasonable to expect that the final order will do so.

mission. Every request from the Commission for data has a cost element, and requires expenditure of staff time and resources. Congress recognized as much in section 3652(e)(1)(B) of the statute, when requiring that reporting obligations be developed to avoid "unnecessary and unwarranted administrative effort and expense of the part of the Postal Service." Particularly at this time, but also continuing into the foreseeable future, the Postal Service asks the Commission to ensure that it is only seeking data from the Postal Service that are absolutely necessary to carry out the Commission's responsibilities, that data only be sought at the time they will be used, and that the Postal Service be allowed to produce data in the most cost effective, least burdensome manner. The Commission has continuing statutory authority to amend the reporting rules, and can do so if a need for additional information subsequently arises.

We offer the following specific suggestions on the proposed rules:

1. Rules for USO-Related Reporting and SEC-Related Reporting Should be Deferred

As explained in its Order, the Commission has created placeholders in the rules for data reporting for service quality. Order No. 104 at 11-12. The Commission is awaiting evaluation of the service performance measurement system currently under review in another proceeding. After that, the Commission intends to solicit public comment on the appropriate service quality data reporting requirements. *Id*. Until then, the Commission is simply inserting placeholders at the appropriate places within its proposed rules (sections 3050.50-53).

The Postal Service supports this approach with respect to service quality data and, in fact, suggests that a similar approach is warranted with respect to several areas where the Commission has instead attempted to proceed with proposed rules. One

such area is the proposed rule (section 3050.30) regarding information needed to estimate the cost of the universal service obligation. Another such area is the proposed rules (section 3050.40-42) regarding additional SEC-type financial reporting, also sometimes referred to as Sarbanes-Oxley (SOX) obligations.

USO-Related Reporting

The Postal Service understands that section 3651 of title 39 places an ongoing obligation on the Commission with respect to annual estimates of costs incurred by providing service to the parts of the nation where service potentially would not be provided absent the requirements of section 101(b), and that this obligation is the genesis of the proposed new rule set forth in section 3050.30. Obviously, though, the type of annual information the Commission is obligated to produce by this requirement is closely related to the types of information being gathered and evaluated for purposes of the Universal Service Obligation (USO) study currently being conducted pursuant to PAEA section 702. Both the Postal Service and the Commission are heavily engaged in digesting large amounts of information in conjunction with the USO study, much of which is being prepared by contractors. Order No. 104 itself recognizes that the new rules it is proposing in this area will need to be re-evaluated in light of the results of the pending USO study. Order No. 104 at 14.

Under these circumstances, the Postal Service submits that the most reasonable course of action is not to prematurely promulgate new rules that will need to be re-evaluated in very short order, but rather to wait until the results of the USO study can be factored into a comprehensive new proposal. Based on what is learned from that extensive body of research, the Commission, the Postal Service, and interested parties

can subsequently confer on what methodologies are most appropriate to develop the needed annual estimates, what input data are required to apply those methodologies, which of those input data are currently available, and what reasonable steps will need to be taken to obtain any input data that are lacking. Just as the pendency of the service quality proceeding militates in favor of employing a placeholder for those rules, the pendency of the USO proceeding would suggest that a placeholder likewise seems appropriate with respect to the USO rule. Otherwise, the Postal Service will need to expend resources to construct a USO reporting system that may well be superseded. Therefore, the Postal Service urges the Commission to set aside proposed rule 3050.30, and, for now, simply insert a placeholder in its stead. With respect to any short-term obligation under section 3651 (i.e., those arising before the above-described process can be completed), it would appear that the results of the USO study would be available to fulfill the needs for compiling the annual report required under that section.

In proffering this suggestion, the Postal Service is by no means motivated by some abstract notions of parallel treatment between service quality issues and USO issues. Rather, there are sound bases for viewing the proposed rules as premature, and the placeholder approach is thus an appropriate alternative. For example, subpart (a) of proposed Rule 3050.30 would require the Postal Service to provide “Mail flow volumes by product (or product group) between each pair of mail processing facilities, including local turnaround mail for each facility.” The Postal Service, although unsure of exactly what is intended by the term “mail processing facilities” in this proposal, generally does not at this time have such mail flow data by product (or product group) under any plausible meaning of the term.

Yet mail flow data are being developed for the ongoing USO studies, and it would seem logical to examine what useful data can actually be produced in that context, *before* attempting to craft a rule that risks imposing an unworkable requirement on the Postal Service. Beyond questions of mere capability, moreover, are more fundamental questions of what is the most appropriate analytic approach to meet the objectives (i.e., providing the annual estimates required by the statute). Once again, the pending USO studies may likewise shed some light on this type of issue. As noted above, given the significant economic challenges it is facing, it is vitally important for the Postal Service that its staff and other resources not be diverted to providing data in pursuit of answers to questions that, in the near future, the USO study may show can more fruitfully be addressed from a different perspective.

Another example of a tangible concern is the “stop” data specified in proposed Rules 3050.30(c)(2) and (d)(1), which involve city and rural routes respectively. Under previous incarnations of carrier data systems, the Postal Service collected such “stop” information, but the data systems were redesigned when the approved costing methodologies no longer utilized “stop” data for cost attribution or distribution. In order to resurrect the ability to collect “stop data,” it would be necessary to undertake an “unredesign” of both CCCS and RCCS, which would not be well received by data collectors or carriers. In fact, given the average hold-up of the carrier of about 1 hour required by the process used when “stop” data were collected, the Postal Service estimates increased costs of about one-half of a million dollars per year, just in carrier time alone, to “unredesign” CCS. Moreover, in order to get to that point, the Postal Service would have to “unredesign” software, policy, and training material. Each of

these would generate additional costs, in addition to the increase in carrier delay costs. The magnitude of the additional costs, as well as the detrimental effect on operations (e.g., delaying the ability of carriers to get to the street, reducing customer satisfaction for those customers who prefer delivery earlier in the day), requires thorough consideration of both analytic and practical alternatives before imposition of such a requirement.[2] The placeholder approach would allow such thorough consideration.

In addition, it appears that the specified information goes well beyond what is required by section 3651 to estimate the annual costs incurred by providing service to the parts of the nation where service would not be provided absent the requirements of 101(b). For example, there is no reason why data on both "stops" and "deliveries" would be required for such a calculation. The estimate of costs incurred first requires identification of the areas of the country that would not receive service without the legal requirements. Such calculations compare the cost of providing service and the revenues generated by that service, and are typically done at the route or ZIP Code level, not the stop or delivery level. "Areas" of the country do not typically refer to individual stops or deliveries. The lack of clear linkage between the specified data and the data required to estimate the annual costs of providing service to the parts of the nation where service would not be provided absent the requirements of 101(b) is an additional reason for initially following the placeholder approach.

[2] This context seems an ideal one in which to give weight to the requirement in section 3652(e)(1)(B) of the statute that the Commission avoid "unnecessary and unwarranted administrative effort and expense of the part of the Postal Service." This principle is just as appropriate with respect to determining what information should be provided pursuant to section 3651(c).

SEC-Type Reporting

The Postal Service likewise urges the Commission not to adopt its own set of rules interpreting the Postal Service's SEC-type reporting obligations. (In Order No. 104, a proposed set of such rules appears as sections 3050.40-42.) Unlike the USO rules, the impetus for which is clearly the need to respond to the Commission's annual reporting requirements of section 3651(b) of title 39, the impetus for the Commission's proposed SEC-related rules is not clear. To be sure, section 3654 of title 39 creates SEC-type reporting obligations for the Postal Service. However, unlike section 3652, which directs the Commission to specify and define the reporting requirements for the Annual Compliance Report, the statutory requirements of section 3654 are quite detailed. Section 3654 directs the Postal Service to file quarterly, annual, and periodic reports within specified time frames and containing the content prescribed in various Forms of the SEC. It also requires the Postal Service to comply with the rules prescribed by the SEC implementing the requirements of section 404 of the Sarbanes-Oxley Act of 2002, beginning with the FY 2010 annual report. While the Commission does not establish the reporting requirements, section 3654(e) provides the authority for the Commission to "improve the quality, accuracy, or completeness of Postal Service data required under this section whenever it appears (1) the data have become significantly inaccurate or can be significantly improved; or (2) those revision are, in the judgment of the Commission, otherwise necessitated by the public interest." Order No. 104 itself identifies no objective to its proposed rules beyond the intent "to incorporate" the requirements of the statute into the proposed rules. Order No. 104 at 3-4.

