

ORDER NO. 719

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Ruth Y. Goldway, Chairman;
Mark Acton, Vice Chairman;
Dan G. Blair;
Tony L. Hammond; and
Nanci E. Langley

Modification of Analytical Principles
in Periodic Reporting
(Proposals Thirteen and Fourteen)

Docket No. RM2011-6

ORDER CONCERNING ANALYTICAL PRINCIPLES
FOR PERIODIC REPORTING
(PROPOSALS THIRTEEN AND FOURTEEN)

(Issued April 28, 2011)

I. BACKGROUND

In Order No. 203, the Commission adopted periodic reporting rules pursuant to 39 U.S.C. 3652.¹ Those rules require the Postal

Service to obtain advance approval, in a notice and comment proceeding under 5 U.S.C. 553, whenever it seeks to change the analytical principles that it applies in preparing its periodic reports to the Commission required by section 3652 of the Postal Accountability and Enhancement Act.

¹ Docket No. RM2008-4, Order No. 203, Notice of Final Rule Prescribing Form and Content of Periodic Reports, April 16, 2009.

On December 22, 2010, the Postal Service filed a petition to initiate an informal rulemaking proceeding to consider two proposals to change analytical methods approved for use in its periodic reports to the Commission.² The two proposals are labeled and referred to here as Proposal Thirteen and Proposal Fourteen.

Proposal Thirteen updates the mail processing cost model for Parcel Select and Parcel Return Service (PRS). This model was filed in both USPS-FY09-NP27 and USPS-FY09-NP15. Proposal Fourteen updates the transportation cost model for the same two products. This model was filed in both USPS-FY09-NP27 and USPS-FY09-NP16.

The Commission approves the changes in the analytical methods proposed, albeit modifying Proposal Thirteen's allocation of MODS cost pools to be consistent with previously approved Proposal Seven.

II. Proposal Thirteen—Development of a New Parcel Select/PRS Mail Processing Cost Model

A. Postal Service Proposal

Proposal Thirteen develops a new mail processing avoided cost model for Parcel Select and PRS. The proposed model reflects the current Parcel Select and PRS products, as well as updated productivity estimates used in Proposal Seven. Proposal Thirteen at 1. The model relies on data introduced in Docket No. RM2010-12—Proposal Seven to update the Parcel Select/PRS mail processing cost model. The Commission approved a modified version of Proposal Seven on January 28, 2011.³

The proposed Parcel Select/PRS mail processing cost model uses the Standard Mail parcel model as a starting point and relies on a methodology similar to other parcel mail processing cost models to develop model cost estimates. Proposal Thirteen at 2.

² Petition of the United States Postal Service Requesting Initiation of a Proceeding to Consider Proposed Changes in Analytic Principles (Proposals Thirteen – Fourteen), December 22, 2010 (Petition).

³ Docket No. RM2010-12, Order No. 658, Order on Analytical Principles Used in Periodic Reporting (Proposals Three through Eight).

These model cost estimates are then used to “de-average” an overall mail processing cost estimate for parcels into price category cost estimates. *Id.* at 3. The proposed model also reflects an assumption that all mailer-entered parcels are submitted in containers and are no longer bedloaded. *Id.* at 1.

The Postal Service filed workpapers and a more detailed discussion of the modifications under seal, which include a new Parcel Select arrival profile data file. *Id.* at 3.

B. Participant’s Comments

Only the Public Representative filed comments regarding Proposal Thirteen.⁴ He states that the proposed model is an improvement over the previous model. He observes that the model should be updated with the cost pool modifications the Commission made in Proposal Seven. *Id.* at 2. He also suggests that certain features of the model could be improved. For example, he believes the Postal Service should obtain more accurate productivity estimates for some operations. He does not argue that these criticisms should prevent approval of the proposed Parcel Select/PRS mail processing model, but suggests that the Commission should encourage the Postal Service to collect better productivity data. *Id.*

C. Commission Analysis

The Commission agrees with the Public Representative that the Postal Service should work to improve the quality of its productivity data in the future. The Commission finds that Proposal Thirteen is an improvement over the previous model because it better reflects the current mail processing, handling, and flows for Parcel Select and PRS products. The Commission therefore approves Proposal Thirteen, but modifies the cost model’s use of MODS cost pools as explained below.

⁴ Comments of the Public Representative in Response to Order No. 626, February 3, 2011 (PR Comments).

