

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

)
Priorities for Future Data)
Collection and Analytical Work)
Relating to Periodic Reporting)
)

Docket No. RM2011-3

INITIAL COMMENTS OF THE PUBLIC REPRESENTATIVE

(February 18, 2011)

I. INTRODUCTION

On November 18, 2010, the Commission issued a Notice and Order opening a strategic rulemaking docket, pursuant to 39 U.S.C. 3652(e), to determine the priorities for future Postal Service data collection and analytical work related to periodic reporting under 39 U.S.C. 3652 and for other Commission reports and studies required by law.¹ The overall purpose of this proceeding is to develop “a schedule with target dates for beginning data collection efforts or completing an initial group of analytical studies.” *Id.* at 5. In developing such a schedule, the Commission stated that it will take into account (a) the cost and benefits of such data collection efforts, (b) impact on estimated volumes, (c) impact on costs, (d) impacts on revenues, (e) time and expense required to complete the project, and (f) the relevance to the Commission’s responsibilities to

¹ Notice and Order of Proposed Rulemaking on Periodic Reporting, November 18, 2010 (Notice and Order).

determine the Postal Service's compliance with the Postal Accountability and Enhancement Act (PAEA) and the reports and studies that the Commission is required to produce under the PAEA. *Id.* at 3-5. The Notice and Order explains that at this initial comments stage, the goal is to determine topics to be discussed at an upcoming public forum and technical conference. These comments raise several considerations regarding budgeting and allocation of resources and discuss the studies and data collection efforts that should be given a higher priority and the rationales supporting those proposals.

II. PRELIMINARY CONSIDERATIONS

One of the Public Representative's primary concerns is the cost of upgrading or initiating new studies, data collection efforts, or other such analytical work. At the same time, with respect to these studies, it is not beneficial to the postal system for parties to continually argue that the administrative effort and expense on the part of the Postal Service in performing such studies is overly burdensome. Therefore, for time and expense to be a meaningful part of the discussion, the Public Representative believes it would be worthwhile to determine an overall budget related to the issues raised in this docket. It would be helpful if the Commission and Postal Service would set or at least provide budgetary guidance to interested parties on the total resources expected to be allocated towards upgrading and improving costing methodologies and other data collection efforts as a result of this docket. With such budgetary constraints in place, the Commission, the Postal Service, and other interested parties can provide more meaningful suggestions on how best to allocate those resources among analytical proposals and data collection efforts.

Similarly, it would be helpful to know the Postal Service's current intent with respect to planned and ongoing studies related to the issues covered by this docket, as well as its plans regarding upcoming petitions to request that the Commission make specific changes or additions to established analytical principles. The Postal Service's

views on the actual potential time and resources required to study these issues, and the availability of resources to perform such studies is of significant importance to the Public Representative and is expected to influence his views in this docket.²

III. PROPOSED PRIORITIES FOR RESEARCH PROJECTS

A. Elasticity Estimates by Product

A primary area of importance for data collection and study is the demand elasticity estimates used for volume forecasting. The elasticities currently used by the Postal Service in its submissions to the Commission under 39 CFR 3050.26 do not reflect the current structure of the Postal Service's operations and product offerings. Instead, these estimates are based on subclasses, a legacy from ratemaking under the ratemaking procedures of the Postal Reorganization Act of 1970 (P.L. 91-375, August 12, 1970) (PRA).

However, with the passage of the Postal Accountability and Enhancement Act in 2006, the concept of subclasses was replaced by a similar, yet distinct categorization system of "products." See 39 U.S.C. 102(6). In 2007, as part of the initial market dominant and competitive product lists, the Postal Service made fairly major changes to the groupings of its postal offerings. See Docket No. RM2007-1, Order No. 43 at 103-04 (October 29, 2007); see also 39 CFR 3020 subpart A, appendix A. These products differ, in some instances quite significantly, from the former subclasses used under the PRA.

For example, under the PRA, there were two commercial subclasses in Standard Mail – Enhanced Carrier Route (ECR) and Standard Mail Regular.³ To forecast mail

² As a result, these Public Representative initial comments are preliminary, subject to the availability of this information, which may influence the Public Representative's ultimate recommendations on how to proceeding in this strategic rulemaking.

