

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

Modification of Costing Methods 2008 –
Postal Service Proposal Twelve

Docket No. RM2009-1

REPLY COMMENTS OF THE UNITED STATES POSTAL SERVICE
REGARDING PROPOSAL TWELVE
(December 10, 2008)

The Postal Service filed its petition regarding Proposal Twelve on November 4, 2008, and on November 7, the Commission issued Order No. 130, establishing this proceeding to consider that proposal. Three sets of initial comments were filed on December 1, 2008, by Time Warner Inc. (TW), by Magazine Publishers of America, Inc. and the Alliance of Nonprofit Mailers (MPA/ANM), and by the Public Representative (PR). The Postal Service hereby responds to those comments.

In general, TW and MPA/ANM are supportive of the proposed changes to the models, and assert that the proposed changes serve to better align the cost models with operational realities. Meanwhile, the PR focuses his comments only with regard to Modification 9. Each responding party also discusses additional and particular concerns with the Periodicals cost model that they would like to see addressed. TW disagrees with the Postal Service's calculation of the container dumping adjustment in Modification 4. TW also expresses a desire for improved measures of model parameters, specifically, allied operation productivities, mechanized incoming secondary incidence, and Periodicals-specific conversion factors for tubs; and asks for

a closer tie between volumes used to calibrate the model and billing determinants. The PR expresses concern over the possibility that an overall CRA adjustment factor may distort estimated cost for Periodicals work-sharing categories. MPA/ANM argue for the inclusion of allied costs in the development of rates. In general, MPA/ANM support the changes and recommends adoption (MPA/ANM Comments at 1). The Postal Service is pleased that, for the most part, the comments support the proposed changes, indicating that the efforts undertaken to improve the flats models were not in vain. For the proposals with which no party disagrees, the Postal Service offers no additional comments. Concerns on any particular modification raised by the three sets of comments are addressed below.

Modification 3

Both MPA/ANM and TW support Modification 3. The comments of MPA/ANM state that Modification 3 resolves their concern raised in Docket No. ACR2007 that the current method effectively ignores the flats preparation costs in Operation Code 140 (MPA/ANM Comments at 3), while TW recommends collecting Periodicals-specific pieces-per-tub conversion factors at a future time (TW Comments at 8). The workshare discount models are a collection of theoretical constructs meant to mimic actual mail processing, but are far less complicated. In some instances, the theoretical construct simply does not exist on the workroom floor. For example, in data collection efforts regarding this specific parameter (Periodicals pieces-per-tub), it was noticed that there were not enough pure Periodicals mail operations to get statistically valid observations. Periodicals are merged with First-Class Mail, Standard Mail, or both, in flat sorting operations. As a consequence, it not possible to explicitly collect data on tubs

containing only Periodicals. Therefore, the Postal Service does not believe that such a change may be incorporated into the cost models.

Modification 4

TW appears to view IOCS data as usable in principle to estimate APPS and SPBS container-dumping time, but objects to aspects of the Postal Service's calculations. TW raises concerns with the treatment of tallies where the employee is indicated as moving mail or equipment into or out of the operation, and questions the interpretation of tallies without detailed activity information recorded in IOCS question 18C12 (Q18C12) (TW Comments at 10).

The Postal Service reviewed the data where Q18C12 was blank and found that the observations mostly represent breaks, clocking, and other "overhead" activities that are properly associated with the APPS and SPBS cost pools. IOCS methods do not collect Q18C12 responses for those tallies. Such overhead activities are traditionally viewed as being incurred in proportion to productive "direct labor" activities. As a result, it is appropriate to effectively distribute those costs to the direct labor activities, which the alternative calculation in the TW comments accomplishes:

Absent further information, we believe a more appropriate adjustment might be calculated by excluding the tallies with no response, in which case the factor would be calculated as $(629.648-163.313-62.301)/(629.648-163.313)$ which equals 86.6% and is close to the value that was adopted in ACR2007.