In addition to the approval of the proposed changes in Proposal Thirteen, the Commission agrees with the Public Representative that the modifications made in Proposal Seven need to be incorporated into the mail processing cost pool allocation for Parcel Select/PRS. In CHIR No. 1, the Commission asked the Postal Service if the mail processing cost pool allocation used in Docket No. R2006-1 should be applied to the Parcel Select/PRS mail processing cost pool allocation.⁵ It also asked the Postal Service to update the Parcel Select/PRS mail processing cost model with the modifications made in Proposal Seven.

In Docket No. R2006-1, the Commission discussed the letter model stating:

The Commission finds the Postal Service's assumption that the cost of non-modeled operations [is] not affected by worksharing to be insufficiently supported. The majority of the costs that MMA and Pitney Bowes claim are inappropriately treated as fixed are in mail processing activities that support other mail processing activities, including piece sortation. It is reasonable to assume that these supporting costs are at least indirectly affected by worksharing.

In the letter mail processing cost model, the Commission assigns the letter sorting cost pools as proportional, consistent with the Postal Service and intervenors. The pools that witness Buc assigns as fixed are assigned as either worksharing-related fixed or non-worksharing related, as appropriate. The remaining costs, which are largely allied and support costs, are distributed to the three groups in the same proportions as the directly assigned pools. The allied and support pools support all mail processing operations, and so it is reasonable to assume that they are affected by worksharing to the same extent as the proportional and fixed operations they support.

PRC Op. R2006-1, ¶¶ 5160 and 5161 (internal citations omitted).

In response to CHIR No. 1, the Postal Service correctly updates the Parcel Select/PRS mail processing cost model by incorporating the modifications made in

⁵ Chairman's Information Request No. 1, March 1, 2011 (CHIR No. 1).

Proposal Seven to the Standard Mail parcel model.⁶ However, the Postal Service states that it does not “fully comprehend the rationale behind the Commission’s cost pool classification methodology” and states that the “Commission’s cost pool methodology appears to distort the price category mail processing unit cost estimates. *Id.*

In its response, the Postal Service also refers to its previous responses concerning Proposal Seven in Docket No. RM2010-12⁷ and to its initial comments in Docket No. RM2010-13.⁸ The Postal Service does not agree with the cost pool classification applied by the Commission to the letter and flats models and thus does not believe it should be applied to the parcel model. In its initial comments in Docket No. RM2010-13, the Postal Service states that it does not believe there is an accurate way to separate the costs within a given cost pool between fixed and proportional and therefore advocates “simply classifying cost pools as either proportional or fixed, seeing no additional value in the continued use of the three-tiered cost pool classification methodology.”⁹ Accordingly, the Postal Service advocates the same methodology that was used prior to Docket No. R2006-1.

The Commission’s approach distributes (“piggybacks”) non-modeled costs for a particular shape according to the ratio of proportional and fixed costs for that shape. For the Postal Service, the issue seems to be primarily one of determining whether a particular kind of “unexpected” cost is appropriate to “piggyback.” Non-modeled costs mostly include allied costs, support costs, and “unexpected” costs. “Unexpected” costs

⁶ Response of the United States Postal Service to Question 1 of Chairman’s Information Request No. 1, March 7, 2011, at 3.

⁷ Docket No. RM2010-12, Responses of the United States Postal Service to Chairman’s Information Request No. 2, December 22, 2010, at 6-10 (Response to Docket No. RM2010-12, CHIR No. 2).

⁸ Docket No. RM2010-13, Initial Comments of the United States Postal Service, February 18, 2011, at 11-23.

⁹ *Id.* at 20. The Postal Service’s initial comments in Docket No. RM2010-13 will be addressed in that docket.

are those appearing in cost pools where costs would not be expected to be incurred by a particular category of mail. *Id.* at 15-16.

For example, the Postal Service discusses a situation where IOCS data indicate that mail of a particular shape is sorted in a mailstream designed to sort mail of a different shape. By objecting to piggybacking this unexpected cost, the Postal Service seems to assume that the IOCS data that report letter or flats processing occurring outside the intended mailstream is erroneous and, therefore, should not be considered worksharing related.