Given the specificity of the statute, the proposed rules are redundant in many respects, and yet, in other instances, they move beyond a mere restatement of the statute. Therefore, they often raise more questions than they answer. For example, section 3654(a)(1)(C) of title 39 makes only a general reference to Form 8-K, rather than specifying compliance with certain sections. Proposed Rule 3050.40(c), however, specifies items within sections 1-6 and 9 of Form 8-K, some of which are plainly inapplicable to the Postal Service, such as all of Section 3 (pertaining to securities and trading markets), Section 5, Item 5.01 (pertaining to change in control), Item 5.03 (pertaining to amendments to articles and bylaws and changes in fiscal year), Item 5.04 (pertaining to suspension of trading in employee benefit plans), Item 5.06 (pertaining to change in shell company status), and all of Section 6 (pertaining to asset-backed securities). This creates confusion, leading to the question of why the Commission would include sections that are so clearly inapplicable.

In a few places, the proposed rules would impose significant additional obligations on the Postal Service, compliance with which would be beyond the control of the Postal Service. The requirement of proposed Rule 3050.40(b)(3), that the Postal Service obtain from OPM the information listed in subparagraph (b)(2) regarding the pension and post-retirement health obligations no later than 30 days after the end of each fiscal year, imposes a burden on the Postal Service that it cannot control. The Postal Service can only request the information from OPM, and has no means to compel OPM to meet its statutory deadline. The proposed rule places the obligation on the wrong entity, whereas the law properly places the burden of supplying the report on

OPM. *See* 39 U.S.C. § 3654 (b) (2) (OPM "shall provide the data … to the Postal Service not later than 30 days after the end of each fiscal year.").

Perhaps a more critical flaw in proposed Rule 3050.41 is the scope of the auditor's opinion required in that rule, which is in addition to the auditor's opinion already required by SEC Form 10-K (See Part II, Item 8 of Form 10-K), with which the Postal Service must comply pursuant to section 3654(a)(1)(B) of title 39. In section 3654(c) of the statute, the scope of the additional opinion is limited primarily to the materials regarding the Postal Service's pension and post-retirement health obligations, specified in section 3654(b)(1) of title 39. Therefore, to track the statute, one would have expected rule 3050.41(a) to limit the scope of the required auditor's opinion to those same pension and post-retirement health obligation materials, specified in the proposed regulations in subsection 3050.40(b)(2). Rather than narrowly referring back to information listed in "3050.40(b)(2)," however, proposed rule 3050.41(a) instead refers back more broadly to the information listed in "3050.40(b)." Linking the scope of the supplemental audit requirement to all of subsection 3050.40(b) would appear to require audit review of the entire Form 10-K annual report, which goes well beyond the audit scope specified in the statute.

Moreover, proposed subsection 3050.41(b) actually calls for the Postal Service and its auditors to "provide" the Commission with audit documentation and other supporting material. In the corresponding part of the statute, however, section 3654(d) merely indicates that the Commission shall "have access to" such materials. Since the extent and format of the audit documentation could vary, there may be a substantial increase in burden relating to an affirmative obligation always to "provide" all of a set of

materials, as opposed to a more passive obligation to allow "access," which may not be necessary in every instance, and which in some instances may only involve a particular subset of the materials. Of course, access to materials can also be obtained in many ways short of actually providing them in a formal filing, such as by allowing examination of the materials at the location where they are kept. The Postal Service believes that the distinction is important, and therefore requests that, if the Commission feels compelled to retain this portion of the proposed rules, the language of subsection 3050.41(b) be changed to establish no greater obligation than that imposed by the language of the statute (i.e., granting the Commission "access" to the audit documentation).

More broadly, the SEC itself has well-developed rules regarding this type of financial reporting, and years of experience in interpreting and applying those rules. There is no regulatory vacuum here. In fact, the opposite is the concern. When the Commission establishes rules, it runs the risk of conflicting with rules that the SEC has already established. For example, proposed section 3050.40(c), restating the requirements to file current reports on Form 8-K, indicates the timeframe within which the 8-K's must be filed as "4 days". The SEC requirement in Form 8-K is actually "four *business* [emphasis added] days", and the SEC could in its discretion change this timeframe in the future (as it has recently done).[3] The statutory provision says that the Postal Service must file these "periodic reports within the time frame and containing the information prescribed in Form 8-K …as such Form (or any successor form) may be

[3] It may be the case that, in light of Commission Rule 15 regarding Computation of Time, the result under the Commission proposed rule and the SEC rule would be the same in this instance, but the general point regarding the potential for conflict remains.

revised form time to time." 39 U.S.C. § 3654(a)(1)(C). The statutory provision clearly links the Postal Service's obligations to the SEC rule, not any conflicting rule that the Commission might have in effect (either through inadvertence, or because the SEC subsequently amends its rule). The potential for conflict with SEC rules is another factor which calls into question the prudence of establishing SEC-related reporting rules without any well-defined need to do so.

The Postal Service views the rules proposed in section 3050.40-42 as neither particularly necessary nor particularly helpful in its efforts to provide SEC-type reporting. Ample guidance is already available from the statute and the SEC regulations. It would seem to make more sense for the Commission to hold off on its rules, wait until some actual experience has been gained with this type of reporting, and then see if any gaps emerge which can beneficially be addressed by additional guidance from specific Commission rules.[4] Until that time, placeholders could be maintained, such as those employed with respect to the service quality reporting.

If the Commission nonetheless feels compelled to proceed now with its SEC-type rules, the Postal Service would note that unless the regulations restate the law

[4] The Postal Service is concerned that, in the course of trying to extrapolate SEC-style reporting to the Postal Service, an entity which differs from typical private sector corporations in fairly major and dramatic ways, Congress may have included some specific provisions in section 3654 to which experience may show that it could be difficult for the Postal Service to respond. In these instances, of course, the root problem would be in the statute, and not in any proposed Commission rules intended merely to replicate those provisions. Postponing adoption of Commission rules now, however, may later allow the Commission and the Postal Service to evaluate ongoing experience and determine if a more nuanced approach to translating the statutory provisions into regulations might be possible. On the other hand, forging ahead with final rules, even rules which very closely track the statutory language (such as those shown in Attachment A, discussed below), may not allow these types of issues to be meaningfully addressed and resolved.

verbatim, there is a chance that any restatement could alter the original meaning. For this reason, while strongly urging the Commission not to issue regulations which seem to serve no particular purpose, the next best alternative would be regulations which, as nearly as possible, restate the statutory provisions verbatim. A sample of such a second-best alternative is appended to these comments as Attachment A. While many of the changes to the proposed rules suggested in Attachment A represent correction of admittedly minor deviations relative to the statutory language, these suggested changes nonetheless avoid the questions raised by deviation from the statutory language in the rules as proposed. The most direct way to avoid unintended conflicts is simply to eschew rules with no clear purpose beyond a restatement of statutory provisions, but if that option is rejected, closer adherence to the statutory language seems warranted.

2. The Placeholder Approach is Also Appropriate to Address the Obsolescence Issues Currently the Subject of Proposed Rule 3050.12

Another topic regarding which the Postal Service submits that the deferral option is preferable to trying to hammer out acceptable revisions to the proposed rules in this proceeding is the topic of obsolescence, covered by proposed section 3050.12. The implicit objective of proposed section 3050.12 is to ensure that the data and information upon which analyses required in the ACR are performed, and upon which the Commission's determination of compliance with the requirements of chapter 36 are based, are current and complete. The Postal Service recognizes the merit of this objective. Neither the Postal Service nor the Commission desires to make business decisions and determine compliance with the requirements of chapter 36 based on data and information that have been superseded by technological or operational changes, or simple changes in results due to changes in mail mix or other factors. To avoid these

untoward circumstances, however, the Postal Service believes that the best approach to employ is similar to that described in Order No. 104 under the heading of "Strategic Rulemakings." Order No. 104 at 32. Specifically, to make necessary and reasonable study updates, coordinated efforts should "identify areas in which research is most needed and most likely to bear fruit." *Id.* Using a strategic rulemaking in this fashion seems like a much better approach than imposing a blanket rule which, as explained below, is likely to do more harm than good. Of course, if one result of such a strategic rulemaking is a subsequent consensus regarding the desirability of some type of provision in the rules relating to the interval of time which has run since a data input or set of data inputs were created, the "placeholder" which the Postal Service is now advocating be established in section 3050.12 could then be filled in with a substantive rule. Until then, however, for reasons discussed next, the Postal Service maintains that any "obsolescence" rule would be both premature and counterproductive.

Initially, of great comfort to both the Postal Service and the Commission should be the knowledge that the aggregate cost data to which the special studies tie are completely replaced on an annual basis. It is actually a misstatement to assert that the Cost and Revenue Analysis Report and its attendant Cost Segments and Components reports "measure" costs. In fact, the CRA and the Cost Segments and Components and many of the associated analyses attribute and distribute costs which have been independently determined and assigned to cost accounts through accounting procedures. This measurement of costs and assignment to the proper cost accounts is performed every year. The CRA and its attendant reports merely attribute and distribute

those costs to categories of mail. This attribution and distribution is also performed every year.

