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

ANNUAL COMPLIANCE REPORT, 2008

Docket No. ACR2008

REQUEST OF THE UNITED STATES POSTAL SERVICE FOR
MODIFICATION OF COMMISSION ORDER NO. 169
(January 16, 2009)

On December 29, 2008, the Postal Service filed its FY 2008 Annual Compliance Report, along with a host of supporting material. On January 12, 2009, the Commission issued Order No. 169, identifying apparent methodological changes in the some of the supporting materials, and directing presentation of alternative versions of that material by January 21, 2009. In addition, the Order scheduled a technical conference for January 26, 2009, to discuss these matters further. While the Postal Service is endeavoring to respond to many portions of Order No. 169, as explained below, there are other portions regarding which the Postal Service submits modifications are warranted.

In large measure, the issues identified in Order No. 169 appear to relate to the transitional nature of this year's ACR. The FY 2008 ACR included the following observations:

> Given that the PAEA was in effect throughout FY 2008, and that the Postal Service had some ability to adjust its reporting systems in response to new requirements, the transition issues this year are less acute than they were last year. Nonetheless, they have not

> disappeared entirely, as efforts are still underway to meld the Postal Service's reporting abilities to meet the demands of the new reporting environment. For example, the lists of market dominant and competitive products within the Mail Classification Schedule (MCS) were still not finalized until after the start of FY 2008, so data were not available from every postal quarter for some product splits. Plus, unexpected kinks are inevitable in converting processes as complex as revenue, cost, and volume reporting from one set of output products to another. Substantial progress has been made in FY08, however, in achieving a report which more closely resembles the format and content contemplated by the new statutory reporting provisions. But, just as last year's ACR was a first-time effort in all respects, this year's ACR is a first-time effort at trying to apply the standards of the PAEA (rather than those of the previous PRA) to the results by product contained within this report. Furthermore, this effort is being made in the absence of final rules concerning the form and content of this Report. It seems likely that this effort will provide further opportunities for all participants to learn more about the most appropriate ways for this process to be conducted.

FY 2008 ACR at 1-2. For better or worse, we seem to be encountering some of those "further learning opportunities," perhaps more quickly than any of us had hoped.

<u>Item One</u>

The topic of Item One of Order No. 169 perfectly exemplifies the lingering transitional issues still manifest in the FY 2008 ACR. That item reads as follows:

> 1. The development of CRA costs for (1) Standard High Density and Saturation Letters and (2) Standard High Density and Saturation Flats and Parcels incorporates a new adjustment to account for High Density and Saturation Letters that fail to meet machinability and barcoding requirements and are consequently rated for postage as Flats. The adjustment shifts some costs identified as Letter costs to Flats and Parcels. *See* USPS-FY08-1.doc. The accepted method used in Docket No. ACR2007-1 kept the volumes, attributable costs, and revenues of all letter-shaped ECR High Density and Saturation mail together whether or not the letters were ineligible for the letter rate. Because letter-shaped mail generally incurs lower per-piece costs than flat-shaped mail, the

> accepted approach may be seen as preferable to the proposed method which adds the cost of these letter-shaped mailpieces to the cost of flat-shaped mail, and thus may not reflect the per-piece cost of flats. In addition to justifying the proposed modification, please include a discussion of why the proposed approach is preferable to the method accepted in Docket No. ACR2007-1.

Order No. 169 (Jan. 12, 2009) at 3. Reading this, one might suppose that there was an established methodology in previous versions of the CRA for reporting, on the one hand, Standard High Density and Saturation Letters and, on the other hand, Standard High Density and Saturation Flats and Parcels. In fact, however, in all previous CRAs, volumes, costs and revenues for all shapes of ECR Standard Mail were reported at the subclass level, on the same CRA line. Below the subclass level, costs by shape were segregated elsewhere, but those separations had no effect on the CRA itself, which focused solely on costs at the subclass level.

Under the new PAEA regime, however, the basic CRA reporting unit is product. Therefore, for the CRA properly to perform its intended function, volume, cost and revenue information for each mail piece should be reported in the CRA line relating to the product as which that piece was entered. For FY08, the product definitions governing that determination are found in the draft MCS filed by the Postal Service on September 24, 2007. Within Standard Mail, the relevant definitions of Standard High Density Letters, and High Density and Saturation Flats and Parcels, are not limited to physical size or shape, and instead also include the following mail preparation elements as well:

> High Density and Saturation Letters must meet presorting, machinability, addressing, barcoding, walk-sequencing, and other preparation requirements as specified in the Domestic Mail Manual.