TW Comments at 9. The Postal Service supports the implementation of TW's alternative calculation based on the subset of tallies with a recorded activity and is prepared to incorporate that approach into the FY 2008 ACR if the Commission approves.

The Postal Service believes that there is merit to TW's argument that a portion of tallies for moving mail into or out of the operations (Q18C12 response 'A') should also be included in the calculation of dumping time, but notes that IOCS data limitations prevent implementation of an adjustment at this time. The activities of moving containers into and out of the SPBS/APPS operations are explicitly modeled. These modeled activities are intended to capture the costs associated with movement of containers from the dock to the SPBS/APPS staging areas, and the movements from the SPBS/APPS operations to the dock or flat sorting operation. These activities would be performed by employees clocked into the 1PLATFRM or 1OPTRANS cost pools and not subject to the adjustment of the APPS/SPBS productivities. In the SPBS/APPS operation, the movement of a container from a staging area to the dumper would elicit an IOCS response 'A' to Q18C12 and could be included in the adjustment. However, those movements are not observationally distinct from the dispatch of containers of processed mail from the machine run-outs, which should not be subject to the dumping adjustment. The Postal Service proposes that the issue be revisited at such time as expanded IOCS data become available.

Finally, TW suggests that the adjustment be calculated separately for APPS and SPBS equipment, since the former is likely to involve a larger fraction of container dumping time than the latter. The Postal Service agrees with TW that the adjustment factors would differ for the equipment, but observes that the APPS/SPBS mix can be properly reflected by regularly updating the factor using the most recent IOCS sample data. Additionally, the model changes required to permit the use of separate APPS and SPBS factors are not trivial.

The Postal Service will investigate methods to identify and isolate container dumping time to improve the adjustment, but believes that the likely effects of further revisions to the dumping time adjustment would be small.

Modification 6

Both MPA/ANM and TW agree with this modification. TW recommends that the Postal Service eliminate all sacks entered at origin by placing the residual bundle volumes on MADC pallets (TW comments at 14). The suggestion would alter mail preparation and processing, and goes beyond the development and refinement of cost models that attempt to present a simplified picture of current operations. The adoption of such a proposed difference in mail processing would require investigation that goes beyond the development of the cost models. The Postal Service would have to further review mail characteristics data and mail preparation requirements to determine if this level of containerization would capture increased operational efficiencies without negatively affecting service. Such a possibility should not delay the incorporation of Modification 6 in the FY 2008 ACR.

Modification 8

TW states that the extent of incoming secondary manual processing for Periodicals is more than indicated in the Postal Service's cost models (TW Comments at 16). Measurement of incoming secondary incidence by class is complicated because each plant continually adjusts what schemes are worked on the FSMs based on the volume flowing through the system at a point in time and the volume flowing to each individual scheme. The Postal Service's proposal of annually updateable parameters is superior to the educated assumptions it replaces. The Postal Service acknowledges

that improved estimates of mechanized incoming secondary piece sorting incidence would enhance the accuracy of the model and will continue to investigate strategies for developing improved estimates. However, such strategies will not be available for incorporation into the FY 2008 ACR.

Modification 9

The Postal Service agrees with much of the thrust of the comments by the PR and TW on Modification 9, and will continue to study the appropriate method to use to calibrate models to the CRA. As in the Standard Mail and First-Class Mail models, the proposed Periodicals model uses a single CRA adjustment factor, which is calculated as the ratio of the weighted sum of modeled costs to total CRA costs of the modeled activities. The Periodicals model differs in the fact that more CRA pools are modeled. At this time, the Postal Service is reluctant to develop multiple adjustment factors because it is known that modeled activities are not unique to any single cost pool. For example, the LDC 43 pool includes piece, bundle, and container processing at stations and branches. Some incoming secondary piece sorts are performed in the MODS MANF pool and others in NON-MODS MANF. The NON-MODS MANF may also include incoming secondary bundle sorting. The Postal Service agrees that comparisons of model costs to a particular cost pool or group of cost pools can be useful in identifying inaccuracies in the model, but does not feel that the CRA and model linkages are understood sufficiently to develop multiple control factors, nor does it believe that the activities are sufficiently isolated within each cost pool such that the costs are pure enough to warrant such spurious calibration. At the same time, the

Postal Service acknowledges the PR's recommendation to revisit analysis of this modification at a later date.