The Postal Service interprets the Commission's designation of "special studies" in proposed section 3050.12 to encompass both the type of studies used to estimate worksharing cost avoidances and other cost differences, as well as the independent fieldwork or analyses required to develop and support the variabilities and distribution keys used within the workpapers associated with the CRA to attribute and distribute costs to different types of mail. In both situations, the studies are not necessarily updated every year, but in both cases the studies are tied to cost information which is updated every year. The cost accounts are updated every year, and the inputs from the major data systems (IOCS, CCCS, RCCS, etc.) are updated every year. Other information required to populate the special studies are also available and updated in a fairly painless manner on an annual basis (e.g., productive hourly wages, compensation to Rural Carriers by shape of mail piece, MODS data, etc).

Thus, both the Postal Service and the Commission may be comforted that the underlying cost information and many of the most significant inputs to those studies are routinely updated. At the levels of data disaggregation to which the Commission's proposed section 3050.12 speaks, both the Postal Service and the Commission share the desire for up-to-date information. However, at this level of data analysis and modeling, the Postal Service has to question the practical utility of the proposed rules and whether the rules, as written, are not unwarranted and burdensome. The rules not only may fail to satisfy the Commission's desire for "new" data and studies, but also may prove to be an unnecessarily burdensome and pointless exercise that will drain

both the time and resources of the Postal Service and the Commission. In addition, several vehicles exist by which inadequate data may be highlighted, emphasized and addressed in the context of questions of resource allocation and the utility of updating studies. These include both the process set forth in section 3654(e) which allows members of the mailing community and the Commission itself to question the costing approaches taken by the Postal Service, as well as the strategic rulemakings noted above which the Commission has suggested be utilized to prioritize cost study updates. The Postal Service represents that the Commission has already developed adequate mechanisms through which the obsolescence of special studies and the possible negative impact on results thereof can be addressed. The detailed requirements of the proposed section 3050.12 add a burdensome bookkeeping and onerous check-off system that will achieve little or nothing in terms of the improvement of study results.

Section (a) of proposed section 3050.12 states that "[f]or each special study…the Postal Service shall indicate the date the study was completed…" The meaning of this basic underpinning of the proposed rule is unclear. This provision seems to presume a uniformity to the development of "studies" that does not exist. Some special studies are, as this rule would seem to suggest, a "one time" snapshot of the postal operating conditions. This type of study tends to be one requiring significant resources in terms of time and development and funding in order to adequately sample postal operations. Examples of this type of study would be a study of carrier street time activity, or a study of window clerk activity and variabilities, or a study of flats bundle breakage on various types of mail processing equipment.

Another type of study often referred to as “special studies” would be cost models such as are used to determine the cost avoidances associated with various types of worksharing activities, such as presorting letters or flats, or dropshipping mail. This type of study is not a “one time” snapshot, but rather, the models have evolved over decades of postal litigation and incorporate new data as possible. For example, wage rates, total mail processing costs by shape, piggyback factors, MODS data, and other inputs to these models are updated every year.

For purposes of complying with this proposed rule and with reference to part (b) which states that a “presumption of obsolescence shall attach to any special study that is more than 5 years old at the time that the annual compliance report is due,” what is the “date the study was completed” for the second type of study described above? For the one-time snapshot studies, the date of completion is fairly established, but for models that evolve over time and reflect new deployment of equipment or new productivities associated with the same equipment, what is the date that the Commission will use as reference? The age of the oldest input into the study? If one input in a study is more than five years old, is the study presumed to be obsolete? It seems doubtful that anyone would seriously contemplate that the Postal Service would, for example, completely jettison the letter cost models and send analysts and data collectors out to the field to redesign such models from scratch every five years. But if not, what is the means by which the Postal Service will “certify that a study reasonably reflects current operating conditions or procedures,” especially for studies that may contain an input that is more than five years old?

Or, for special studies which are not snapshot studies, but which are models evolving over time, does the Commission envision that the Postal Service is to provide a listing of each and every data input and the age thereof, and seek waivers for every input to the models that may be more than five years old? The enormity of this task, and the attendant lack of value, may be seen when one considers that for the First-Class Mail letter cost model, there are over 319 individual data elements used as inputs to the model. While many of these data elements would be updated as a matter of course every year, and presumably the ones representing the most significant share of the costs would be among those updated, if even ten percent of the data elements are more than five years old, the Postal Service would have to produce, and the Commission would have to review, a chart for more than thirty data elements with requests for waivers. And that would be for just one cost model. In such a scenario, with so many data inputs, it is reasonable to expect that only in a few instances would a single input likely be significant enough to cause an extreme shift in results. In fact, the Postal Service analysts could probably spend months of their limited time varying the results for each and every input to determine whether that particular input would meet an unspecified threshold for “a significant effect” as stated in (c) (2).

The determination of a five-year rule is decidedly arbitrary. In fact, for some processes in environments of flux, five years may be too long. For other processes, five years may be too short either due to lack of changes in the operating environment, or due to the enormous cost and small payoff in improvement in data quality that may result from updating the study, a result that the Commission’s criteria for waivers contemplate. Given the mechanisms for review already available through the

Commission's Annual Compliance Determination (ACD), and possible rulemakings on the cost studies, more appropriate and meaningful consideration may be given to the necessity and/or timing of cost study updates without reference to an arbitrary rule of five years. The Postal Service proposes that, for this and other reasons more fully discussed below, a more thoughtful approach to addressing the Commission's apparent concern with the quality and vintage of special studies and their inputs would be to address these concerns in a separate proceeding such as a strategic rulemaking. This would allow the Commission, the Postal Service and other interested parties to focus on a particular study or, even more narrowly, the particular elements of a study, rather than codify an arbitrary and burdensome process which will likely prove to be repetitive and perhaps even demand the use of limited resources that otherwise might be directed toward actually updating the studies.

The proposed rules would create an enormous effort that would provide little more than what is, in most instances, currently available by reference to the footnotes already provided in the workpapers presenting the studies themselves. If the documentation of the existing studies is inadequate, the Commission certainly has opportunity to require the Postal Service to be more forthcoming. The practical application of this rule, in and of itself, could lead to a pro forma filing every year for the same "obsolete" data elements for the same reasons cited in the previous year's request for waiver. It is highly unlikely that a data input for which a waiver was requested in the previous year on the grounds that updating the element "would not have a significant effect on the costs, volumes, or revenues estimated for any postal product" (criterion (2)) would suddenly rise to the level of a significant effect in the

following year. Thus, each year, the Commission could anticipate the same request for a waiver. Similarly, particularly in the current financial environment, it is difficult in most instances to envision that a waiver filed in one year on the grounds that “the cost of updating the special study would outweigh the resulting benefits” would be inapplicable in the following year because the relationship of the cost and benefit of the data collection would suddenly reverse itself.

It is also not clear what would rise to the level of adequate support in a statement that is to certify that “the operating conditions reflected in the special study have not changed”. For example, in the cost avoidance studies, there are many operating conditions reflected. Certification that the data reflect the current operating conditions is not the same as certifying that every element of data used to reflect those operating conditions is not more than five years old. In fact, the model may more than adequately reflect the current operating conditions, while not having the precise percentages or productivities that may be slightly different from those measured five years ago.

The proposed rule lists four criteria as possible bases for requests for waiver, specifying that a request for a waiver must be filed at least 60 days before the due date for the Annual Compliance Report. Not mentioned is what the Postal Service is expected to do in the event of a denial of the waiver, other than perhaps provide a timetable for an updated study, the resources for which may or may not exist. Furthermore, the proposed rules do not address the sometimes necessary use of assumptions. Within many models, some information is simply not available, or is not measurable, and assumptions must then be deployed. The proposed rules, while addressing the age of inputs that the Postal Service has endeavored to measure,

seems to permit the circumstance where data becomes obsolete, but assumptions are timeless.

The Postal Service acknowledges the Commission's concern about the quality of the special studies but submits that there are more meaningful ways to ensure data quality through avenues such as the use of mailer comments on the ACR, the Commission's ACD, and strategic rulemakings. Such approaches are more likely to result in substantive inquiry and appropriate and efficient direction of resources, rather than the premature imposition of a rigidity that has not yet been determined to be necessary to achieve the Commission's goal.

