

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

ANNUAL COMPLIANCE REPORT, 2010

Docket No. ACR2010

REPLY COMMENTS OF THE UNITED STATES POSTAL SERVICE
(February 17, 2011)

In Order No. 636 (Jan. 4, 2011), the Commission solicited comments on the United States Postal Service's Annual Compliance Report for Fiscal Year 2010. On February 2, 2011, the Public Representative and a number of private parties submitted comments. The Postal Service hereby provides its reply comments, addressing the main proposals and arguments set forth by commenters.

I. Public Representative (PR)

The Public Representative (PR) has a variety of comments that, broadly speaking, relate to the operating environment, and more specifically, changes in the operating environment and their potential effects on postal costs. The premises of these statements, however, are not always correct.

A. The Reality of FSS Deployment in FY 2010 Does Not Match the PR's Assertions

The PR comments contain several misstatements regarding the Flats Sequencing System (FSS): For example, on page 19 of those comments, the PR presents Table 8, showing information taken from a Postal Service website regarding FSS machines. With regard to that table, the PR claims:

Table 8 lists the 40 Flats Sequencing System (FSS) machines that are currently operational. Most of the FSS machines on that list were

processing live mail during FY 2010; however, the costs associated with the FSS machines are not presented along with the AFSM and FSM machines.

PR Comments at 18.

There are two errors in these statements. First, during FY 2010, essentially 8 to 12 FSS machines were operational, and operation of these machines was constrained by equipment acceptance testing for most of the fiscal year. At the beginning of FY 2010, 8 FSS machines were operational. By the end of FY 2010, 6 additional FSS machines had become operational, but two of those began operations only in the last several of weeks of FY2010. The FSS machines that were operational by the end of FY2010 are the first 14 FSS machines listed in Table 8 of the PR's comments. Operations on the other 26 other FSS machines listed in Table 8 began during FY 2011. The first 12 FSS machines listed in Table 8 were accepted (contractually speaking) as of September 1, 2010. At that point, they were no longer under any test constraints that had previously limited the Postal Service's ability to add sort plans (zones). Thus at end of FY 2010, these machines could be considered as fully operational. Even by the end of the fiscal year, however, operations on these 12 FSS were not fully ramped up to include all zones and routes intended for each FSS. Instead, as stated in the FY 2010 Comprehensive Statement at page 30 –"by [fiscal] year end FSS covered 4,874 routes with 279 delivery zones." Thus, the PR is in error to suggest that "most" of the FSS machines listed in Table 8 were processing live mail during FY 2010.¹

¹ The PR subsequently repeats this error on page 20, asserting that "more than one third of all the FSS machines that will eventually be deployed in the United States were fully operational in FY 2010." As noted above, 8 to 12 FSS machines (of the 100 to be deployed) operated during FY2010. Even these can not be said to have been "fully

Second, as noted in USPS-FY10-7 and USPS-FY10-8, the costs for these initial FSS operations were included in the AFSM 100 category. USPS-FY10-7 in USPS-FY10-7 part1.xls shows that in MODS operations 530, 531 and 538, there were 539,044 hours (or roughly \$22.8 million) in clerk and mailhandler costs, which were included in the AFSM 100 cost pool. As indicated in USPS-FY10-8, the estimated facility space for FSS of 381,114 sq. ft. was included in the AFSM 100 category (see FCILTY10.xls). Likewise, fy10equip.xls indicates the depreciation and maintenance costs for FSS of \$5.2 million and \$3.2 million, respectively, were included in the AFSM 100 category. As noted in the preface of USPS-FY10-8, "as deployment progresses, a new equipment category and/or facility space category will likely be sought." The rationale for including these costs in the AFSM 100 category is that the mail mix or distribution of costs is likely to be very similar.

B. The Public Representative's Criticisms of MODS Productivity Data Do Not Show that Worksharing Cost Avoidances Are Inaccurate

The Public Representative observes that MODS data exhibit "certain flaws" and suggests that inaccuracies in productivities derived from "not...properly scrubbed" MODS data may lead to inaccurate estimates of worksharing cost avoidances. PR Comments (Feb. 2, 2011) at 22-23. Echoing criticisms originally aired in the course of litigating the use of MODS data for econometric estimation of mail processing volume variability factors,² the PR notes that MODS data frequently exhibit measurement errors,

operational," as acceptance from the contractor providing this equipment was not completed until very late in the fiscal year.

² The PR erroneously contends that "MODS data is also used to calculate the mail processing volume variability factors by cost pools...that go into the Cost and Revenue Analysis (CRA) model." PR Comments at 23. The Commission explicitly rejected the

that the screening procedures applied in folder USPS-FY10-23 may not eliminate all observations with measurement errors, and that aggregating data prior to screening may "hide" erroneous observations. PR Comments at 23-24. Finally, the PR contends that decreasing "sample size" for MODS data may constitute a change in analytical principles. PR Comments at 24-25.

The PR's critique of the MODS-based productivities consists largely of assertions that well-known measurement errors in MODS data may lead to biased productivities. In the absence of original analysis, the PR relies heavily upon findings from the report of a 2007 MODS audit by the Postal Service's Office of the Inspector General (USPSOIG; Report MS-AR-07-003, August 6, 2007). USPSOIG found high rates of anomalous MODS data at low levels of aggregation at a group of seven facilities examined over a three-month period. USPSOIG examined four types of anomalies, which the PR also lists: observations with hours but zero volumes, observations with volumes but zero hours, observations with FHP greater than TPH, and observations with negative volumes.

The PR does not appear to have recognized that the data screening and aggregation programs in folder USPS-FY10-23 (yr_scrub.tsp and bmc_scrub.tsp) exclude observations with workhours but zero volume, volume but zero workhours, and negative volumes at the facility/operation group/month level prior to screening the tails of the productivity distribution. These types account for most of the anomalies reported

use of MODS-based econometric volume variability factors in the R97-1, R2000-1, and R2006-1 rate cases, and the CRA mail processing volume variable cost model uses Commission-accepted attribution methodology.

by USPSOIG. The FHP anomalies are largely irrelevant to the USPS-FY10-23 methods, as they do not employ FHP data.³

The USPSOIG report provided little assessment of whether the anomalies actually constituted errors, and did not indicate whether the errors were large or small relative to valid data. USPSOIG Report MS-AR-07-003 at 7. The USPSOIG report actually undermines the PR's contention that MODS data aggregation may be expected to lead to less accurate data, observing that aggregation over time and/or operations improves the reliability of MODS data:

While the individual data records had a high error rate, when they are aggregated at the plant level on a daily, weekly, or monthly basis, the total volume and workhour data at the facilities is generally reliable, especially for the Postal Service's purposes. (USPSOIG Report MS-AR-07-003 at 7.)

In a related appendix, the USPSOIG report provides an example of MODS anomalies that are corrected by aggregating to cost pools:

Data entries 1 through 4 depict anomalous data because the work was performed in operation numbers [redacted] but the workhours were reported in operation numbers [redacted]. However, the total... volume and workhours – aggregated at the level for Postal Service [costing] use – are correct. (USPSOIG Report MS-AR-07-003 at 24.)

That is, when workhours for an activity are recorded under operation A but the workloads are recorded under operation B, the individual operations' data are in error but the sum of operations A and B is correct. The relevant issue is not the accuracy of

³ At the time of the USPSOIG report, MODS FHP was measured primarily by weighing mail prior to distribution and applying pound-to-piece conversion factors, while TPH and TPF for automated operations were based on direct machine counts. See, e.g., Docket No, R2006-1, USPS-T-12 at 24. Given machine counting for TPH, the accuracy of the FHP conversion would be the likeliest cause of such anomalies. Since then, MODS methods have been revised to replace weighing of letters and flats for FHP with an analysis of End-of-Run (EOR) data.

the finest-grained data produced by the system, but the accuracy of the data at analytically relevant levels of aggregation.