³ There were also two corresponding subclasses for Standard Mail nonprofit mailpieces.

volume for these two subclasses, the Postal Service determined a separate demand elasticity estimate for both ECR and Standard Mail Regular. The ECR subclass was composed of carrier route mail, high density mail, and saturation mail while Standard Mail Regular contained all other commercial Standard Mail mailpieces. With the creation of the market dominant and competitive product lists in 2007, however, the postal offerings of the former-ECR and former-Standard Mail Regular subclasses shifted to the following products: High Density and Saturation Letters; High Density and Saturation Flats/Parcels; Carrier Route; Letters; Flats; Not Flat-Machinables (NFM)s/Parcels.

This change from the old subclass structure to the new product structure creates issues for volume forecasting when the demand elasticity estimates are not updated and realigned to reflect the new PAEA product structures. Following the Standard Mail example above, the High Density and Saturation Letters product does not precisely line up with the ECR subclass. The ECR subclass, and accordingly, the elasticity estimates of that subclass, contain carrier route, high density, and saturation mailpieces of all shapes. Similarly, the Standard Mail Regular subclass, and accordingly, its elasticity estimates, contain mailpieces of various shapes – letters, flats, NFM)s, and parcels. Using an elasticity that includes flats, NFM)s, and parcels to forecast the demand for letters is not ideal. Thus, applying the demand elasticity estimates for the old subclasses will likely result in serious inaccuracies for forecasting the volumes of postal offerings by product that are categorized based on mailpiece shape and other demand based characteristics.

The Commission found in Docket No. RM2008-4 that having accurate demand elasticity estimates are important for fulfilling its regulatory responsibilities under the PAEA.⁴ First, elasticity of demand estimates provide quantitative evidence of market power, which allows the Commission to make its statutorily mandated product list determinations under 39 U.S.C. 3642. Second, the Commission requires accurate

⁴ See Docket No. RM2008-4, Order No. 203 (April 16, 2009) at 38-43.

product-level volume forecasts to review price cap compliance of rates in cases where the Postal Service proposes to adjust rates for some products on a later timeframe than others.⁵ Third, the Commission needs accurate volume forecasts to assess whether revenues for specific competitive products with low profit margins are likely, at proposed rates, to be above their attributable costs in conformance with 39 U.S.C. 3622(a)(2). Fourth, volume forecasts are also a crucial part of the Commission's duties under section 3651 to assess the degree to which the modern system of rate regulation is achieving the objectives of sections 3622 and 3633. This is particularly important given the recent significant mail volume declines. Fifth, accurate elasticity estimates are important in both designing and measuring volume response to postal incentive programs such as negotiated service agreements and "summer sales." Finally, accurate volume forecasts on a product-by-product basis can be extremely important in determining how to fashion remedies for complaints found to be justified under section 3662(c).⁶ If the elasticity estimates submitted are not accurate at the product level, their usefulness in helping the Commission to fulfill these statutory and regulatory responsibilities is significantly impaired.⁷

The Public Representative recognizes that an effort to update the elasticity estimates on a product-by-product basis could prove to be costly, it is reasonable to assume that responsible management would see the need for such information for its own planning purposes and to understand the net revenue consequences of the Postal Service's rates and discounts. Thus, such information would not only be useful as a transparency-related regulatory requirement, but also in managements' best interest to

⁵ See e.g., Docket No. R2009-2, Order No. 191 (March 16, 2009).

⁶ Commission action to remedy the effects of any noncompliance as a result of its findings in the Commission's Annual Compliance Determination under 39 U.S.C. 3653(c) could use such information in a similar manner.

⁷ While not necessarily directly related to this strategic rulemaking, see Notice and Order at 4, accurate elasticity of demand estimates are also required for the Commission to complete its work in relation to service standards under 39 U.S.C. 3691(d) and its Universal Service Obligation mandates under 39 U.S.C. 3651(b), in particular for calculating nonprofit mail discounts and uniform rates for First-Class Mail.

have a sound understanding of the effectiveness of its product offerings, particularly given the stark volume decline trends that have occurred over the past several years.

B. Variability Studies

Several of the candidate areas for study identified by the Commission in its Notice and Order involved variability in postal operations. The Public Representative believes that the Commission and the Postal Service should seriously consider updating the variability for city carrier street time study and volume variability of mail processing study in the near to medium term. The results are likely to have profound impacts on the allocation of costs. Each of the specific potential variability related studies and the rationales for updating these studies is discussed below.