3. The Role of Forecasting Inputs Has Changed Under the PAEA

Under the old ratemaking regime, in which rate recommendations were carefully constructed to allow forecasted revenues and costs in a prospective test year to balance, the role of volume forecasting was central to the entire ratemaking process. The "breakeven" structure of rate cases required the Commission to employ volume forecasting procedures and inputs at virtually every step, whether rolling costs forward to the test year, setting rate policy objectives, or designing rates to meet those objectives. That simply is no longer the case under the PAEA. The primary determinant of changes in rate levels is inflation (as measured by CPI) over an historical 12-month period, not the prospective 12-month period of rate case test years. The shift in the relative importance of volume forecasting is a noteworthy aspect of the shift in the Commission's role in ratemaking -- from the active primary designer of recommended rates, to a more passive reviewer of the compliance of rates selected by the Postal Service with specific statutory standards.

Obviously, demand analysis and volume forecasting are still critical components of the Postal Service's ability to make informed decisions on operations, personnel, pricing, budgeting, investments, and strategic planning, just as they are to any large business. The Postal Service therefore maintains its demand analysis and forecasting functions, just as it did before, and they are instrumental aids to the management of the organization. Getting the volume and revenue forecasts right – neither too high nor too low – remains the paramount objective for providing management the right information necessary to make the right decisions.

Order No. 104 goes to some lengths to downplay the primacy of backward-looking historical analysis in the new regulatory environment, and emphasize the continuing role of demand analysis and other more forward-looking perspectives. *See* Order No. 104 at 3-4, 10-11. The Postal Service agrees that, for example, the Commission has a legitimate interest in current price elasticities, and the broad range of inferences that can be drawn from price elasticity information. The Postal Service does not agree, however, with any suggestion of parity in the Commission's authority to prescribe demand analysis and forecasting methodologies, versus its authority to prescribe costing methodologies. Section 3652(a)(1) requires the information the Postal Service provides in the ACR to "analyze costs, revenues, rates, and quality of service, using such methodologies as the Commission shall by regulation prescribe … ." Clearly, for example, the Commission has been authorized to direct the Postal Service regarding what costing methodologies to employ as it reports the costs necessary to evaluate compliance with the statute. Unlike costing methodologies, however, neither demand analysis nor volume forecasting are included within the list of analyses for

which the Commission is authorized to prescribe methodologies. That omission, as discussed below, has implications for certain limited portions of the proposed rules.

Before reaching that discussion, however, it may be useful to address the broader sections regarding demand analysis to which the Postal Service does not object. Proposed Rule 3050.26 would require the Postal Service, by January 20 of each year, to provide econometric estimates of demand elasticity for all postal products, accompanied by the underlying econometric models and the input datasets used. For FY07, the Postal Service did not formally file such demand elasticity information as part of the ACR submission at the end of December, but did provide it separately by letter to the Secretary on January 16, 2008. The information provided in that letter included extensive computer files and documentation, and, as far as the Postal Service is aware, would have been sufficient to have met the requirements of the new rule, had the rule been in effect. In other words, the Postal Service views the new rule as formalizing the procedure followed for FY07, which appears to have satisfactorily met the needs of all concerned, and the Postal Service has no objection to that approach. Proposed section 3050.26 provides a reasonable procedure to make available updated demand analysis information, for whatever purposes that such information has relevance and utility within the new ratemaking environment.

Another section, proposed rule 3050.60(f), involves a filing in July of each year of a succinct narrative explanation of how the estimates in the most recent ACD were calculated, and the reasoning behind those calculations. The rule explicitly establishes, as the model for this narrative, the document traditionally filed in rate cases as USPS-LR-1, the “Summary Description of USPS Development of Costs by Segments and

Components." That document was focused entirely on costing, however, and never had any relationship with the demand analysis and forecasting material separately filed in rate cases. Commensurately, the language of proposed rule 3050.60(f) itself makes no mention of demand analysis. It is only in the text of Order No. 104, at page 20, where the suggestion appears that the July filing in compliance with rule 3050.60(f) should also cover "demand analysis." The Postal Service objects to that suggestion on the grounds that, unlike with respect to a comprehensive "summary description" of costing, the narrative explanation of the demand analysis will already have been filed in January. Implicitly extending the requirements of proposed rule 3050.60(f) to encompass demand analysis as well as costing materials would impose a redundant and unnecessary burden on the Postal Service, with no corresponding benefit to anyone.

A similar concern exists with respect to proposed subsection 3050.21(d), which requires the ACR filed in December to include the "price elasticity of demand for each product." Since the Postal Service will be providing updated elasticity estimates on or before January 20 pursuant to section 3050.26, it is unclear why the rules would also require price elasticities in the December filing. If the requirement of proposed subsection 21(d) remains, the Postal Service would meet the December requirement simply by citing back to the elasticities filed the previous January. Having elasticities from the prior January in circulation during the ACD process, as well as updated elasticities filed pursuant to Rule 3050.26, would appear to create an unnecessary opportunity for confusion. On that basis, the Postal Service suggests that subsection 21(d) be omitted.

The Postal Service's primary concern with respect to demand analysis and forecasting matters, however, involves Order No. 104's apparently expansive approach to the process by which analytic changes "must be reviewed and accepted by the Commission in advance." *See* Order No. 104 at 27. Specifically, to the extent the proposed rules contemplate that changes in demand analysis (and by implication, forecasting) methodologies would be subject to the same advance approval process as changes in costing methodologies, the Postal Service views such a proposal as untenable. First, the ability to dictate demand analysis procedures is tantamount to the ability to dictate forecasting procedures, and, as noted above, there is no longer any support in the structure of the statute for an alleged intent to expand the areas of Commission oversight to include forecasting. It is vital for the Postal Service to maintain control over the ability to forecast its own future, just as it would be for any large and complex business enterprise, and the Postal Service does not contemplate relinquishing control over its internal forecasting function.

Even putting the scope of authority issue to the side, however, there is a much more fundamental pragmatic concern. Demand analysis is by nature more dynamic and fluid than cost analysis. In cost analysis, regression models are run that provide variability estimates that are usually applied without change over numerous years. In contrast, for demand analysis, once new input data become available, the demand model regressions are re-estimated in order to obtain the inputs necessary for forecasting. If, with inclusion of the new data, a prior model no longer provides the best basis for forecasting a particular type of mail, the model has to be adjusted to match the new "reality." The task of incorporating new regression input data, rerunning the

demand models, incorporating new econometric results into the forecasting models, and assessing the resulting forecasts, is a complex and necessarily iterative process.[5] It commonly involves assessment of details of the models such as economic variables to include or omit, trend variables to include or omit, lag structures, and the like.

On page 28, Order No. 104 indicates that changes in "analytic principle" include changes in functional form, model specification, or similar aspects of regression analysis. If "analytic principles" are contemplated to include those applied to demand analysis, then there is no practical opportunity to submit any such changes for advance review in the very short period of time between the availability of new data and the deadline for the production of updated forecasts. The Postal Service cannot compromise its ability to generate the best possible forecasts as quickly as possible for the sake of an advance review process that has never been employed for demand analysis in the past, and for which there is no demonstrated need currently.

The narrative portion of Order No. 104 makes clear the intention to extend imposition of an advance review requirement, in addition to costing methodologies, to the methodologies used to estimate the price elasticities provided to the Commission in periodic reports. For example, at page 29, Order No. 104 states:

> Updating an estimated price elasticity for a given mail product by using (in a consistent manner) more recent DRI forecasts for various macroeconomic control variables already present in an accepted

[5] In costing work, the general progression of events is a perceived opportunity for improvement in the established methodology, an attempt to achieve such an improvement, and the opportunity for assessment of whether that attempt has succeeded or not. If the attempt is deemed unsatisfactory, there is usually the option to fall back to the established methodology. In demand analysis, work usually starts with new data applied to the existing models. If those models no longer work, than adjustments *have* to be made, because there is no option *not* to generate the updated forecasts upon which various functions of the organization rely.

> econometric model of demand would not constitute a change in an accepted analytical principle, and would not require review in a rulemaking.

The unmistakable implication of this statement is that, in contrast, other changes in the demand models, beyond mere insertion of updated exogenous input data, *would* "require review in a rulemaking." Looking at the actual language of the proposed rules, the inclusion of the phrase "elasticity of demand" in the penultimate line of proposed subsection 3050.11(a)(1) appears to be the vehicle by which demand analysis is incorporated into the set of analyses to which the advance review requirements apply.

As explained above, though, changes in the demand equations used for forecasting are not amenable to the advance review process spelled out in proposed section 3050.11. If final rules were issued which matched the proposed rules, the Postal Service would have two options – surrender its ability to adjust demand equations as rapidly evolving circumstances warrant, or prepare one set of demand equations for use in forecasting, and a separate set for use in periodic reporting. Under the second option, the Postal Service would make necessary model adjustments to estimate elasticities to use in its internal forecasts, but make no model adjustments (and hence no changes in "analytic principles") to generate another set of elasticity estimates based on the old models and new input data. The latter set of elasticities would be those reported to the Commission. Note, however, to the extent that such "reported" elasticities differ from the forecasting elasticities, they would necessarily be inferior, because model adjustments made to generate the forecasting elasticities would likely be motivated by specific perceived deficiencies in the results of the old model (i.e., the "reported" elasticities). Putting the Postal Service in the position of generating two sets

of elasticities, and reporting the inferior of the two sets, would not seem to be in the interest of anyone.