While screening and aggregation can be useful tools, the Postal Service recognizes that it does not correct all errors and anomalies in the MODS data. However, the simple sums of MODS workhours, Total Pieces Fed (TPF), and Total Pieces Handled (TPH) developed in USPS-FY10-23 do not require error-free data to produce accurate results for the productivity calculations. For a sum (or, similarly, a mean⁴), "aggregating" mean-zero errors does not lead to bias. This is in sharp contrast to volume variability models based on ordinary least squares regression, where measurement issues rose to the forefront of methodological and data quality disputes because regression estimates are subject to bias from mean-zero measurement error in explanatory variables.

For the sums in USPS-FY10-23, increasing the sample size will decrease the relative standard deviation of the measurement error in the sum—specifically, with the square root of the sample size.⁵ This attenuation of measurement error again, contrasts with an issue from the variability analyses whereby certain regression techniques could amplify the bias from small measurement errors. Given sufficient sample sizes, even relatively large measurement errors at the observation level would be expected to have relatively small effects on sums (or means) of the data. Notwithstanding declines in the numbers of observations, the typical MODS-based productivity has a relatively large

⁴ While the USPS-FY10-23 MODS productivities are directly calculated as the ratios of the summed group TPF to summed hours, they are equivalent to the ratios of the corresponding means—the (1/N) terms in the means cancel in the ratio.

⁵ This follows from the well-known result that the mean of a random sample of size N where the observations has standard deviation σ/\sqrt{N} .

number of underlying observations—hundreds or thousands of observations in most cases.

In the end, for the PR's concerns to be valid, it is not sufficient for the MODS data to be measured with error, it must be measured with large bias. While the PR asserts that the productivities may be biased downward, the anomalies the PR cites via the 2007 USPSOIG MODS audit do not have a clear direction of bias. MODS measurement methods, likewise, do not point to mechanisms for biases as opposed to non-biasing errors. Most of the reported productivities are for automated operations where TPF and TPH volumes are obtained from direct machine counts of pieces. While misclocking is unfortunately common, there is little reason to expect it to result in bias rather than error; adding-up constraints for total workhours imply that every operation's workhours cannot be biased in the same direction.

Finally, while the PR implies that reductions in MODS observation counts may amount to changes in analytical principles, closer inspection shows that the changes owe largely to operational changes. Table 1, below, decomposes the PR's Table 12 (PR Comments at 25) by operation group. The retirement of UFSM 1000 equipment and the end of certain Return to Sender operations (supplanted by PARS) account for a majority of the decline in observations. Where mail processing equipment is retired, there simply is no ongoing data with which to compute productivities; the Postal Service attempts to highlight those changes as they occur. Where necessary, the Postal Service has developed alternative means of computing productivities and sought approval of the methods in rulemakings. For example, when Function 1 (but not Function 4) CSBCS

operations ended, the Postal Service presented an alternative method in Docket No. RM2010-5, Proposal 27.

Table 1. MODS observations by operation category, FY2007 and FY2010

Operation Category	Observations		Difference	Difference % of Total
	FY2007	FY2010		
Outgoing Automated Letters	11,118	10,357	-761	6%
Incoming Automated Letters	15,548	14,576	-972	7%
Manual Letters	13,709	11,989	-1,720	13%
LMLM	2,161	1,648	-513	4%
AFSM 100	10,560	10,083	-477	4%
UFSM 1000	9,368	3,357	-6,011	45%
Manual Flats	10,970	10,019	-951	7%
SPBS/LIPS/APPS	4,072	3,270	-802	6%
Manual Parcels	3,482	3,092	-390	3%
Return to Sender				
ISS/OSS	1,188	25	-1,163	9%
PARS/CIOSS	14,449	14,755	306	-2%
Total	96,625	83,171	-13,454	100%

The Postal Service agrees with the PR that the accuracy of the input data for worksharing cost avoidance models is important, and can envision future improvements to the methods for calculating MODS-based productivities. It should be noted that the alternative to using operating data such as MODS would be to conduct an array of special studies which would have their own accuracy issues, including sampling variability from statistical study designs and potential non-sampling errors. Ultimately, the appropriate venue for changes to the USPS-FY10-23 methods would be a rulemaking procedure in which the worksharing models' data requirements, the relevant MODS data issues, and applicable analytical methods can be carefully considered.

C. Increases in the Manual Share of Flat Sorting Costs Observed by the PR Are Partly Due to Improvements to Automated Flat Sorting Operations

The Public Representative considers it "troublesome" that the ratio of manual to automated flat sorting labor increased from FY2007 to FY2010. PR Comments (Feb. 2, 2011) at 21. While the observation regarding the change in the ratio is correct, it is less troublesome than it may initially appear. The Public Representative neglected to recognize that the level of manual flats costs have declined over the period, and the principal driver of the change in the composition of flat sorting operations is the ongoing retirement of UFSM 1000 flat sorting equipment. Table 2, below, shows total costs for the Function 1 flat sorting cost pools from FY2007-FY2010.

Table 2. Total Costs for Function 1 Flat Sorting Cost Pools, FY2007-FY2010

Cost Pool	Total Cost for Cost Pool (\$000)				Percent Change FY07-FY10
	FY07	FY08	FY09	FY10	
Manual Flats – Function 1	227,480	218,273	214,261	194,865	-14%
AFSM 100	688,248	701,871	697,266	665,905	-3%
FSM 1000	203,684	162,203	95,036	46,119	-77%
Total Function 1 Flat Sorting	1,119,412	1,082,347	1,006,563	906,889	-19%
Manual Flats					
% of Function 1 Flats	20%	20%	21%	21%	6%
AFSM 100					
% of Function 1 Flats	61%	65%	69%	73%	19%

Source: ACR folders USPS-FY07-7, USPS-FY08-7, USPS-FY09-7. USPS-FY10-7

While Function 1 manual flats increased as a fraction of Function 1 flat sorting, manual flats costs declined in absolute terms over the period. The main operational change is due to the retirement of UFSM 1000 equipment and the corresponding sharp decline in costs assigned to the FSM 1000 cost pool. However, data from USPS-FY07-23 and USPS-FY10-23 show that the fraction of Function 1 workload processed on automation has increased slightly, from 92.7 percent of flats TPF in FY2007 to 93.5 percent in FY2010. See Table 3, below. Since AFSM 100 equipment has higher

productivity than other flat sorting equipment, it takes fewer workhours to sort a given volume of mail with a higher AFSM 100 share of the sorting mix, which may tend to increase the manual cost share (but not level) even as flat sorting becomes more efficient overall. See also Docket No. R2010-4, Supplemental Response of the United States Postal Service to Question from the Bench at the Hearing for Mr. Neri (filed August 27, 2010), showing increases in Function 1 flat distribution productivity from FY2006 to FY2010 (YTD through July 2010).

Table 3. Flat Sorting Workload (TPF) by Operation Group, FY2007 and FY2010

Operation	FY2007	FY2010
AFSM 100	29,375,342	20,745,485
UFSM 1000	3,588,745	1,047,299
Manual Flats	2,596,679	1,525,978
% Automated TPF	92.7%	93.5%

Source: ACR folders USPS-FY07-23, USPS-FY10-23

In fact, the fraction of Function 1 flat sorting costs in the AFSM 100 cost pool has increased more than the manual share. Since the AFSM 100 is the highest-productivity flat sorting equipment, and indeed has been improved with the deployment of Automated Induction (AI) and Automated Tray Handling System (ATHS) upgrades, the increase in the AFSM 100 share should not be considered troublesome.

The data also do not indicate shifts of flat sorting costs to manual Function 4 operations as a major cause for concern. Table 4 shows that from FY2007-FY2010, dollar-weighted IOCS tallies for MODS Function 4 and non-MODS flat sorting activities declined at roughly the same rate as Function 1 flat sorting costs shown in Table 2, above—20 percent and -19 percent, respectively. The Function 4 and non-MODS manual flat sorting decline is faster overall than the 14 percent decline in costs for the Function 1 manual flat sorting cost pool.