> High Density and Saturation Flats/Parcels must meet presorting, addressing, walk-sequencing, and other preparation requirements as specified in the Domestic Mail Manual.

USPS Draft Mail Classification Schedule (Sept. 24, 2007) at 11, 13. Note that to qualify as part of the letter product, in addition to size requirements, a mailing must meet barcoding and machinability requirements, but does *not* need to meet such additional requirements to qualify for the flat product. As the Postal Service explained on page 1 of the Preface to USPS-FY08-1, pursuant to the Domestic Mail Manual (DMM), "[l]etters failing to meet such machinability and barcoding requirements must be paid at flats rates and fall under the Standard High Density and Saturation Flats and Parcels category. DMM 243.6.4.1 and 243.6.5.1." And, of course, when one examines the MCS price schedules for High Density and Saturation Letters, one finds no price schedule for pieces paying flat rates. Instead, the prices for flats appear only in the price schedules for High Density and Saturation Flats/Parcels. USPS Draft Mail Classification Schedule (Sept. 24, 2007) at 12, 14. Under the MCS and the DMM, therefore, it seems beyond cavil that High Density and Saturation mailings that pay flats rates are not part of the High Density and Saturation Letter product, regardless of the physical shape of the mail pieces.

Consequently, in order to present appropriate costs, volumes, and revenues for High Density and Saturation Letters, it is necessary to remove the costs, volumes, or revenues for any letter-shaped pieces which paid flat rates, if they otherwise would incorrectly be included with the High Density and Saturation Letter product. Unfortunately, that was exactly the situation the Postal

Service realized it was facing as it entered the final stages of CRA production. Volumes and revenues for the High Density and Saturation Letter product had correctly been based solely on pieces paying High Density and Saturation Letter prices, but costs reflected all letter-shaped pieces, regardless of whether they paid High Density and Saturation Letter prices, or High Density and Saturation Flat/Parcel prices.[1] This situation arose because, as Order No. 169 itself suggests, in the past, letter-shaped costs were based on all letter-shaped pieces, regardless of the rates they paid within the same Standard ECR subclass. And as data collectors looking at a piece of Standard Mail in isolation have no reliable way to know whether a letter rate or flat rate was paid for the piece, nothing within the existing datasets allows a direct cost assignment based on such a determination.[2] Therefore, some indirect method of attempting to remedy the situation was required.

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[1] Moreover, as also explained in the Preface to USPS-FY08-1, the portion of total letter-shaped pieces that paid flat rates was far from trivial, being over half a billion pieces of mail and constituting approximately 9 percent of the letter-shaped total. Clearly, when trying to track the costs, volumes, and revenues of 200 billion pieces of mail generating aggregate costs and revenues in excess of $75 billion, there will invariably be instances in which certain data anomalies are simply too small to justify the time and resources that would be necessary to achieve perfection. The magnitude of this particular discrepancy, however, compelled some effort towards a better resolution.

[2] Hypothetically, if the data systems had the means to split costs directly between letter-paid pieces and flat-paid pieces (as they do for volumes and revenues), and if the Postal Service had simply utilized such data to develop FY08 costs for the two new products initially, the Postal Service would not consider such a procedure to constitute a "methodological change" requiring advance review. Instead, it would simply be a logical consequence of the establishment of new product definitions, and the requirement to report separate costs for those new products. Unfortunately, the actual situation was not so simple.

Ideally, the Postal Service would have anticipated this dilemma earlier during the year, and would have submitted a proposed adjustment for comment and review in time to incorporate that feedback into the CRA production process, just as was done with numerous other proposed changes. Instead, in this instance, realization lagged regarding the full consequences of transforming the line between letter-paid and flat-paid pieces from a line merely separating rate categories within a subclass, to a line separating distinct products. Therefore, the Postal Service was unable to submit another rulemaking proposal with any realistic prospects of getting any comprehensive mailer feedback, much less a resolution by the Commission, before it was necessary to finalize the CRA to meet the ACR filing deadline. Nonetheless, the Postal Service by no means disputes the notion that interested parties may have useful suggestions regarding this situation, and, to the extent that one purpose of Order No. 169 was to provide a vehicle by which parties could submit comments on adjustments such as that discussed in Item One, the Postal Service supports that objective.