The Postal Service therefore suggests the following with respect to the proposed rules as they relate to price elasticities. First, because advance review rulemaking proceedings applicable to changes in costing methodology are not appropriate for changes in demand models, the Commission should limit the intended scope of such rulemaking proceedings to exclude demand models. As long as that limitation is made clear in the text of any final order, it appears to the Postal Service that the only change necessary in the actual language of the proposed rules would be to delete the phrase “elasticity of demand” from subsection 3050.11(a)(1). The practical result of this approach would be submission by the Postal Service each January, pursuant to section 3050.26, of material like that submitted in January of 2008, which provided not only input data and models, but also extensive narrative discussion of the models and any changes therein. As noted above, there has been no indication that any pertinent information was lacking from that submission, or that additional procedures are necessary to achieve some broader objective or correct some specific perceived deficiency.[6] Second, for the reasons discussed above, the Commission should delete subsection 3050.21(d), requiring somewhat stale price elasticity information in the

[6] The Commission, of course, would have the opportunity to react to the Postal Service’s demand analysis materials in the ACD, or later in the year at a time of its own choosing. Over the years, the Postal Service has consistently endeavored to respond to the Commission’s identification of areas of possible improvement in demand analysis and forecasting, and there is no reason to believe that the Postal Service would forgo the benefits of that practice. While this may not be "advance" input like that provided in the proposed costing rulemakings, it could perform an essentially similar function.

December ACR filing, and should clarify that the July “summary description” document does not need to include redundant information on demand analysis.

4. Each of the Two Examples Given in Order No. 104 Regarding Advanced Review Requirements for Data Collection Changes Raises Concerns

On page 28, Order No. 104 identifies two examples of data collection changes which are apparently intended to illustrate the types of data collection changes which would require advance review in an informal ratemaking. Both of these examples raise concerns. The first example involves a change made by Postal Service Operations to the process by which First Handling Pieces (FHP) are determined in the Management Operating Data System (MODS) for certain types of mail. Previously, that mail was weighed, and a weight/piece conversion factor was applied to calculate FHP. A new procedure, however, recently replaced the weight conversion process with more accurate machine counts. While it may be true that this change would have had some effect on operating data figures which eventually make their way into some of the cost study results reported in the ACR, the Postal Service’s concern is the lack of an apparent recognition that MODS is, as its very name indicates, an <u>operating</u> data system. It is, therefore, not under the control of the ratemaking team that will be responsible for coordinating advance review of ratemaking methodologies in informal rulemakings.

MODS data, including FHP, are routinely used throughout the Postal Service operational organization on a daily basis. The fraction of usage of FHP data from MODS for purposes that could influence reports to the Commission is miniscule compared with far more common usage of FHP and other MODS data for operating purposes. It is therefore appropriate for decisions regarding potential improvements to

MODS to remain within the Postal Service's operational function, and not be bogged down by an additional regulatory encumbrance that is unlikely to be based on a perspective geared to the full range of operating considerations critical to the Postal Service. Once again, the situation brings to mind the requirement in section 3652(e)(1)(B) of the statute that the Commission, in developing data reporting procedures, avoid "unnecessary and unwarranted administrative effort and expense of the part of the Postal Service." Stacking an additional and unnecessary external review process on top of the internal review process could impede the Postal Service's ability to make necessary changes in MODS on a timely basis. As a result, although fully understanding the Commission's justifiable interest in changes in data collection systems designed specifically for costing and other ratemaking functions, the Postal Service submits that this type of change in MODS data collection is not an appropriate example of a change in "analytic principles" requiring advance review by the Commission.

The second example cited on page 28 of Order No. 104 does involve a costing data collection system, but raises a different type of issue. The second example is the discontinuance in carrier data systems of the collection of stop-type data, for reasons described by the Postal Service in a letter to the Commission's Secretary on January 10, 2008 (and posted on the Commission webpage on that date). Contrary to what Order No. 104 appears to suggest, however, this change would not have constituted a change in an "accepted analytic principle" which potentially would have caused the proposed "advance review" rule to be invoked, had the proposed rules been in effect. That is because, since Docket No. R2005-1, the "accepted" carrier methodology does

not utilize the stop-type data, although such data had been necessary for the previous carrier methodology in use prior to Docket No. R2005-1. The proposed definition of an "accepted analytic principle" in rule 3050.1(a) only covers analytic principles that have been applied by the Commission most recently (or have subsequently been changed by a final rule). As obvious from the above discussion of USO-related reporting, the Commission maintains an interest in stop-type data. Nevertheless, the Postal Service is compelled to note that the change cited in no way impaired the Commission's ability to continue to apply the analytic principles used for carrier costing in the FY07 ACD. Therefore, this change does not appear to be an appropriate example of a data collection change that would have triggered a proceeding under proposed section 3050.11.

5. The ACR Reporting Rules for Negotiated Service Agreements Can Be Improved with Minor Modifications

Proposed rules regarding reporting for NSAs in the context of the ACR appear in sections 3050.26(f)-(g), and are discussed on pages 8-10 of Order No. 104. The Postal Service finds the discussion on those pages to be somewhat unclear with respect to the distinction between market dominant and competitive NSAs. For example, on page 8, the broad claim is made that the PAEA requires a "Commission determination as to whether NSAs 'improve the net financial position of the Postal Service.'"[7] However, the

[7] The Postal Service notes the statement on page 8 appears stricter than the statutory requirements. While the Commission may appropriately require a net benefit analysis for all market dominant NSAs in the Postal Service's annual report, the lack of a net benefit would not mean that a NSA is in noncompliance. Section 3622(c)(10) allows NSAs that "enhance the performance of mail preparation, processing, transportation, or other functions" even if there is no net financial benefit, as long as the NSA does not cause unreasonable harm to the marketplace. The proposed rules adequately address these two elements: subsection 3050.21(f)(3) solicits information relevant to the NSA's

provision of title 39 cited -- section 3622(c)(10) -- is applicable only to *market dominant* NSAs. Of course, as discussed next on page 8 of Order No. 104, to the extent that individual *competitive* NSAs are products, revenue from each competitive product must cover its attributable costs. Because estimates of revenue and attributable cost are consequently both required for each competitive NSA that is a separate product, it follows that an estimate of contribution to institutional cost must likewise be available as well, since contribution is simply the difference between revenue and cost. Although such a calculation of contribution is entirely adequate to fulfill the requirement of "contribution to institutional costs provided by each product" in proposed section 3050.21(b), the Postal Service does not understand it to be equivalent to a determination of the improvement to the "net financial position" of the Postal Service relating to the NSA. No such determination is required for competitive NSAs.

It would appear that the Commission is in agreement with that assessment, as the bottom of page 8 of Order No. 104 indicates that the subsection covering the analysis of the effect on net financial position, subsection 3050.21(f)(4), is applicable to "each market dominant NSA." There certainly is no ambiguity in that respect in the proposed rules themselves, as subsection 3050.21(f) explicitly addresses market dominant NSAs, subsection 3050.21(g) explicitly addresses competitive NSAs, and no provision comparable to 21(f)(4) appears in subsection 21(g). What does appear in subsection 21(g)(2), however, is a proposed requirement that an estimate of "price elasticity of demand" be provided for each competitive NSA. This requirement seems misplaced, as page 9 of Order No. 104 makes clear that the application of the price

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impact on operations, and subsection 3050.21(f)(5) seeks information on the NSA's impact on the marketplace.

elasticity would be to the analysis of the effect on "net financial position." Since, as shown above, no such analysis is required for competitive NSAs, there is no discernible reason to require identification of any "price elasticity of demand" for a competitive NSA. The "price elasticity" requirement of proposed section 3050.21(g)(2) should therefore be omitted.

Moreover, not only is the "price elasticity" requirement unnecessary for competitive NSAs, but it is unlikely to provide any useful information. The Postal Service does not have any mailer-specific elasticities, and sees no reasonable prospects for obtaining them. While elasticities hopefully will be available at the "product" level (in the non-NSA sense of "product"), a sound basis to apply those product elasticities to NSA partners is particularly lacking in the context of competitive products and competitive NSAs. For example, if a potential mailer is currently utilizing a competing shipper, or if a current mailer is contemplating a move to a competing shipper, the availability of an NSA may be the difference between receiving all of their business, or none of their business. Movements along the implicit "demand curve" for each of these customers is hardly likely to be well represented by the product elasticity, which is an aggregation of the responses of all of the product's customers, many of whom would not be making such a binary purchasing decision. For competitive NSAs, the Postal Service simply is not going to be able to provide a price elasticity estimate that would serve any useful purpose.[8]

[8] The situation is particularly acute in the context of International Mail, where at the moment there is only one available aggregate elasticity for competitive mail (International Commercial Mail). Moreover, on Inbound mail, the link between changes in what the Postal Service charges foreign postal administrations, and the prices actually paid by the foreign mailers who generate the mail, is tenuous at best.