Table 4. IOCS Weighted Tallies (\$000) for Function 4 Flat Sorting, FY2007-FY2010

Function 4 Category	IOCS Weighted Tallies (\$000)				Percent Change FY07-FY10
	FY07	FY08	FY09	FY10	
MODS Function 4 and LDC79 - Manual Flats	228,351	237,728	215,637	197,994	-13%
Non-MODS Manual Flats	478,908	480,067	436,167	366,519	-23%
Total	707,260	717,796	651,804	564,513	-20%

Source: Analysis of IOCS data in folders USPS-FY07-NP21, USPS-FY08-NP21, USPS-FY09-NP21, and USPS-FY10-NP21.

D. Retail Access and Collection Boxes

At page 6 of its Comments, the Public Representative initiates a discussion referencing a number matters; the number of postal retail locations and delivery points in each of the past five fiscal years; current estimates of the proportion or postal retail revenue generated over the counter; PRC Docket No. N2009-1 and a related USPS Office of the Inspector General report; the Post Office Discontinuance Tracking System; its successor, the Post Office Discontinuance and Emergency Suspension System; PRC Docket No. PI2010-1 and USPS Handbook PO-101. These topics apparently establish a foundation for the Public Representative's discussion at page 11 of a January 24, 2011 *Washington Post* article. There, the Public Representative references the newspaper reporter's characterizations of (a) existing postal processes for the compilation and review of internal operating data relevant to retail location closure/discontinuance determinations and (b) advances by postal management in computerized standardization of the compilation of such data for review.

Next, the Public Representative invites the Commission's attention to the article's attribution to unnamed postal officials of the revelation of a "plan" which is characterized as having the potential to result in a 50 percent reduction in postal retail infrastructure

by the year 2020. PR Comments at 11.⁶ In reaction to the newspaper article, the Public Representative ends this portion of its comments with a paragraph comprised mainly of its characterizations of postal procedures for closure/consolidation of retail locations and a series of questions regarding those procedures. Alluding to the above-referenced newspaper article, the Public Representative offers the opinion that

the closure of or consolidation of 2,000 offices would certainly appear to constitute a "change in the nature of postal services on at least a substantially nationwide basis . . ."

within the meaning of 39 U.S.C. § 3661. The Public Representative follows this declaration with its ultimate question which appears to seek (1) a confirmation that a plan to close 2,000 offices in the future exists, and (2) the statement of a legal conclusion by the Postal Service regarding the application of section 3661 to such a plan.

In response to this question, the Postal Service reminds the Public Representative that Docket No. ACR2010 is limited to a review of the Postal Service's Annual Compliance Report for FY 2010. Any future plans, such as ones that might be developed to consider future closure/consolidation of retail facilities, are inherently beyond the scope of the instant docket. Accordingly, despite its general interest in clarifying or correcting matters reported in the press, the Postal Service considers that it has a higher obligation to avoid perpetuating the discussion of matters beyond the scope of this docket by offering factual clarifications or legal opinions about such matters here.

⁶ Despite the strong temptation to do otherwise, the Postal Service will refrain from commenting here on the accuracy and clarity of the characterizations in the newspaper article, because doing so would only serve to perpetuate discussion of matters in the instant FY 2010 Annual Compliance Review docket that are well beyond its scope.

In a similar vein at pages 12-14, the Public Representative raises the issue of collection boxes, and references data showing the number of such boxes by U.S. state or territory in the past five fiscal years, as well as changes from FYs 2006 to 2010 in the number of boxes by location type. At page 12, the Public Representative alludes to the Postal Service's Docket No. N2009-1 explanation for why changes in the location of boxes or number of boxes at a specific location might occur. Appearing to acknowledge the reasonableness of that explanation, the Public Representative cautions that:

reducing the availability of collection boxes should be integrated with other realignment activities so as not to reduce access to postal services beyond what could be considered cost effective levels or on a geographically uneven basis.

PR Comments at 13-14. The Postal Service questions the relevance of the Public Representative's collection box comments, given the narrow focus in section 3652(a)(2)(B) on reporting about aspects of market dominant *product* performance and the limited scope of the annual determination of compliance, as defined by 39 U.S.C. § 3653(b). It is insufficiently clear how the Public Representative defines an appropriately *cost effective* removal of collection boxes or an inappropriately *geographically uneven* distribution of collection boxes. In any event, the Public Representative does not assert that any changes to collection boxes in FY 2010 reflect a lack of integration with realignment activities or raise such cost or geographical considerations.

II. Valpak

Consistent with its filings in past annual compliance proceedings, Valpak claims that 39 U.S.C. § 3622(c)(2)'s cost recovery requirement applies at the product level. Valpak Comments at 24 fn.27. Valpak accurately cites instances in the FY2008 and

FY2009 ACDs where the Commission has invoked Section 3622(c)(2). *Id.* The remainder of Valpak's comments regarding alleged noncompliance take for granted that this interpretation of Section 3622(c)(2) is correct. At this point in the Commission's jurisprudence, however, it is far from clear that these assumptions can so blithely be made.

More recently than the ACDs that Valpak cites, the Commission has extensively discussed Section 3622(c)(2) and appears to have concluded that it applies at the class level, not the product level.

The attributable cost floor [of Section 3622(c)(2)] applies to each "class or type of mail." While this phrase is broad enough to include an individual "product," it is not confined to an individual "product." . . . Thus, there is nothing in section 3622, the pricing section of the PAEA, that supports the Postal Service's theory that the PAEA contemplated regulation of market dominant prices primarily at the product level. . . .

Congress identifies the services to which a pricing standard applies where that is its intent. For example, section 3622(b)(8) (establishing the "just and reasonable" standard) specifies that it applies "within, between, or among classes of mail." Congress also specifies when a pricing requirement applies to individual "products" and when a pricing requirement applies at a more general level. This conclusion is corroborated by noting that Congress also applies non-price requirements at the product level when that is its intent.⁷

The Commission apparently rejected the suggestion that the ACR's product-level reporting correlates to product-level evaluation of compliance:

The term "product" is used in 3652(b) for the same reason that it is used in 3652(a), to make sure that there is granular reporting of data on all products, so that no mail is left out. . . . Since granular reporting is an all-purpose tool, it does not support an inference that Congress wanted the relevant standard (such as the ceiling on workshare discounts) to be evaluated at any particular level.

⁷ Order No. 536, Order Adopting Analytical Principles Regarding Workshare Discount Methodology, Docket No. RM2009-3, September 14, 2010, at 26-29 (emphasis added, footnotes omitted).

The inference that the granular reporting required by section 3652(b) determines the scope that Congress intended for section 3622(e) is unsupported. This can be seen by examining the other pricing standards of the PAEA. . . . Similarly, the attributable cost floor for market dominant products established in section 3622(c)(2) applies to “each class or type of mail service.” It is not plausible to contend that despite this broad language, the attributable cost floor applies at the product level and no higher because the only compliance tool that section 3652(a) provides is data reported at the product level.⁸

The Postal Service recognizes, of course, that a petition for review of this portion of Order No. 536, among others, is pending before a federal appellate court. Suffice to say, the Postal Service draws attention to Order No. 536 not to validate it, but to draw attention to the confusion that has resulted for Section 3622(c)(2)’s role in the present context.

In short, the Commission discarded the same construction now advanced by Valpak and held that Section 3622(c)(2)’s cost-recovery requirement applies at the class or broad “type of service” level – as stated in that provision – not at the granular product or sub-product level. If the Commission or the appellate court were to remain faithful to Order No. 536’s interpretation of Section 3622 in its forthcoming ACD, then, whatever observations and suggestions the Commission might offer about market dominant products or product components with costs that exceed revenues, the Commission could not find that these products themselves do not violate Section 3622(c)(2) except insofar as they cause a larger mail class to do so.⁹ On the other

⁸ Order No. 536 at 31-32 (emphasis added, footnote omitted).