Currently, under the Commission's treatment of non-modeled costs in the letter and flats models, letters processed in the flats mailstream are piggybacked on letter mail costs, and flats processed in the letter mailstream are piggybacked on flats costs. The Postal Service does not agree with this treatment in the letter and flats cost models and argues that it is even more unlikely that parcels are sorted outside of their intended mailstream. The Postal Service asserts that parcels are "typically" sorted in a mailstream that is housed in a building where letters and flats are not sorted, making the blurring of the parcel mailstream with a letter and flats mailstream particularly unlikely. Response to Docket No. RM2010-12, CHIR No. 2, at 6-9.

The Commission does not find the Postal Service's rationale persuasive. While the parcel shape is generally more distinct than a letter or flat shape and, as the Postal Service asserts, parcels may be typically sorted in a building separate from letter and flats mail, some light, thin parcels could be miscategorized as flats by a mailer and entered into the flats mailstream by the Postal Service. There are also instances in which letter, flats, and parcel sorting equipment are co-located in the same building (e.g., where a processing and distribution center is co-located with a network distribution center). Therefore, even though the processing of parcels outside their intended mailstream may be less frequent than for letters or flats, it cannot be ruled out. If the frequency is relatively lower, that should be reflected in the cost data. The unit cost data indicate that the costs for parcels sorted in letter and flats operations are relatively low when compared with other operations, which is consistent with the

assumption that they occur infrequently. Therefore, the Commission concludes that it is more reasonable to piggyback non-modeled costs consistently in letter, flats, and parcel cost models.

The Commission approves Proposal Thirteen with the following modification of the cost pool allocation, which the Postal Service correctly applies in response to CHIR No. 1. The Commission concludes that it is reasonable to treat parcel sorting cost pools as proportional; a group of other cost pools as fixed;¹⁰ and allied, support, and unexpected costs as piggybacks. The Commission notes that there will be an opportunity to examine the issue of the appropriate treatment of non-modeled costs in greater depth in Docket No. RM2010-13, Consideration of Technical Methods to Be Applied in Workshare Discount Design, which is pending.

III. Proposal Fourteen—Development of a Modified Parcel Select/PRS Transportation Cost Model

A. Postal Service Proposal

The Postal Service proposes five modifications to the Parcel Select/PRS transportation cost model:

1. The transportation cost estimates should only be presented for the current price categories;
2. The transportation legs for the non-dropship price categories should be estimated using 2010 PostalOne! data;
3. The official revenue, pieces, and weights (RPW) volumes should be incorporated into the analysis;
4. The PRS transportation costs should be distributed using the same method that is relied upon to distribute the Parcel Select transportation costs; and
5. A new methodology should be used to estimate the return network distribution center (RNDC) cubic foot miles by zone.

¹⁰ See Response of the United States Postal Service to Question 1 of Chairman's Information Request No. 1, March 7, 2011, Excel; File: RM11.6.CHIR.1.Q.1a.xls, tab: Cost Pool Data.

The Postal Service filed workpapers and a more detailed discussion of the modifications under seal.

B. Participant Comments

Only the Public Representative commented on Proposal Fourteen. He finds that the model is an improvement over the former model, and recommends the model in Proposal Fourteen be accepted by the Commission. PR Comments at 2-3. However, he has some concerns about the quality of the sources and links in the model. Specifically he states, that the Postal Service should link data in this model to the source data from the Cost and Revenue Analysis, RPW, “B” workpapers, or special purpose regressions to allow for increased methodological transparency. He also observes, that there is no source listed in tab: “Regression Inputs”. *Id.* at 3.

C. Commission Analysis

The Commission agrees with the Public Representative that Proposal Fourteen is an improvement over the previous transportation model. The proposed modifications reflect the current Parcel Select and PRS products, as well as use the most reliable data available, such as the RPW volumes. The modifications also promote consistency within the model by using the same method to distribute Parcel Select and PRS transportation costs.

While no errors were discovered in the Postal Service’s workpapers, the Commission agrees with the Public Representative that its workpapers should be better sourced and linked.

The Commission finds that the proposed model more accurately reflects the way that the current Parcel Select and PRS products incur costs, and therefore approves Proposal Fourteen. In future filings, the Postal Service is reminded that to promote transparency, all workpapers should be properly linked and sourced.

It is ordered:

For purposes of periodic reporting to the Commission, the Commission accepts the changes in analytical principles proposed by the Postal Service in its Petition of the United States Postal Service Requesting Initiation of a Proceeding to Consider Proposed Changes in Analytic Principles (Proposals Thirteen – Fourteen), filed December 22, 2010, with the modification to Proposal Thirteen described in the body of this Order.

By the Commission.

Shoshana M. Grove
Secretary