In reality, of course, the situation with respect to market dominant NSAs is hardly any better. Logic suggests that, other than with respect to NSAs that might feature unique or customized additional services at higher prices, the Postal Service is more likely to enter NSAs with customers who are more price sensitive than the product average. This makes application of the product elasticity, as the best available proxy, a shaky proposition at best. Yet the Postal Service is unlikely to be able to come up with any better alternatives. Unfortunately, to make much headway in obtaining a meaningful customer-specific elasticity, one practically would need the customer's demand curve over the entire range of relevant prices, and if one actually had such a demand curve, there would not be a need for the elasticity to back out "before rates" or "no-NSA" volumes: the revenue piece of the NSA contribution could be calculated right off of the demand curve. But none of the same old obstacles to "knowing" what a customer's volume would be at different price levels, ceteris paribus, have gone away. Because of that, the Postal Service lacks confidence in the elasticity-based evaluation method discussed on page 9 of Order No. 104 (and presumably intended to be applied to comply with subsection 3050.21(f)(4) in the proposed rules regarding market dominant NSAs).

One other aspect of proposed subsection 3050.21(f)(4) raises concerns. As discussed at the bottom of page 8 and the top of page 9 of Order No. 104, this proposed rule attempts to circumvent reporting problems associated with NSAs for which prices are dependent upon cumulative volume in 12-month periods that run

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Consequently, exactly what a price elasticity for Inbound Mail is supposed to be measuring is unclear. Thus, even at the product level, much less at the level of specific mailers, the challenges in obtaining elasticity estimates for International Mail are much more daunting.

across fiscal years. The proposed solution is to tie the contribution assessment to the 12-month "contract year" which ends within the fiscal year to which the ACR pertains. This feature of the rule essentially tracks past practice, in which the Postal Service has filed NSA data collection reports based on each "contract year." The Postal Service agrees that allowing the contribution assessment to be based on "contract year" is a useful tool to address this situation. Nevertheless, it may also be possible to devise a means of conducting contribution assessments based directly on the fiscal year. If so, NSA data linked to the fiscal year would be more amenable to integration with the rest of the fiscal year reporting presented in the ACR. Therefore, the Postal Service requests that the proposed rule be amended to allow it the option to report on either a fiscal year basis or on the most recent year of operation.[9] Building this flexibility into the rule could result in reporting procedures that are more efficient for both the Postal Service and the Commission.

To summarize with respect to NSA reporting and proposed sections 3050.21(f)-(g), the Postal Service has two concrete recommendations. First, the reference to "elasticity of demand" for competitive NSAs should be deleted from proposed subsection 3050.21(g)(2). Second, it would be helpful if the contribution analysis for market dominant NSAs addressed in subsection 3050.21(f)(4) could be conducted on

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[9] This objective could be achieved, for example, by amending the first two sentences of the proposed subsection to read:

> Analyze the contribution of the agreement to institutional costs either for the fiscal year covered by the Postal Service's Annual Report, or for its most recent year of operation. If the latter option is selected, the year analyzed shall end on the anniversary of the negotiated service agreement that falls within the fiscal year covered by the Postal Service's Annual Report and include the 12 preceding months.

either a fiscal year basis, or on a 12-month "contract basis," at the option of the Postal Service.[10] Additionally, the Postal Service maintains the view that a contribution analysis necessarily based on a proxy elasticity is not appropriate even for market dominant NSAs, but recognizes that a rulemaking on reporting requirements may not be the ideal forum to resolve that more substantive policy question.

6. Because Additional Resources Would Be Necessary to Allow the Postal Service to Produce Billing Determinants Every Quarter, Which Outweigh Any Benefits of Such Data, That Proposed Requirement Should Be Dropped

Proposed rule 3050.25 covers documentation for volumes and revenues, such as the RPW reports, the Quarterly Statistics Reports, and the billing determinants. The only portion of this proposed rule with which the Postal Service currently could not comply is the proposal in subsection 25(d) that would require the Postal Service to provide quarterly billing determinants within 40 days of the end of each quarter. In other words, this is not a rule which merely requires the billing determinants provided at the end of the year to be broken out on a quarterly basis, but instead would actually require a separate billing determinant filing each quarter.

Without the expenditure of additional resources, the Postal Service could not produce billing determinant reports on a quarterly basis in compliance with this proposal. Necessary inputs, such as special weight reports and other input data, are

[10] In fact, it would likewise be helpful if the Postal Service, in conducting the "revenue minus attributable cost" contribution analysis for competitive products, also had the option of using either a fiscal year basis or a 12-month "contract basis." The same potential difficulties with the fiscal year approach that the Commission discusses on the bottom of page of page 9 of Order No. 104 in the context of market dominant NSAs can also be encountered in the analysis of competitive NSAs. This suggests that commensurate changes in both subsections 3050.21(f)(2) and (g)(2) may be warranted.

not routinely available on a quarterly basis. Even if they were available on a quarterly basis, without extraordinary effort, a deadline of 40 days would not be sufficient to obtain the necessary inputs and complete the billing determinant production process.[11] A longer deadline, on the other hand, would simply ensure that the Postal Service would be constantly engaged in a never-ending series of billing determinant production routines. Under current procedures, that burden would fall on critical personnel who are also responsible for a wide variety of other pricing functions.

Order No. 104 at page 22 suggests that the Commission needs such data on a quarterly basis "to help the Commission prepare its annual report." While it may be true that having billing determinant data at the end of each quarter could in theory have some advantages, it is not clear practically how it would assist in the Commission's year-end preparation of the annual report. Quarterly RPW data are subject to revisions. If the Postal Service waits until the end of the year to prepare billing determinants, it can utilize final RPW data. If billing determinants were prepared quarterly, however, they would have to be redone when the underlying quarterly RPW data were later revised. The advantage of avoiding unnecessary duplicate effort is another factor favoring the year-end approach. The Postal Service urges the Commission to delete proposed rule 3050.25(d), as whatever benefits might accrue to the Commission are unlikely to

[11] The Postal Service is not claiming that, even if compelling circumstances warranted, it would nonetheless still be impossible to obtain necessary inputs and generate quarterly billing determinants at some point other than at the end of the year. For example, at the bottom of page 22, Order No. 104 correctly observes that quarterly billing determinants would be needed if the Postal Service were to file an off-cycle rate change. In such an instance, the Postal Service would expend the necessary additional resources on billing determinants, in order to obtain the benefits of the desired acceleration of rate changes. The proposed rule, however, would require the expenditure of those resources every quarter.

outweigh the additional costs to the Postal Service of routinely submitting billing determinant reports on a quarterly basis.

7. SEC-Type Reporting Supplants Certain Previously-Provided Periodic Reports as the Vehicle by Which the Objective of Appropriate Transparency is Best Achieved

Throughout Order No. 104, repeated references appear regarding the transparency objective of the PAEA. *See, e.g.,* Order No. 104 at 1, 2, 22. The existence of such an objective within the new law is not in dispute. On an annual basis, the Annual Compliance Report is surely intended to be the primary vehicle addressing and fulfilling the transparency objective, although the newly required annual report on Form 10-K will also be quite useful in that respect. As contemplated by the Commission's proposed rules, the ACR will consist largely of materials based on a framework quite similar to that utilized for the materials provided by the Postal Service to the Commission on an annual basis prior to enactment of the new law. On a less-than-annual basis, however, the PAEA establishes a quarterly reporting requirement unlike anything that existed under the old law. That requirement, established as part of section 3654, requires the quarterly submission of information comparable to that contained in the Form 10-Q that would be filed with the SEC every quarter by most private sector corporations (i.e., those that are publicly traded). The Postal Service is already providing such "Form 10-Q" information, and the most recent example can be found on the Commission's webpage under the Daily Listings for August 11, 2008. The report filed on August 11 contains not only a wide variety of data regarding financial performance in Quarter 3 and Year-to-Date, but it also provides extensive narrative discussion and context to aid in the proper interpretation of those data.

In addition to quarterly Form 10-Qs, however, the proposed rules (in section 3050.28) would also require monthly submission of the National Consolidated Trial Balances (NCTB) and the Revenue and Expense Summary (RES). On page 22, Order No. 104 states these monthly submissions will "enhance transparency and accountability by helping mailers determine whether there are likely to be grounds for filing a complaint under 39 U.S.C. 3662."