⁹ Notwithstanding seemingly contradictory statements elsewhere in the FY2008 and FY2009 ACDs, this was the approach taken by the Commission in the FY2008 ACD, when it found that “[t]he PAEA addresses cost coverage in terms of the class as a whole” and suggested that the Postal Service focus its remediation efforts on particular Periodicals products in the interest of achieving class-level compliance. FY2008 Annual Compliance Determination at 54.

hand, if the Commission were to find in the ACD that individual loss-making products or, in the case of Ancillary Services, sub-product categories within an otherwise profitable mail class constitute violations of Section 3622(c)(2), such a determination would undermine a key portion of the reasoning behind Order No. 536.

III. Time, MPA, ANM, and ABM

In the Annual Compliance Report, the Postal Service noted the impossibility of the Postal Service bringing certain products to full attributable cost coverage levels and stated that it would be useful for the Commission to determine whether the Commission's own powers allow it to remedy the cost coverage shortfalls of such products itself. In their Comments, several parties have argued that section 3622(d) precludes the Commission from raising any rates beyond what the price cap framework would allow.¹⁰ In support of their arguments, they point to the fact that, whereas the attributable cost coverage provision of section 3622(c)(2) is labeled a "factor," the price cap provision of section 3622(d) is labeled a "requirement." They state that this distinction makes the price cap paramount above section 3622(c)(2) and any other component of the rate regulation system set forth in section 3622, and that the Commission raising a rate above what the price cap framework allows would therefore violate section 3622. In response, the Postal Service would like to make two observations.

First, in its Fiscal Year 2009 Annual Compliance Determination, the Commission stated that "[w]hile the Commission has characterized section 3622(d) 'as the

¹⁰ See, e.g., Initial Comments of Time Inc. on USPS FY 2010 Annual Compliance Report, Docket No. ACR2010 (Feb. 2, 2011); Comments of Magazine Publishers of America, Inc., Alliance of Nonprofit Mailers and American Business Media, Docket No. ACR2010 (Feb. 2, 2011).

administrative cornerstone of the new rate setting system for market dominant products[,]’ this statement does not render the balance of section 3622 irrelevant... there are other important policies set out in title 39 that must be recognized.” In light of this statement, the Postal Service interprets the Commission’s position to be that the price cap does not in every circumstance override every other provision of the statute. This view is reinforced by the existence of section 3622(d)(3), which directs the Commission to review the rate regulation system after ten years and make such changes as it deems necessary to achieve the objectives set forth in section 3622(b). These changes could potentially include the elimination of the price cap altogether. The fact that section 3622 grants the Commission discretion eventually to eliminate the price cap demonstrates that the price cap does not trump all other considerations.

Second, section 3662, which, by operation of section 3653, directs the Commission to remedy rates that are not in compliance with chapter 36, contemplates the Commission taking an action far more drastic than raising rates beyond the price cap. Specifically, section 3662(c) furnishes a non-inclusive list of actions the Commission may take to remedy noncompliance, and one such action is “ordering the Postal Service to discontinue providing loss-making products.” Ordering the elimination of a product is plainly more severe than ordering that the product’s rates be raised beyond the price cap. Further, the elimination itself has price cap implications (because users of the eliminated product would be forced to use other products whose rates may be higher than the eliminated product’s rates) but would occur irrespective of the price cap. Thus, if section 3662(c) contemplates an action – ordering the elimination of a product – that is both more drastic than ordering the piercing of the price cap and could

itself potentially involve the piercing of the price cap – it is not clear why another action contemplated by section 3662(c) – namely, the Commission “ordering unlawful rates to be adjusted to lawful levels” – cannot break the price cap as well.

Regardless of the Commission’s ultimate determination as to the contours of its powers, it is critical that the Commission make a determination. If the Commission determines that it can raise rates beyond the price cap, then such determination would open the way to resolving the longstanding subsidization of certain loss-making products by profitable products. If the Commission determines that it cannot raise rates beyond the price cap, then such determination would clarify to Congress that, if Congress believes that the Commission should have the power to raise rates beyond the price cap. Congress must act to grant the Commission such power. The status quo of uncertainty as to the Commission’s powers should not continue.

IV. Time

Time criticizes the Postal Service’s supposed conclusion about the impossibility of achieving full cost coverage for Periodicals under the constraints of the price cap. It points out that Periodicals unit costs have risen faster than the growth in CPI, despite growth in worksharing and concludes this is evidence of inefficiency, particularly evidenced by too much manual piece distribution of Periodicals leading to excessive processing costs. It also complains it has not been privy to the work of the Commission and Postal Service on the Periodicals Report – so it is not able to fully consider the evidence. (Initial Comments of Time, Inc at page 5-10) The evidence on the challenges of achieving full cost coverage under a price cap for Periodicals is abundant on the public record and it refutes all of Time’s claims of inefficiency.

A. Efficiency Declines Cannot Be Deduced Simply from Cost Coverage Trends

Mr. Stralberg begins his comments with a review of Periodicals cost coverage from FY 2007 to FY 2010. Simply by looking at the trend in cost coverage, he concludes:

So in FY 2007 and even more in FY 2008 and FY2009, there must have been major slides in the efficiency with which Periodicals were being processed and delivered. (Addendum to the Initial Comments of Time, Inc at page 2)

Efficiency declines cannot be deduced simply by looking at trends in cost coverage. Change in cost coverage comes from change in prices, product mix, input prices, and productivity. Mr. Stralberg chooses to consider only one (prices) and assign blame to another (productivity) without considering the impacts of the cornucopia of change in the distribution of pieces and weight across rate elements or input prices. The failure to consider all the elements that can affect cost coverage is neither “careful” nor “deeply informed”. (Initial Comments of Time, Inc at page 23)

The period from FY 2007 to FY 2010 has seen dramatic changes in Periodicals mail. Total volume decreased by 20 percent from 7.9 billion pieces to 6.4 billion pieces. Advertising pounds decreased by 36 percent from 1.5 billion pounds to 1.0 billion pounds. Advertising pounds per piece declined 17.5 percent. The proportion of carrier route presorted flats has increased from 50.4 percent in FY 2007 to 59.1 percent in FY 2010. (USPS-FY07-14, USPS-FY10-14) Average clerk and mail handler wages have increased by 14.4 percent. The number of city, rural and highway routes has declined from 259 thousand to 243 thousand while the number of delivery points served by these routes has increased from 127 million to 131 million (AIS data). Average delivery points

per route have increased by 9.3 percent, making it easier for some customers to qualify for Carrier Route. None of these changes were foreseen when projections were made in Docket No. R2006-1.

For mailers at the margin, the reduction in revenue as pieces migrate from 5-Digit to CR can exceed the cost reduction from the migration¹¹. The result can be a decline

¹¹ Consider a hypothetical example where a publication has 30 pieces to a 5-Digit zone served by six routes. If these pieces are evenly distributed across the routes the mail will be prepared in a single 5-Digit bundle with 30 pieces. If the focus is on costs that are affected by presort level (bundle, piece costs and delivery), the variable cost of handling the pieces is \$8.55, the sum of:

- \$0.4579 – Mail processing costs of a 5-Digit bundle on an SCF pallet – ChIR.1.Q.2.5.6.7.Rev.FY10.Periodcl.xls – Sheet “Summary” – Cell S17
- 30 X \$0.1102 – Mail processing costs of a 5-Digit machinable barcoded piece – ChIR.1.Q.2.5.6.7.Rev.FY10.Periodcl.xls – Sheet “Summary” – Cell G14
- 30 X \$0.1595 – Delivery Costs of a Standard Regular flat – USPS-FY10-19 UDCmodel10.xls – Sheet “1.Table 1” – Cell C68.