1. Variability of City Carrier Street Time

The city carrier street time study is used to distribute the attributable portion of salaries, benefits, and related costs of most city carriers to specific products and services for the activities they perform on the street. The presently used city carrier street time study established time and variability factors that are used to attribute approximately \$11.1 billion in Postal Service delivery costs – 49 percent of the \$22.6 billion in total delivery costs.⁸ Because such a significant portion of the Postal Service's costs rely on the city carrier street time study, it is important that this information is accurate. The current estimates of the variability of city carrier street time were collected in 2002 as a result of a special study. In April of 2004, the Postal Service updated the data used to produce the 2002 study. The data in the 2004 revisions contained substantially different outcomes from the results produced in the 2002 study. However, the data from the 2004 revisions has not been considered or approved by the

⁸ United States Postal Service Office of Inspector General Audit Report No. CRR-AR-09-001 (January 21, 2009) at 4.

Commission as an accepted analytical principle and was not used to update variability factors.⁹ These differences are a cause for concern regarding the reliability and accuracy of the currently accepted analytical principles regarding variability of city carrier street time.

Additionally, several actual, proposed, and pending operational changes since 2002 had (or are expected to have) an impact on delivery operations and street time variability. First, as the Postal Service's Office of Inspector General (USPS-OIG) points out in its January 21, 2009 audit report, there have been "significant changes" in city carrier street activities. *Id.* at 1.¹⁰ Since the completion of the 2002 study, there have been changes in the mail mix, an increase in the use of Delivery Point Sequencing (DPS), changes to bundle handling, and an increase in popularity of Click-N-Ship and other similar carrier package pickup programs. *Id.* at 2. Additionally, the Postal Service acknowledged that in 2002, city carriers carrying scanners and the Postal Service's Delivery Operation Information System (DOIS) were relatively new concepts. *Id.* at 15. Since 2002, however, there have been significant improvements to scanning technology and DOIS which allows for improved data collection monitoring by supervisors. *Id.*

Second, widespread adoption of the Flat Sequencing System (FSS) for processing flat-shaped mailpieces could have a meaningful impact on the variability of city carrier street time. With full implementation of FSS, a typical city carrier can be expected to spend more street time combining DPS letters, FSS flats, saturation bundles, and residual mail pieces at delivery points than currently occurs in the absence of FSS mail processing operations. As the USPS-OIG points out, "[s]ignificant changes are continuing with the roll-out of the Flats Sequencing System, which...will change

⁹ The apparent goal of the 2004 revisions was to determine whether a smaller sample size would yield comparable results. *Id.* at 12.

¹⁰ Such "significant changes" in city carrier street activities are part of the USPS-OIG's rationale for noting that another study may be warranted. *Id.* at 12 (stating that "the percentage of data quality issues remaining in the cleansed data set, combined with changes that have occurred in the delivery environment subsequent to the completion of the study, indicate that another study may be warranted.").

bundle handling processes, with particular impact on carriers walking sections of routes.” *Id.* at 11.

Finally, the Postal Service is requesting approval to make a major change in its delivery operations by reducing its number of delivery days. This potential operational change could have a significant impact on the variability of city carrier street time. If Saturday delivery is discontinued, mail volume is expected to increase city carrier street time, and will likely change its variability, on the following Monday¹¹ and other delivery days in the case of deferrable mailpieces. The Postal Service also appears to agree that street time variability will be affected by a change to five day delivery.¹²

Accordingly, while the Public Representative believes that the issues relating to the Postal Service’s 2002 and 2004 studies and updates regarding variability of city carrier street time need to be addressed and the operational changes that have occurred in the delivery need to be accounted for, it may be best to wait until Congress makes a firm decision with respect to the Postal Service’s ability to reduce its number of delivery days and the Postal Service’s FSS plans are solidified. That is not to say that the Public Representative is against undertaking such a study in the short term. The Public Representative believes that the early planning stages of a new city carrier street time study can and should begin in the near term.¹³ The Public Representative expects that the latter two changes, if they occur, will likely have a significant impact on city carrier street time variability. It would be preferable if the Postal Service did not have to expend resources at the present time to undertake a new study, only to again undertake another study in the near to medium term when decisions on FSS and five day delivery are made. This is especially true given that a special study relating to city carrier street time is expected to be relatively high in cost and its results are expected to have wide-ranging effects. This expected relatively high cost of a special study related to city

¹¹ If Monday is a holiday, the mail volume on Tuesday is expected to be even greater.