The NTCB and RES reports contain large amounts of very specific financial information, but provide no guidance in terms of how to interpret the raw data to understand the "big picture." It is highly unlikely that these monthly submissions alone could ever form the adequate basis for the filing of a complaint. Moreover, it seems doubtful that any of the private sector competitors of the Postal Service would be publishing this level of detail about their finances on a monthly basis. Instead, they presumably rely on the Form 10-Q quarterly submissions for public disclosure of financial information on a routine basis. Requiring the Postal Service to make available to those competitors the information contained in the NCTB and the RES on a monthly basis, if no comparable monthly reporting requirement exists for them, would not constitute progress towards a level playing field. The SEC-type reporting requirements of section 3654 demonstrate a Congressional preference for the quarterly disclosure of data in order to ensure transparency. Reporting on more frequent intervals is unnecessary.

The Postal Service's proposed solution to these circumstances is straightforward. For transparency purposes, the Commission should rely on the availability of the quarterly Form 10-Q submissions. Interested parties would have the same opportunity

to review such materials as they currently do with respect to comparable SEC filings by the Postal Service's competitors. On the other hand, while the Postal Service could continue to provide the Commission with NCTB and RES reports on a monthly basis, a level playing field does not require those reports to be publicly disclosed. Order No. 104 (at page 22) indicates that the short time period allowed by statute between filing by the Postal Service of the ACR and issuance by the Commission of the ACD requires the Commission "to stay as current as possible on the financial and operating performance of the Postal Service as the reporting year unfolds." The Order, however, does not articulate with specificity how any of the monthly NCTB or RES information is used to aid in preparation for the tasks that are subsequently required to develop the ACD. It would perhaps be useful for the Commission to clarify, perhaps with specific examples, exactly how that information fulfills the interim function described in Order No. 104. In any event, there is no discernible reason why, for purposes of meeting that function, the NCTB or RES data would need to be posted on the website or otherwise circulated to the public. If the Commission prefers to maintain its proposal to require NCTB and RES reporting on a monthly basis, it should specify that such monthly reports will not be circulated externally. For public consumption, the quarterly Form 10-Q filings, including the extensive narrative analysis which constitutes a critical portion of those reports, provide a much more useful source of information.

8. Minor Refinements Would Improve the Alternative Reporting Format Illustrated in the Appendix to Order No. 104

Section 3050.14 of the proposed rules defines two formats for the ACR: "a format reflecting the classification structure in the current Mail Classification Schedule" and "an alternative, more disaggregated format capable of reflecting the classification

structure in effect prior to the adoption of the Postal Accountability and Enhancement Act." The text of Order No. 104 explains that the alternative format "would present costs, volumes, and revenues by product and rate category, reflecting the classification structure that was in effect immediately prior to the implementation of the PAEA," and that the alternative format is illustrated by the appendix to the Order labeled "Products and Categories." Order No. 104 at 16.

The distinction between the current Mail proposed Classification Schedule and the classification structure immediately prior to the implementation of PAEA has an intervening step for international mail. In May 2007, the Postal Service rebranded its U.S. Origin products, which not only renamed products, but also eliminated surface offerings. There are thus three relevant formats: 1) the pre-PAEA format that appeared in the FY 2006 ICRA (filed with the Commission on March 15, 2007), 2) the rebranded format that appeared in the FY 2007 ICRA (filed with the FY 2007 ACR), and 3) the format shown in the Appendix to Order No. 104.

There are some problems with the format shown in the Appendix. The first is that the format shown in the Appendix is a mixture of the FY 2006 and FY 2007 formats. The Appendix shows: 1) Outbound Single-Piece Letters, Flats, International Parcel Post, and Parcels with air and surface separately and 2) Outbound Single-Piece Cards with air and surface separately. Although the titles, particularly International First-Class Mail, are more similar to the May 2007 rebrand format, the air and surface separation reflects the pre-PAEA format of FY 2006. Outbound Priority Mail International, though, is entirely an FY 2007 rebrand format, because it refers to classifications after May 2007. Prior to May 2007, there were two separate categories (Outbound Air CP, and

Outbound Surface CP), yet the Appendix uses the air-only Priority Mail International service that followed rebranding.

The FY 2007 rebrand results could be incorporated by using the FY 2007 format as the starting point for comparisons. The surface offerings from FY 2006 did not exist after May 2007, and numerous products that did not exist in FY 2006 did exist after May 2007. As such, a more useful comparison could be made between the FY 2007 format, and the more detailed Appendix with current products that the Commission apparently envisions with its use of the rebranded product names.

The second problem is that the Appendix does not appear to maintain a consistent naming convention throughout. For instance, compare the same two outbound categories that were used as the example in the previous paragraph.

1) outbound letter post refers to UPU Target System Countries, UPU Transition System Countries, and Subject to bi-lateral agreement;
2) Priority Mail refers to Subject to Terminal Dues for UPU Target System Countries, UPU Transition System Countries, and Subject to Non-UPU Rates.

Outbound letter post uses the terminology “Subject to bi-lateral agreement” and Priority Mail uses the terminology “Subject to Non-UPU Rates.” Under the assumption that these are slightly different labels for the same category, the appendix would seem to be more useful if the categories were labeled consistently.

Third, there is, hopefully, consensus on the futility of establishing reporting categories for which neither revenue nor cost information exists. This concern arises primarily in the context of inbound special services. On that basis, the Postal Service suggests that the following categories should be removed from the appendix:

Market Dominant:

Inbound International Return Receipt

Inbound International Insurance

Competitive:

Inbound International Return Receipt

Inbound International Insurance

On the other hand, the appendix omits mention of Inbound delivery confirmation. Such a category would cover revenue from the delivery confirmation surcharge for Xpresspost and Expedited Services for Canada inbound.

9. The Wording of Proposed Rule 3050.24 May Unintentionally Create Ambiguity Regarding Worksharing Activities

Proposed Rule 3050.24 essentially lists a variety of special costs studies that the Postal Service customarily provided in rate cases and, more recently, provided in the FY07 ACR. The contents of the lists seem to conform with past practice, and do not appear to create any particular problems. The Postal Service nonetheless offers two suggestions regarding wording. The proposed rule is entitled "Documentation supporting estimates of costs avoided by worksharing in the Postal Service's Annual Report." Based on this title, a reader might mistakenly assume that all of the cost estimates provided relate to activities which meet the statutory definition of worksharing set forth in section 3622(e)(1) of title 39. That clearly would not be the case, as the list includes, for example, costs by shape, which is not a worksharing category. To avoid unnecessary confusion, the Postal Service suggests that the title of the section be changed to "Documentation supporting special cost studies in the Postal Service's Annual Report relating to worksharing and other mail characteristics."

The Postal Service also notes that subsection 3050.24(h) refers to "Enhanced Carrier Route mail processing saturation savings." Although this admittedly was the title given by the Postal Service to a special study provided for last year's ACR (in which it was designated USPS-FY07-18), the Postal Service now views this title as a less than optimal description of the contents of that study. The Postal Service intends to label the corresponding study in this year's ACR as "Enhanced Carrier Route mail processing unit costs," and requests that the language of proposed subsection 3050.24(h) be amended accordingly.

10. The Capabilities of An Incremental Cost Model Must be Kept in Perspective

Proposed rule 3050.23 would require the Postal Service to provide estimates of incremental costs. Using the methodologies developed for that purpose over several rate cases starting in Docket No. R97-1, the Postal Service anticipates that it can provide incremental cost estimates starting in FY09. Order No. 104 suggests that the primary objective of the incremental cost analysis should be to identify the incremental costs of competitive products as a group, but also identifies a further goal to develop a model for individual market dominant products "to help identify cross-subsidy of one market dominant product by another." Order No. 104 at 12. First, it may be noted that an incremental cost model may indicate that a product, because it is not covering its incremental costs, is being cross-subsidized, but it cannot necessarily identify the product or group of products which is providing the cross-subsidy. More importantly, it must be recognized that some of the market dominant products are, compared with competitive products, extremely large. As explained next, very large products can create practical issues for incremental cost estimation.

The incremental cost for a product or group of products is the additional cost incurred by an enterprise that arises because of the addition of that product or group of products to the vector of outputs otherwise produced by the firm. In other words, the calculation of incremental cost takes as its starting point the ongoing actual operations of the enterprise.[12] For a small product, such a starting point is reasonable and appropriate. The incremental cost of Express Mail, for example, takes the ongoing operations for First Class Mail, Standard Mail, and Priority Mail as given, and focuses on the calculation of the additional cost the Postal Service incurs as a result of adding Express Mail to the mix. In contrast, the calculation of incremental cost for a very large product or group of products is more difficult, because it requires assuming that the ongoing operations for the remaining smaller products remains the same in the absence of the large product or group of products. For example, an exercise that contemplates the calculation of incremental cost for the group of market dominant products made up of First Class Mail and Standard Mail requires assuming that the nature of Postal Service operations would be the same absent these two products.