The combined piece and bundle revenue is \$8.425, the sum of

- \$0.145 – 5-Digit bundle on SCF container charge
- 30 X \$0.276 – 5-Digit barcoded machinable piece charge

If, the mail were now be prepared as 5 Carrier Route bundles with 6 pieces each (now that the minimum number of piece per bundle can be achieved for the CR bundles). The total bundle and piece costs will be \$7.86, the sum of:

- 5 X \$0.9096 – Mail processing costs of a Carrier Route bundle on an SCF pallet – ChIR.1.Q.2.5.6.7.Rev.FY10.Periodcl.xls – Sheet “Summary” – Cell S18
- 30 X \$0.0022 – Mail processing costs of a machinable Carrier Route piece – ChIR.1.Q.2.5.6.7.Rev.FY10.Periodcl.xls – Sheet “Summary” – Cell E15
- 30 X \$0.1082 – Delivery Costs a Standard Basic ECR flat – USPS-FY10-19 UDCmodel10.xls – Sheet “1.Table 1” – Cell G74.

The combined piece and bundle revenue is \$6.74 the sum of:

- 5 X \$0.279 – Carrier Route bundle on SCF container charge
- 30 X \$0.178 – Basic Carrier Route piece charge

As a result, the cost coverage for these pieces would drop from 98.5 percent to 85.7 percent.

in cost coverage. The simplistic notion that additional worksharing, in and of itself, should lead directly to higher cost coverage is false. The increase in the proportion of Carrier Route presorted mail is the result of many factors, including the increase in co-mailing and the loss of publications with low densities. However, under current rates many smaller Carrier Route bundles do not cover costs relative to larger 5-Digit bundles. A relatively greater share of these small Carrier Route bundles will lead to a lower Periodicals cost coverage in aggregate. Thus, it is simply wrong to just assume that a change in billing determinants toward higher presort levels would unconditionally improve cost coverage.

B. Stralberg Ignores Other Causal Factors for Cost Coverage Changes

The precipitous drop in Periodical Outside County weight, particularly advertising weight, is a major contributor to the decline in cost coverage. In FY 2007 38.2 percent of Periodicals Outside County revenue was derived from pound charges. In FY 2010, only 28.2 percent of revenue was derived from pound charges (ACR07-USPS-FY07-14, ACR10-USPS-FY10-14). On a per-piece basis, this amounts to a 2.4 cent decline in average revenue. However, many mail processing costs are largely unaffected by piece weight. A 6-ounce piece flows through an AFSSM 100 at nearly the same rate as an 8-ounce piece. A 6-pound bundle is processed at nearly the same rate as an 8-pound bundle. A 600-pound pallet can be moved no faster than an 800-pound pallet. Because over 80 percent of Periodical Outside County weight is entered at or near destination, the Postal Service does not have the opportunity to recoup the revenue losses through transportation savings.

Although weight is not a significant cost driver in sortation operations, the reduction in piece weight can lead to degradations in preparation. Given equal density, fewer 5-Digit pallets can be made at lower piece weights because five-digit pallets require 250 pounds of mail. As the average weight of Outside County Periodicals fell, so did the proportion prepared on 5-digit pallets – from 10.7 percent in FY 2007 to 7.5 percent in FY 10. When a carrier route bundle migrates from a 5-Digit pallet to an SCF pallet the Postal Service incurs an additional \$0.531 in costs because of the additional sorts the bundle will incur, but the Postal Service will only gain an additional \$0.132 in revenue.

Mr. Stralberg also ignores input prices in his discussion. In the time period of his analysis, FY 2007 to FY 2010, clerk and mail handler wages have increased from \$35.91 per hour to \$41.10 per hour or 14.4 percent. Over the same time period Periodicals Outside County prices have only increased by 6.8 percent. Under current labor contracts a major efficiency gain would be needed to maintain cost coverage. Mr. Stralberg prefers to ignore input prices and attributes everything to his “major efficiency slide”. (Addendum to the Initial Comments of Time, Inc at page 2)

Based on publicly available CRA data, between FY 2006 and FY 2010, Periodicals Class unit attributable costs rose 20.2 percent -- from 28.5 cents to 34.3 cents, a 5.8 cent rise. CPI rose 8.3 percent over this time period. However, CPI is not a measure of the Postal Service's input cost growth, and unit labor and nonlabor costs of the Postal Service are not intrinsically linked to CPI. The public record contains evidence that 1.7 cents of this increase was due to a rise in service-wide benefits costs per piece – stemming in large part from PAEA retiree health

costs and the new attribution method for these costs.¹² This 1.7 cent increase accounts for nearly 30 percent of the 5.8 cent increase, or about 6 percentage points of the 20.2 percent unit cost increase.

Data filed with the PRC show that the average cost per workhour of field personnel rose from \$35.90 to \$40.60 between FY 2006 and FY 2010, a 13.1 percent rise¹³. This accounts for the bulk of the rest of the increase. Time has ignored the public record on this.

The FY 2006 and FY 2010 mail processing unit costs (with indirect or piggyback costs) were 16.5 cents and 18.6 cents, respectively. This 13 percent increase is roughly in line with the increase in unit labor costs. However, increases in service-wide benefits costs and higher per-piece equipment and facility costs mask some reductions in per-piece labor input (workhours). Also, after increasing during the initial recession-related volume losses, unit mail processing costs dropped 5 percent from FY2009 to FY2010, suggesting that cost reduction efforts may be catching up with the precipitous volume declines.

C. Reducing Manual Sortation Would Not, as Stralberg Suggests, Cure the Cost Coverage Shortfall

The conceptual chain that is required in order to follow Mr. Stralberg's argument to the conclusion he would like the Commission to accept, that the cost coverage problem

¹² The service wide costs or cost segment 18.3 costs for Periodicals for FY 2006 were \$100.0 million and in FY 2010, were \$200.7 million (see publicly-filed cost segments and components reports of FY 2006 and FY 2010). This translates into unit costs of 1.1 cents and 2.8 cents per piece for FY 2006 and FY 2010 respectively – a 1.7 cent difference. The methodology change in retiree health benefits is discussed in ACR 2007 in USPS-FY07-2.

¹³ National Payroll Hours Summary Report for the last pay periods in FY 2006 and FY 2010, page 111, row 43, year-to-date, average hourly rate.

is due to excessive manual handling, requires several leaps of faith that are neither supported by the data nor can be made with such confidence as he represents. Furthermore, those leaps of faith require landing on footings that are not as firm as Mr. Stralberg would like one to believe. Specifically, Mr. Stralberg asserts that:

- “In the Periodicals model, ... all the processing operations that correspond to the CRA costs used in the adjustment have been explicitly modeled. (Addendum of the Initial Comments of Time, Inc. at page 5)
- “the CRA piece sorting cost pools are generally distinct from the cost pools that handle bundles and containers, so that it should be possible to verify, and adjust, modeled piece sorting costs separately from other modeled costs.” (Ibid, page 5)
- “modeled bundle, sack and pallet costs, in aggregate, have been remarkably close to their CRA costs” (Ibid, page 6)
- “Piece sorting costs are much higher than the model indicates they should be.” (Ibid, page 5)
- “Regarding the large discrepancy between modeled and actual piece sorting costs, there can be little doubt that this must be related to the widespread tendency in postal facilities to sort Periodicals flats manually.” (Ibid, page 6)

In other words, Mr. Stralberg would like the Commission to believe that separate CRA adjustment factors may be applied distinctly to the “piece sorting” modeled costs and to the “modeled bundle, sack and pallet costs”, and that the validity of those modeled costs may be determined based on how closely the CRA adjustment factors approach 1.0. Mr. Stralberg would contend that, if the CRA adjustment factor is far from 1.0, then the modeled costs are too low and that must be because the Postal Service is handling pieces too often in manual operations. In the discussion that follows, the Postal Service will negate each step of this argument, demonstrating that Mr. Stralberg is mistaken in his representation of the CRA adjustment factors work, he is mistaken in the certainty with which he assigns cost pools to “piece sorting” and to “bundle, sack and pallet

costs”, and he is mistaken in his certainty that the observable cost increase has been driven by postal inefficiency, particularly excessive manual handling.