Other Proposed Improvements in Model Parameters and Calibration Volumes

TW raises two issues that it believes remain to be addressed (TW Comments at 21, 22). The first issue is the use of old data for productivity rates for container movement and handling. Developing estimates of container movements are made challenging by the sheer complexity and diversity of the Postal Service. A simple construct, such as moving a container of bundles from the APPS /SPBS to a flats sorting operation, can be enormously different depending on in what plant it occurs. For example, in one plant, the bundle sorting may occur at an annex. In this case, the APPS/SPBS to FSM movement includes the movement from the APPS/SPBS to dock staging, loading to transport, unloading at plant, transporting from dock to elevator, elevator movement to FSM floor, and then unloading from elevator to FSM staging. In another plant, it may be a 20 foot movement from APPS run-out to the FSM staging.

The second issue that TW raises is in regards to the mismatch of Periodicals volumes used in the costs models relative to the billing determinants. Volumes used in the FY 2008 ACR will be controlled to billing determinants. The Periodicals rate regime established in Docket No. R2006-1 was not implemented until the fourth quarter of FY 2007. Prior to the implementation of the Docket No. R2006-1 rates, the AFSM 100 compatibility generally had no impact on rate eligibility. As a result, mailers had no incentive to construct AFSM 100 compatible pieces, nor was there any incentive to accurately record or report the machinability characteristics in mail.dat files provided to the Postal Service. With the implementation of the Docket No. R2006-1 rates, mailers

have the incentive to do both. As a consequence, it is expected that the proportion of AFSM 100 pieces mailed will decline and the accuracy of estimates derived from mail.dat files provided to the Postal Service will be improved. The current year is the first year in which there is a complete record of billing determinants under the new rate regime. In the development of the calibration volumes for the current 2008 ACR, the calibration volumes are tied, whenever possible, to the FY 2008 billing determinants. The exception to this comes in the estimation of the machinability of pieces prepared in 5-Digit bundles. The Postal Service, in anticipation of FSS deployment, allows pieces that are not AFSM 100 compatible to claim machinability rates. For this reason, the machinability characteristics are not explicitly tied to billing determinant levels.

The Postal Service will continue to seek ways to develop estimation techniques that can provide these estimates, but will be reluctant to deploy hastily designed studies, educated guesses, or undocumented assumptions that could potentially produce results that distort modeled costs further than the estimates they replace.

MPA/ANM pushes for allied costs to be included in the cost avoidance estimates (MPA/ANM Comments at 4, 5). Resolution of this issue is not necessary for the Commission to determine whether the Proposal Twelve changes to the cost models may be incorporated in the FY 2008 ACR.

Conclusion

For the purposes of the FY 2008 ACR, with the few exceptions discussed above, both TW and MPA/ANM agree with modifications 1-3, 5-7, and 9-13. The Postal Service agrees with TW's version of Modification 4. Until better data surface for

Modification 8, the Postal Service's methodology is an improvement over the current method. The Postal Service takes the PR's recommendation under consideration regarding revisiting Modification 9 before the FY 2009 ACR. The proposed changes are steps in the Postal Service's continuous improvement for accurate cost estimation and rate design. The Postal Service urges the Commission to adopt the proposed changes for the upcoming ACR, including TW's suggested improvement to Modification 4.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

R. Andrew German
Managing Counsel, Legal Policy &
Ratemaking

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking

Eric P. Koetting
David H. Rubin

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.

Eric P. Koetting

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-2992, FAX: -5402
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