To aid in that exercise, specifically to make it even more simple for parties to judge the impact of the adjustment, the Postal Service shows in an attachment to this pleading how the two affected lines of the CRA differ with and without the adjustment. As explained in the Preface to USPS-FY08-1, the costs without the adjustment are those emanating from the Summary Column of the Cost Segments and Components Report (USPS-FY08-2), but in the attachment, both are shown in CRA format to highlight the effect on unit costs, cost coverage, etc. No other lines of the CRA were affected by this adjustment (since it was only applied as a Final Adjustment in the D Report). The dollars shown in that table are in millions.

In response to Item One of Order No. 169, the Postal Service sees value in justifying its adjustment, and allowing parties to comment. What the Postal Service perceives as lacking in value, however, would be an exercise in which it would be necessary to redo other, downstream analyses, as if the Cost Segments and Components Report correctly segregated the product costs for High Density and Saturation Letters from the product costs of High Density and Saturation Flat/Parcels. We know that not to be the case. Analyses based on that erroneous assumption (i.e., analyses predicated on the unadjusted Cost Segments and Components costs) would be flawed *ab initio*. Yet, taken literally, Order No. 169 would seem to be mandating precisely such an unwarranted exercise. Therefore to the extent that Item One of Order No. 169 is seeking more from the Postal Service than 1) an analysis of the impact on the CRA of its adjustment (which is already shown in the attachment to this pleading), and 2) a justification of the Postal Service's adjustment (e.g., vis-à-vis other potential adjustments), the Postal Service respectfully requests that Order No. 169 be modified to eliminate any such additional objectives. Specifically, the Postal Service submits that it would be highly premature to require replication of extensive downstream analyses using input data which the Postal Service views as fundamentally incorrect.

Other Items

There are several other items regarding which perhaps no modification of Order No. 169 is necessary, but which the Postal Service nonetheless wishes to mention in order to better align potential expectations with actual responses. On Item Four, the concern is expressed that, in moving the DAL adjustment from the Delivery Cost Model (USPS-FY08-19) to the B Workpapers, the scope of the adjustment was expanded to include High Density as well as Saturation Mail. Order No. 169 at 4. The Postal Service did not intend any such expansion, and is checking to verify that the scope of the detached address label (DAL) adjustment remains unchanged. The response is therefore likely to be limited to discussing those portions of the respective analyses which show that to be the case. In those circumstances, of course, there would be no actual change from the established methodology to “reverse.”

Regarding Item Three, Order No. 169 correctly notes a change in the treatment of Special Handling costs. Order No. 169 at 3. Reallocating the cost of Special Handling to the host piece products brings the CRA into conformance with the way the Special Handling fees have customarily been treated in the RPW. With respect to this change in the format of cost reporting, there was an apparent miscommunication between the Postal Service and the Commission in the course of discussions on how to structure data reporting under the new PAEA product mapping. To actually undo this change in the most comprehensive fashion, it would be necessary to go back to initial IOCS coding, recode the handful of tallies (out of 700,000) which have been identified as including Special Handling, and rerun the entire set of IOCS programs, mail processing programs, CRA model, etc. Rather than embark on an exercise consuming resources which would be utterly disproportionate to the magnitude of any possible changes in output, the Postal Service's response to Item Three will focus on generating estimates commensurate with the established methodology that rely on various shortcut procedures. In view of the fact, for example, that the reported FY07 CRA costs for Special Handling were only $700,000 (*see* USPS-FY07-1), such a less comprehensive approach to performing the reallocation necessary to show what the results would be under the established methodology seems entirely appropriate.

Respectfully submitted,

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Mail Classes and Products (note 1)	Revenue (note 1)	Attributable Cost (note 2)	Volume Variable Cost (note 2)	Product Specific Cost (note 2)	Revenue $	Attributable Cost $ (note 2)	Contribution $ (note 2)	Cost Coverage (note 2)
Standard Mail:								
As submitted on December 29:								
High Density and Saturation Letters............................	**734.2**	**320.5**	**319.9**	**0.6**	**0.131**	**0.057**	**0.074**	**229.08%**
High Density and Saturation Flats and Parcels...........	**2,158.3**	**844.4**	**842.8**	**1.5**	**0.159**	**0.062**	**0.097**	**255.61%**
With the adjustment removed:								
High Density and Saturation Letters............................	**734.2**	**351.2**	**350.6**	**0.6**	**0.131**	**0.063**	**0.068**	**209.03%**
High Density and Saturation Flats and Parcels...........	**2,158.3**	**813.6**	**812.1**	**1.5**	**0.159**	**0.060**	**0.099**	**265.27%**

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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