Mr. Stralberg’s comments regarding his analysis of the Periodicals flats cost models are misleading and his analysis is simply wrong. Mr. Stralberg begins his comments with the following:

The following comments address some of the Periodicals data reported in ACR2010 and the Postal Service’s claim ***that it is impossible to raise the Periodical cost coverage significantly without “authority” to raise Periodicals rates beyond the inflation cap specified by the PAEA.*** (Addendum to the Initial Comments of Time, Inc at page 1, emphasis added)

He continues, claiming that:

...Periodicals mail processing cost, particularly piece sorting costs, are much higher than they ought to be according to the Postal Service’s own model data. To correct this situation, the Postal Service will need to solve the perennial problem with flats being diverted unnecessarily to manual sorting. (Addendum to the Initial Comments of Time, Inc at page 1)

Together these comments imply the Postal Service could increase Periodicals cost coverage simply by reducing manual sortation and eliminating so-called HOT 2C lists. His comments overstate the degree to which the Periodicals Flats mail processing cost model captures pertinent mail processing activities; grossly misrepresents the treatment of CRA cost pools and the CRA adjustment factor in the models, and, perhaps more importantly, he implies that the cost of manually handling Periodicals mail is much larger than it really is.

Relative to the gap between average revenue and average attributable costs, manual mail processing costs are small. In FY 10, Periodicals Outside County unit attributable costs were 36.4 cents and average revenue per piece was 27.3 cents. Average attributable costs exceed average revenue by 9.1 cents. The unit costs in

pools associated with manual processing (MODS MANL, MODS MANF, MODS MANP, LDC43, NONMODS MANL, NONMODS MANF, NONMODS MANP) were only 4.57 cents(ACR10-USPS-FY10-11). Eliminating all manual costs would not, alone, cover the shortfall in revenue versus attributable costs. Furthermore, not all manual sorting costs are avoidable, even in theory, as manual processing is required to process nonmachinable mail and machine rejects, among other reasons. As described below, the majority of pieces worked manually are worked manually for reasons that have nothing to do with service (Hot 2C) concerns.

Some mail is worked manually because it does not meet the machinability standards. In FY10, 4.02 percent of non-carrier route Periodicals Outside County Flats were non-machinable on the AFSM 100. Mail that is machinable may nevertheless not be processed on machinery for a number of reasons. A significant proportion of Periodicals Outside County mail (8.65 percent) destinate at small facilities that do not receive sufficient volume to justify the expense of mechanized equipment. These pieces are worked manually in those locations because there is no mechanized equipment available to work them on. Some facilities are only equipped with FSM 1000s which are typically not used to perform incoming secondary; 5.15 percent of Outside County mail destinate at FSM 1000 only facilities. Thus, for almost 14 percent of Outside County periodicals mail, regardless of its characteristics as “machinable”, there are no machines for the incoming secondary sort. Even when a facility does have mechanized equipment, not all delivery zones will have their incoming secondary sorts performed on mechanization. There are a number of operationally efficient reasons for excluding zones from mechanization. For instance, rural zones often do not have

sufficient volume to rationalize mechanization or are too distant to allow for both mechanization and transportation to the delivery unit in the available processing window. (ACR10 USPS-FY10-14)

There are also an uncountable number of situations that occur on the workroom floor that result in machinable mail being diverted to manual processing including: mail being rejected on mechanized equipment; accidental piece damage in bundle or container processing that prevent mail from being machinable; 5-digit bundles for mechanized zones being missort and co-mingled with carrier route bundles; machine breakdown or machine capacity constraints.

D. The Time /Stralberg Analysis of CRA Adjustment (Control) Factors for Subsets of Cost Fails to Correctly Account for Periodicals Model and CRA Structure

Mr. Stralberg purports to measure the degree to which Periodicals are diverted to manual operations by looking at the ratio of modeled mail processing costs in direct piece operations to the measured costs in pools associated with manual processing. Time Initial Comments, Addendum at 4-6. This analysis incorrectly presupposes that the Periodicals mailflow model represents all CRA costs that would be mapped to the proportional classifications, and that there is a simple correspondence between modeled activities and cost pools. While the Periodicals models do encompass a relatively broad array of piece distribution and allied labor activities, there remain many non-modeled activities including handling of undeliverable as-addressed (UAA), missent, and missorted mail. Also, many cost pools where the primary activity is piece distribution involve some "incidental" allied labor—e.g., obtaining mail for distribution, packaging mail for dispatch, and disposing of empty equipment. Post office activities (in

MODS Function 4 and non-MODS cost pools) tend to involve more fluid work assignments than plants, and include activities such as breaking down 5-digit pallets and spreading carrier route bundles to routes.

As an example, Table 5 below shows the unicomponent activities of three manual flat distribution cost pools: MODS MANF (a plant cost pool), MODS LD 43 and NONMODS MANF cost pools. Table 6 shows the percentage distribution over activities. The underlying In-Office Cost System (IOCS) question 18 (mail processing activity) and question 20 (type of piece or container handling) responses confirm that the Function 4 operations, in particular, involve multiple tasks including piece distribution and allied labor activities, such as:

- Distributing pieces to PO Boxes,
- Handling containerized mail and separating bundles to carrier routes ,
- Processing UAA mail,
- Handling empty equipment and miscellaneous activities in which mail is not being handled.

In the Periodicals model, the Function 1 MODS productivities for sorting operations (both automated and manual) will encompass the workhours for incidental allied labor performed by employees clocked into the operations. Thus, the Function 1 MODS MANF pool can be viewed as a baseline to roughly isolate the Function 4 allied labor activities such as bundle and container handlings that are not incidental to piece sorting. The Function 4 manual pools include 0.69 cents/piece of allied labor, bundle, item, and container handling cost above the 0.11 cents of incidental allied labor in MODS MANF.

In addition, those pools include 0.3 cents/piece of PO Box distribution and UAA handling.

Treating an appropriate portion of Function 4 allied labor as non-piece costs would reduce the CRA control factor for piece operations and increase it for non-piece operations. Additionally, the non-modeled UAA and PO Box distribution would explain a portion of the remaining difference between modeled and CRA costs for sorting cost pools as other than an excess of manual handling.¹⁴

**Table 5. Periodicals Outside County Flats, FY 2010
Mail Processing Unit Cost (cents/piece) by Processing Activity**

Activity	MODS LD43	NONMODS MANF	MODS MANF
Piece Handling	0.48	1.15	0.55
Sort into PO Boxes	0.01	0.15	0.00
UAA	0.04	0.06	0.04
Bundles	0.29	0.33	0.06
Items/Containers with Mail	0.14	0.13	0.05
Allied Labor	0.02	0.00	0.00
Empty Equipment	0.09	0.08	0.03
Breaks/Personal Needs	0.16	0.17	0.15
Clocking In/Out	0.02	0.03	0.02
Other	0.05	0.04	0.05
Total	1.28	2.05	0.96

Source: Analysis of IOCS data in USPS-FY10-NP21

¹⁴ In addition to the manual costs shown here, some costs for UAA Periodicals will be incurred in automated distribution operations.