In addition, it may well be that accurate calculation of incremental cost for a large product (or a large group of products) is technically difficult. Unlike marginal cost, which requires solely calculating cost at a point along the underlying cost curve, incremental cost requires calculating cost along a range of the underlying cost curve. It is not uncommon to be comfortable with the accuracy of the measurement of the slope of the cost curve in an area around the current level of production, but somewhat

[12] *See* Bradley, Michael D., Jeff Colvin and John Panzar, "On Setting Prices and Testing Cross-Subsidy with Accounting Data," Journal of Regulatory Economics, Vol. 16, July 1999 at 85.

uncomfortable with the accuracy of that measurement some distance away from current experience.[13] For a small product, the range over which incremental cost is calculated is quite close to current levels of production, so the shift from marginal cost calculation to incremental cost calculation is not difficult and does not raise accuracy issues. However, for very large products or groups of products, the range of calculation may cover considerable ground which is far away from the current level of production. If so, the calculation of incremental cost for that large product (or group of products) may involve a higher level of approximation than was first anticipated.

The Postal Service does not offer these comments for purposes of suggesting any revisions in the incremental cost rule proposed by the Commission. As noted above, the Postal Service anticipates that it will be able to comply with proposed rule 3050.23 starting in FY09. It may be useful, however, to begin to temper expectations regarding the actual purposes to which the model output will be capable of being most appropriately applied. Given relative size, incremental cost estimates are always likely to be most useful with regard to competitive products, even notwithstanding moderate or substantial refinement in the models going forward.

11. The Proposal Regarding Miscellaneous Publications and Handbooks Can Be Improved

Proposed section 3050.60(a)-(c) requires the Postal Service to provide a master list of publications and handbooks at the beginning of each fiscal year (subsection (a)), electronic copies of each "publication, handbook, and data collection form" at the beginning of each fiscal year (subsection (b)), and data collection forms and corresponding training handbooks, "when changed" (subsection (c)). Subsections (a)

[13] This is particularly true for flexible functional forms such as the translog.

and (c) carry over requirements in the existing periodic reporting rules (39 C.F.R. § 3001.102(d)(3) and (4)), which require provision of a master list and data collection forms and handbooks, "when changed." No explanation is given why the master list requirement has been altered, and why the new requirement for electronic copies of each publication specifies renewed submissions at the beginning of each fiscal year. Also, the requirement for "data collection forms" redundantly appears in both subsections (b) and (c), and it would appear the reference to "data collection forms" in subsection (b) should thus be deleted.

The Postal Service has no objection to providing lists of publications, data collection materials, or the publications themselves. Under the PRA, many of these items were routinely provided during the course of omnibus rate cases. Furthermore, many, but not all, of the publications and instructions are currently available through the Postal Service's public web site. We note, however, that, at least initially, it may be time consuming to create electronic copies of all of the items encompassed by the description in subsection (b), and it would be an unnecessary burden to provide a complete set of such materials "each fiscal year." The Postal Service therefore suggests that the proposed rules be amended to require provision of the materials in all three categories each year "when changed." Initially, a complete set would be provided. The Postal Service would also provide any information regarding the status of the publications and other references each year, as needed.

The Postal Service should also note that some of the documents encompassed by these rules might be considered sensitive and not available for routine disclosure to

the public. These items will be identified when submitted, subject to the provisions of section 504(g) of title 39.

12. The Compliance Analysis Required by Proposed Section 3050.20 Should Not Have to Address Matters Already Covered in the Comprehensive Statement

Proposed Rule 3050.20 requires the Postal Service to provide a "compliance analysis" that discusses, among other things, how its products "meet the goals established under 39 U.S.C. 2803 and 2804." The Commission should delete this requirement from the rule. The Postal Service recognizes that one of the Commission's tasks each year will be to "evaluate…whether the Postal Service has met the goals established under sections 2803 and 2804." *See* 39 U.S.C. § 3653(d). However, this does not require that the Postal Service expressly discuss those goals in the "compliance analysis" required by Rule 3050.20. Section 2803 requires the Postal Service to establish and describe performance goals, while section 2804 requires the Postal Service to discuss, each fiscal year, whether it achieved those goals. Both of these sections explicitly require that the specification and discussion of these performance goals occur in the Comprehensive Statement required under section 2401(e). This Comprehensive Statement is, in turn, required to be filed with the Commission pursuant to section 3652(g) of title 39. This indicates that the Commission's task in complying with the first portion of section 3653(d) is to review the Postal Service's Comprehensive Statement, rather than requiring the Postal Service to provide a separate discussion of its section 2803 performance goals in the ACR.

Two additional considerations support this conclusion. First, the information provided under Rule 3050.20 would likely be duplicative in all material respects of the

information that the Postal Service is already required to provide in its Comprehensive Statement. There is no need to require the Postal Service to provide the same information twice, once in its ACR and once in its Comprehensive Statement. Second, the performance goals discuss issues that oftentimes have little relationship to the Postal Service's "products," such that it is difficult to ascertain any rational reason why the Postal Service should be required to discuss how its "*products*" meet those performance goals in the ACR, in addition to discussing how the *Postal Service* has met those goals in the Comprehensive Statement.

Respectfully submitted,

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ATTACHMENT A – SUGGESTED ALTERNATIVE FOR §§ 3050.40-.42 IF PLACEHOLDER APPROACH NOT ADOPTED

§ 3050.40 Additional financial reporting

(a) Additional Financial Reporting.—

(1) In general.—The Postal Service shall file with the Commission beginning with the first full fiscal year following the effective date of this section—

(A) within 40 days after the end of each fiscal quarter, a quarterly report containing the information required by the Securities and Exchange Commission to be included in quarterly reports under sections 13 and 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78*o*(d)) on Form 10-Q, as such Form (or any successor form) may be revised from time to time;

(B) within 60 days after the end of each fiscal year, an annual report containing the information required by the Securities and Exchange Commission to be included in annual reports under such sections on Form 10-K, as such Form (or any successor form) may be revised from time to time; and

(C) periodic reports within the time frame and containing the information prescribed in Form 8-K of the Securities and Exchange Commission, as such Form (or any successor form) may be revised from time to time.

(2) Internal control report.—For purposes of defining the reports required by paragraph (1)(B), the Postal Service shall comply with the rules prescribed by the Securities and Exchange Commission implementing section 404 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7262), beginning with the annual report for fiscal year 2010.

(b) Financial Reporting.—

(1) The reports required by subsection (a)(1)(B) shall include, with respect to the Postal Service's pension and post-retirement health obligations—

(i) The funded status of the Postal Service's pension and postretirement health obligations;

(ii) Components of the net change in the fund balances and obligations and the nature and cause of any significant changes;

(iii) Components of net periodic costs;

(iv) Cost methods and assumptions underlying the relevant actuarial valuations;

(v) The effect of a one-percentage point increase in the assumed health care cost trend rate for each future year on the service and interest costs components of net periodic post retirement health cost and the accumulated obligation;

(vi) Actual contributions to and payments from the funds for the years presented and the estimated future contributions and payments for each of the following 5 years;

(vii) The composition of plan assets reflected in the fund balances; and

(viii) The assumed rate of return on fund balances and the actual rates of return for the years presented.

(2) The Office of Personnel Management shall provide the data listed under paragraph (1) to the Postal Service not later than 30 days after the end of each fiscal year.

(3)(A) Beginning with reports for the fiscal year 2010, for purposes of the reports required under subparagraphs (A) and (B) of subsection (a)(1), the Postal Service shall include segment reporting.

(B) The Postal Service shall determine the appropriate segment reporting under subparagraph (A) after consultation with the Commission.

§ 3050.41 Treatment of additional financial reports

(a) For purposes of the reports required by subsection 3050.40(a)(1)(B), the Postal Service shall obtain an opinion from an independent auditor on whether the information listed in subsection 3050.40(b) is fairly stated in all material respects, either in relation to the basic financial statements as a whole or on a stand-alone basis.

(b) Supporting Matter.—The Commission shall have access to the audit documentation and any other supporting matter of the Postal Service and its independent auditor in connection with any information submitted under section 3050.40.

§ 3050.42 Proceedings to improve the quality of financial data

The Commission may, on its own motion or on request of an interested party, initiate proceedings to improve the quality, accuracy, or completeness of Postal Service data required under section 3050.40 whenever it shall appear that—

(a) the data have become significantly inaccurate or can be significantly improved; or

(b) those revisions are, in the judgment of the Commission, otherwise necessitated by the public interest.

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with Section 12 of the Rules of Practice and Procedure.

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