¹² See Docket No. N2010-1, Direct Testimony of Michael D. Bradley on Behalf of the United States Postal Service, USPS-T-6, March 30, 2010, at 8-20.

¹³ Indeed, the Postal Service has stated that it “is looking forward to working with the PRC and other interested parties to update the CCSTS [city carrier street time study] in the near future.” *Id.* at 15.

carrier street time also makes the use of the Postal Service's DOIS to determine street time variability more attractive.

At the very least, the Commission and the Postal Service should consider upgrading the DOIS system to allow it to accurately measure street time variability. Such an approach has the benefit of being more economical in the long run.

An updated city carrier street time study is important to the Commission's responsibilities because the city carrier street time study is the basis for allocating a large amount of delivery costs to competitive and market dominant products. Changes in city carrier street time variability will impact the variability factors applied to cost pools. This will result in cost allocation changes for most of the Postal Service's products. Accordingly, changes in street time variability will have direct and indirect effects on compliance related issues in the Postal Regulatory Commission's Annual Compliance Determination, including whether products cover their attributable costs and their contributions to institutional costs.

2. Volume Variability of Mail Processing

As the Commission notes in its Notice and Order, "[m]ail processing is the largest source of volume-variable costs in the postal system." Notice and Order, Attachment at 1. At the same time, the Commission recognizes that mail processing "volume variability has never been successfully modeled, due, in large part, to a lack of data on volumes finalized at processing plants that are reasonably free of measurement error." *Id.* The Public Representative is optimistic that the expected widespread adoption by mailers of the intelligent mail barcode (IMB) will remedy many of these historical problems with modeling volume variability in mail processing.

Moreover, because the IMB system is an internal tracking system based on collected data, the costs associated with using and, if necessary, modifying the IMB system to track mailpieces in such a manner, are not expected to be relatively high. In fact, the largest hurdle with respect to using the IMB system in this manner seems to be

the timeline for full implementation and widespread adoption of IMB by mailers. Waiting until the IMB system is fully operational before attempting to analyze IMB data for volume variability measurements intuitively makes sense.¹⁴

Updating the volume variability of mail processing due to the new IMB technology is expected to have a profound impact on the allocation of direct and indirect costs to the mail classes, products, and rate categories. The allocation of costs among the various mail piece categories is important to the Commission's Annual Compliance Determination (ACD). Among other things, in the ACD, the Commission calculates the actual workshare discounts provided by the Postal Service and determines if such discounts meet the requirements of 39 U.S.C. 3622(e). Moreover, the Commission's responsibilities in considering the appropriateness of Type 1-A and 1-B rate adjustments for market dominant products include determining whether the proposed workshare discounts in those cases run afoul of the requirement of 39 U.S.C. 3622(e). If all interested stakeholders can agree on the use of IMB for measuring volume variability, it should finally put to rest the long standing technical disagreement between the Postal Service and the Commission on the impact that volume changes have on mail processing costs. The significant mail volume declines in recent years should also serve as an empirical exercise to help determine how close to 100 percent volume variable mail processing costs are. Simply, the more that costs drop in relation to volume drops, the closer to 100 percent variability the mail processing costs actually are.¹⁵

¹⁴ Additionally, the operational change of the FSS for the sortation of flat-shaped mailpieces should have an effect on mail processing operations, which could affect volume variability.

¹⁵ See *also* United States Postal Service Office of Inspector General White Paper No. RARC-WP-10-006 (September 29, 2010) at 25-26.

IV. CONCLUSION

The Public Representative respectfully submits the preceding comments for the Commission's consideration and discussion at the upcoming public forum and technical conference.

Respectfully Submitted,

/s/ Robert Sidman

Robert Sidman
Public Representative for
Docket No. RM2011-3

901 New York Avenue, N.W., Suite 200
Washington, DC 20268-0001
(202) 789-6827; Fax (202) 789-6891
e-mail: robert.sidman@prc.gov