**Table 6. Periodicals Outside County Flats, FY 2010
Distribution of Pool Cost by Processing Activity**

Activity	MODS LC43	NONMODS MANF	MODS MANF
Piece Distribution	37.2%	51.5%	57.3%
Sort to PO Boxes	1.0%	7.5%	0.2%
Processing UAA Mail	3.2%	2.8%	4.5%
Bundle Handling	22.4%	16.1%	5.8%
Handling Items/Containers with Mail	10.7%	6.5%	5.4%
Other Allied Labor	1.4%	0.0%	0.2%
Empty Equipment	6.9%	3.7%	3.5%
Breaks/Personal Needs	12.2%	8.4%	15.8%
Clocking In/Out	1.2%	1.3%	1.9%
Other Activities (Not Handling Mail)	3.9%	2.2%	5.4%

Source: Analysis of IOCS data in USPS-FY10-NP21

E. The Stralberg Control Factor Analysis is Inconsistent With Time's Longstanding Claim that Periodicals Bear Excess Mixed-Mail and Not-Handling Costs in Allied Labor Cost Pools

It is curious that in this proceeding, Mr. Stralberg is asserting that the distance of the CRA adjustment factors from 1.0 can be used as a determinant of the accuracy of the models, when previously, in his Time Warner et al complaint case testimony, Docket No. C2004-1, TW et al - T - 2, Mr. Stralberg noted:

"Since the modeled piece sorting costs in fact are very close to the CRA costs, and some judgment is involved in determining precisely which CRA costs to compare them with, I did not adjust them." page 33, lines 6 to 9:

If comparisons of the CRA costs and modeled costs involve "judgment" and are not strictly an empirical exercise, how can adjustment factors ever truly be looked to as measures of cost model "accuracy"?

For the reasons described above and below, the Postal Service does not agree that Mr. Stralberg's analysis can be properly interpreted as an indication of the fidelity of the cost models to reality or the presence of unwarranted manual costs for Periodicals.

Nevertheless, the Postal Service observes that Mr. Stralberg's CRA factor analysis conflicts directly with Time's contention that the Commission-approved mail processing cost methodology over-distributes mixed-mail, overhead, and other “not-handling” activities in non-piece operations to Periodicals. If the CRA adjustment factor is less than 1, then the supposedly excessive top-down distribution of allied labor costs to Periodicals—a foundation of Periodicals mailers' opposition to the mail processing cost distribution method going back to the R97-1 omnibus rate case—does not actually exceed the bottom-up modeled costs for those activities.

Because of the limitations of Mr. Stralberg's analysis, the Commission should not conclude that Periodicals' allied labor costs should be higher than is measured by Commission-approved methods. However, the Postal Service observes that cost distribution under the Commission's 100 percent volume variability assumption for mail processing is a zero-sum game. Lowering the volume-variable costs of Periodicals to “correct” an excess distribution of costs to Periodicals necessarily entails higher costs for some other product(s). In the end, though, Time has not articulated a rational basis for altering mail processing cost distribution methods.

The Periodicals cost model, while complex, is still a simplified version of reality. Just as a road map does not document each and every twist or turn in a road, the models only account for those activities that the Postal Regulatory Commission, with input from the customers, the Postal Service and other interested parties, has deemed necessary to establish reliable estimates of cost avoidances. Contrary to Mr. Stralberg's claims, there are many processing activities that are not explicitly modeled. For example, the models do not explicitly account for the tertiary distribution of pieces to

P.O boxes (presumably because these costs would not be included in the discount structure for presort or dropshipping – after all, the models were developed to provide a basis for determining workshare-related cost avoidances). The models do not explicitly model the redirection of UAA mail. The models do not explicitly model the redirection of missent mail. There is no mechanism in the model to account for mail that is bent or damaged in transit and is no longer machinable. Further the model does not capture the cost associated with machine breakdowns, power failures, floods or any other event that can cause mail to be redirected or incur unanticipated costs.

In his analysis, Mr. Stralberg attempts to conflate a set of CRA cost pools with a measure of the costs of direct piece sortation, which they aren't. Then he compares these costs to an incomplete set of modeled costs. He then claims that the result of these calculations can be taken as a meaningful measure of mail “flats being diverted unnecessarily to manual sorting”. (Addendum of the Initial Comments of Time, Inc. at page 1) The Postal Service disagrees.

As he begins to introduce his discussion of the proper interpretation of the CRA adjustment factor in the Periodicals model, Mr. Stralberg states that, “In the First Class and Standard flats models, for example, the CRA adjustment is used to distribute the costs of various not modeled operations (e.g., platform operations) among presort categories, on the (unproven) theory that the costs of such operations can be distributed based on the costs of modeled (e.g., piece sorting) operations.” (Initial Comments of Time, Inc., Addendum, page 4) This is a mistaken interpretation of both the First-Class Mail and Standard Mail flats models and the application of the CRA adjustment factors in those models. Mr. Stralberg’s attempt to use the higher CRA adjustment factors in

the First-Class Mail and Standard Mail models relative to that in the Periodicals model as evidence of the superiority of the modeling in the Periodicals model and the appropriateness of using the CRA adjustment factors as evidence of postal inefficiency is misguided.

While an in-depth discourse on the First-Class Mail and Standard Mail flats cost models might seem a bit far afield from the immediate concern, it may help elucidate why the CRA adjustment factors may be far from 1.0 but not represent faulty modeling or inefficient operations, but rather, faulty assignation of cost pools and misinterpretation of the CRA adjustment factor. In the Standard Mail flats models, the full array of cost pools are divided into the following four categories: Piece Sorting, Non-Workshare Related Fixed, Unexpected, and Allied/Support, while in the First-Class Mail flats cost model, an additional category, Forwarding/Acceptance/Customer Service, is also included. Mr. Stralberg is correct in his observation that these models do not explicitly model all of the mail processing activities. The models for these mail products only incorporate activities associated with piece handling and some bundle or tray handling necessary to support that piece sortation. Thus, the Piece Sorting activities are modeled, and the cost pools associated with Piece Sorting are included in the “proportional” totals. If analytical purity were a goal in cost modeling, the CRA adjustment factor, or the “proportional adjustment factor” would simply be the ratio of the costs in the CRA cost pools associated with Piece Handling divided by the sum of the modeled piece handling costs. This resulting adjustment factor would then only be applied to the modeled costs, while the fixed costs and nonworkshare-related costs would remain unadjusted.

However, over the course of decades of rate cases, the Commission has adopted proposals proffered by parties seeking to expand the differences between rate elements (thus, expanding the cost avoidances used to determine available discounts). The Commission-approved models now include an interim step that serves to expand the CRA adjustment factor. That interim step divides some of the cost pools cleanly into proportional or fixed, but then takes others -- the Unexpected and Allied/Support cost pools -- and moves part of these costs into proportional based on the ratio of the clearly identified proportional cost pools divided by the sum of the clearly proportional plus the clearly fixed or non-workshare related cost pools. To wit, an arbitrary adjustment is applied to the Unexpected and Allied/Support cost pools based on the ratio of the clearly proportional costs to the sum of the clearly proportional and clearly fixed or non-workshare related costs such that this proportion of the Unexpected and Allied/Support cost pools is moved into proportional and the remainder falls into a fixed category. There is absolutely no empirical basis for assuming that, if (for example) 87 percent of clearly classified costs are proportional, then that same percent of the non-modeled Unexpected and Allied/Support costs would also be proportional. In fact, this subverts the entire purpose of the proportional assignment as being costs that are modeled. In fact, now the cost pools assigned to proportional include activities that are not modeled, and therefore cannot be included in the denominator of the ratio of the proportional cost pools to the modeled costs. The result is a bloated CRA adjustment factor that has nothing to do with the accuracy or inaccuracy of the modeling, but rather with the arbitrary assignment of costs to the proportional category without any modeled activities to generate costs to include in the denominator of the equation. The application of this

bloated CRA adjustment factor to the proportional costs results in expanded cost avoidances between workshare levels. Under those circumstances, it should be no surprise to see CRA adjustment factors that deviate from 1.0.

Thus, using the larger CRA adjustment factors in the First-Class Mail and Standard Mail models as the benchmark against which to judge the validity of the Periodicals cost model does not, as Mr. Stralberg would contend, demonstrate the superiority and completeness of the modeling in the Periodicals model, but rather, is a demonstration of the arbitrary assignation of cost pools in First-Class Mail and Standard Mail. The higher CRA adjustment factors are due to a mismatch of the modeled activities and the cost pools, not due to an incompleteness of the models.

Mr. Stralberg is mistaken when he asserts that in the First-Class Mail and Standard Mail models, “the CRA adjustment is used to distribute the costs of various not modeled operations (e.g., platform operations) among presort categories, on the (unproven) theory that the costs of such operations can be distributed based on the costs of modeled (e.g., piece sorting) operations.” (Ibid, page 4) It is not the CRA adjustment factor that is used to distribute the costs of non-modeled activities among presort categories, but rather the arbitrary application of the ratio of clearly proportional to the sum of clearly proportional plus clearly fixed or nonworkshare-related in determining the treatment of non-modeled activities such as platform operations or costs in unexpected cost pools.

This misunderstanding of the CRA adjustment factors in the First-Class Mail and Standard Mail models has led Mr. Stralberg into an unearned confidence regarding the Commission-approved Periodicals model and the narrow interpretation of the CRA

adjustment factor in that model. He states that,

In the Periodicals model, on the other hand, all the processing operations that correspond to the CRA costs used in the adjustment have been explicitly modeled. As I first noted in my R2006-1 testimony, this opens up the possibility to use the CRA costs, not just for an overall adjustment, but to verify the accuracy of different parts of the model. Specifically, the CRA piece sorting cost pools are generally distinct from the cost pools that handle bundles and containers, so that it should be possible to verify, and adjust, modeled piece sorting costs separately from other modeled costs. (Ibid, page 4)

As the Postal Service has discussed in detail above, Mr. Stralberg is mistaken in his confidence that the Periodicals model is accurately identifying “piece handling” costs. Nor is it clearcut that all of the processing activities corresponding to CRA mail processing costs have, in fact, been modeled. If the cost pools were entirely pure and contained only costs that were explicitly modeled, it might be appropriate to use the cost pools at a finer level to test the accuracy of the model, but as the Postal Service has described above, the necessary level of purity does not exist.

In fact, the Table 1 provided by Mr. Stralberg supports the Postal Service’s assertion that “Pure Piece Sorting” is neither “pure” nor “piece” sorting. For example, UAA mail and missent/missorted mail are nonmodeled activities in cost pools classified as proportional, even though these operations may include both piece handlings and non-piece handlings. Mr. Stralberg’s contention that the CRA adjustment factor for the Piece Handlings part of the model should be closer to 1.0 simply due to its primacy in development is puzzling.

In conclusion, Mr. Stralberg is correct in that the Postal Service cares about its customers. To the extent possible, the Postal Service responds to the needs and concerns of customers that rely on the Postal Service to deliver their product and those

that receive these products. Local management could turn a callous ear to the concerns of the final customer – the recipient who paid a subscription to receive a periodical containing news while the news is still timely -- and eliminate a small fraction of Periodicals Outside County mail cost attributed to manual processing, but this would not and could not close the gap between revenue and attributable cost in any meaningful way.

F. Time's Assertions Regarding Periodicals Pricing Are Off-Base

The comments of Time regarding pricing and rate design are not well founded. For example, on page 6 of its Comments, Time claims that the Postal Service has not made “any serious effort to develop a more efficient Periodicals rate and classification structure.” The assertion ignores the fact that, in 2006, the Commission recommended Time Warner’s basic proposed approach, which added separate rates for bundles, sacks, and pallets.¹⁵ Although the Commission lowered their proposed passthroughs and changed some elements in their model, it retained key features of the Time Warner proposal, including:

1. continuing to rely on pieces and pounds as basic elements;
2. introducing bundles, sacks and pallets as new elements and linking them to presort level and point of entry;
3. introducing a distinction between machinable and nonmachinable pieces;
4. de-averaging the Basic Rate piece category into ADC and Mixed ADC categories, and retaining other recognition for presorting and pre-barcoding.

The current Periodicals structure has all of these elements.

¹⁵ “The Commission recommends adoption of the framework underlying the Time Warner Inc. (Time Warner) proposal in this case and its related costing support, but with significant moderation of passthroughs.” Docket No. R2006-1, Opinion & Recommended Decision, para. 5607, p.301.

Time is now urging the Commission to direct the Postal Service to take the following specific steps in order to raise the cost coverage of Periodical Class:

- Assure at least an (80%?) passthrough of the costs identified with each rate element in the Periodicals rate structure, including costs associated with each category of bundle, sack and pallet, as well as costs associated with piece sorting machinability.
- Similarly, assure at least an (80%) passthrough of the cost differentials associated with different levels of piece presortation.

Time Comments at 22-23. Yet it is not clear how an 80 percent passthrough of costs could be applied on every rate element without the percentage increase in price for the Periodicals Mail Class substantially exceeding the CPI cap of 1.741 percent. It should be noted that for sacks, bundles and containers, whose current cost coverage hovers around 30 to 50 percent, full cost coverage would require very large price increases, of the type that the Commission itself discouraged in Docket No. R2006-1, in response to the Time Warner proposal at that time, and in other dockets, out of concern for the impact on mailers.

In Docket No. R2010-4, the Postal Service proposed balanced changes to Periodicals pricing that would have led to an 8 percent overall price increase for the class, which would have brought Periodicals closer to full cost coverage. In his Statement on behalf of the Postal Service, witness James M. Kiefer stated:

The FY2009 cost coverage for Periodicals was only 76 percent, and if the entire cost coverage gap were to be addressed with these price increases, the price increase needed to achieve full cost coverage would be 25 percent and would likely imperil the already fragile Periodicals industry. The Postal Service believes that given the Periodicals market conditions and their unique status and ECSI value, any increases approaching this magnitude would be risky and ill-advised. (p. 41, lines 3-9)

...The Periodicals cost coverage problem is long-standing, and it may not be a problem that can be quickly resolved. However, the operational efficiencies outlined are expected to result in substantial improvements in flats cost coverage. (p. 41, lines 12-15)

However, the Postal Service proposal was rejected by the Commission, which in turn has led to the current docket.

In the Stralberg Addendum to the Time Comments (at page 10), it is suggested that the rate design changes the Postal Service advanced in Docket R2011-2 “do not appear designed to enhance efficiency, but rather to punish its most efficient mailers.” The Postal Service disagrees. The new price differential between 5-digit automation and Basic Carrier Route pieces actually remains unchanged at 9.8 cents. In no way should a price differential that is held constant be construed as a way to “punish” anyone. Rather, the design is to help ensure efficient mail preparation consistent with the advent of the Flats Sequencing System (FSS) environment. While carrier route sortation will continue to have value in non-FSS zones, expanding this discount would tend to encourage customers to undertake work that may not be necessary in an FSS-environment.

Moreover, the fact that origin-entered pallets would receive an above average price increase under the new pricing (3.0 percent vs. 1.741 percent, respectively) further refutes the suggestions that the Postal Service is not encouraging the most efficient mail preparation, and that it is any way “punishing” the most efficient mailers. Machinable pieces were given a below-average 1 percent increase to provide reasonable incentives to mailers to prepare machinable pieces. This step seems entirely consistent with the suggestion in the Stralberg Addendum (page 13) that there should be “stronger rate incentives to use a machinable flats format.”

V. Conclusion

The Postal Service appreciates the opportunity to comment on the major issues raised by the parties in their initial comments. Although it is not possible to resolve all of these issues within the framework of the Annual Compliance Review, the Postal Service looks forward to discussing these issues in more detail with the Commission in the coming year.

Respectfully submitted,

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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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