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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 Nine through Twelve)

Docket No. RM2011-5

ORDER CONCERNING ANALYTICAL PRINCIPLES FOR PERIODIC REPORTING (PROPOSALS TEN THROUGH TWELVE)

(Issued May 4, 2011)

I. INTRODUCTION

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.

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

On December 20, 2010, the Postal Service filed a petition to initiate an informal rulemaking proceeding to consider four proposals to change analytical methods approved for use in its periodic reports to the Commission.[2] The four proposals are labeled Proposals Nine through Twelve. This Order addresses Proposal Ten through Twelve. Proposal Nine will be addressed in a subsequent order.

Proposal Ten concerns Inbound International Mail. The Postal Service proposes to change the basis for allocating clerk and mail handler labor costs to country groups (Canada, other Target System Countries, and Transition System Countries).

Proposal Eleven proposes to report International Money Transfer Service (IMTS) separately for IMTS-Outbound and IMTS-Inbound in the International Cost and Revenue Analysis (ICRA) report.

Proposal Twelve proposes to use new data inputs to the Media/Library Mail mail processing cost model, the Bound Printed Matter (BPM) transportation cost model, and the Bulk Parcel Return Service (BRPS) cost model.

The Commission approves Proposals Ten and Eleven as filed. Proposal Twelve is also approved with certain modifications to the model. Each proposal is discussed below.

II. PROPOSAL TEN—ASSIGNING CLERK AND MAIL HANDLER LABOR COSTS TO COUNTRY GROUPS FOR INBOUND INTERNATIONAL MAIL

A. Postal Service Proposal

The ICRA report presents costs, revenues, and volumes for each of the Postal Service's outbound and inbound products.[3] Proposal Ten involves the five categories of Inbound International Mail that conform to the Universal Postal Union's (UPU)

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[2] Petition of the United States Postal Service Requesting Initiation of a Proceeding to Consider Proposed Changes in Analytic Principles (Proposals Nine – Twelve), December 20, 2010 (Petition).

[3] *See* USPS-FY10-NP2, Excel File Reports (Booked).xls, Docket No. ACR2010, December 29, 2010.

classification system.[4] It also involves certain cost segments that are derived from the In-Office Cost System (IOCS): Supervisors, Clerk and Mailhandler mail processing, window service, and administrative and support activities, and in-office city carrier activity. The IOCS provides the information needed to distribute the attributable cost of the above activities to products.[5]

The ICRA also includes revenue, attributable cost, and volume data below the product level for selected products. For inbound mail, the Postal Service provides separate information for Canada; Target System Countries, excluding Canada; and Transition System Countries, including Mexico.[6] Prior to FY 2010, the Postal Service used a special IOCS study that provided weighted direct tallies by the three country groups for each of the IOCS-derived costs. The Postal Service distributed the IOCS related costs to country group in proportion to the distribution of the weighted tallies by country group.

The Postal Service proposes to stop conducting the special IOCS study and instead use its standard procedure for distributing attributable costs to products. The standard approach includes the use of mixed mail tallies, *i.e.*, attributable costs are distributed to product in proportion to the distribution of direct and mixed mail tallies combined, by product. The Postal Service proposes to use this approach only to distribute clerk and mailhandler costs. The Postal Service incorporated the Proposal Ten methodology into the FY 2010 ICRA.[7]

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[4] The five Inbound International Mail categories are: Surface Letters-Cards/All Other (LC/AO), Air LC/AO, Surface Parcels (Surface CP), Air Parcels (Air CP), and Express.

[5] *See* Summary Description of USPS Development of Costs by Segments and Components, FY 2009.

[6] The Target System refers generally to industrialized countries participating in the Quality Linked Measurement System (QLMS) established by the UPU. Under the QLMS, terminal dues payments are adjusted for the quality of service provided in the country of destination for inbound letter post from other countries that participate in the QLMS. The Transition System refers generally to developing countries that do not participate in the QLMS.

[7] Docket No. ACR2010, United States Postal Service FY 2010 Annual Compliance Report, December 29, 2010, at 5.

According to the Postal Service, the methodology for assigning clerk and mailhandler labor costs for Inbound International Mail is consistent with the methodology used to distribute such costs for other mail products. Proposal Ten at 1-2. The Postal Service further states that Proposal Ten is similar to Proposal Six approved by the Commission in Docket No. RM2010-12, which also concerned the "splitting of inbound International costs" by country group. *Id.* at 1. However, the Postal Service asserts that the instant proposal "extends Proposal Six to incorporate the methodology change of using results of the mail processing model within the ICRA." *Id.*

As part of its Petition, the Postal Service provides a table showing the impact that Proposal Ten would have on the distribution of FY 2009 Cost Segment 3.1, mail processing costs, to the Inbound International Mail categories by country group. *Id.* at 2. The percent change in mail processing costs ranges from a positive 8 percent for Air Express to a negative 19 percent for inbound Surface LC/AO from Transition System Countries. *Id.*

In response to CHIR No. 4, the Postal Service describes its methodology for assigning the mail processing costs of inbound mail by country group that arise from supervisors and in-office city carrier activities.[8] The Postal Service explains that because supervisors generally do not handle mail, IOCS tallies for supervisors record the type of labor being supervised, *e.g.,* clerk, mailhandler, city carrier, etc., rather than direct or mixed mail tallies. *Id.* question 2. As a result, the costs of supervisors are distributed on the basis of mail processing costs (Cost Segment 3) and in-office city carrier activities costs (Cost Segment 6). *Id.* The Postal Service further explains that it uses only direct tallies to distribute in-office city carrier activity costs rather than direct and mixed mail tallies because there are relatively few mixed mail tallies. *Id.* question 1. Accordingly, the Postal Service maintains that the value of using mixed mail tallies is outweighed by the potential problem of limited tallies for developing costs. *Id.*

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[8] Responses of the United States Postal Service to Questions 1-2 of Chairman's Information Request No. 4, April 8, 2011 (Response to CHIR No. 4).

Moreover, the Postal Service states the use of direct tallies "has a relatively small effect on measured volume-variable costs." *Id.* (Footnote omitted.)

B. Participant Comments

Comments were filed by the Public Representative.[9] No other interested person submitted comments. The Public Representative states that this change in methodology "appears to be an improvement in the allocation of mail processing costs" to country groups. The Public Representative recommends that the change be accepted. *Id.* at 5. The Public Representative observes, however, that it would be helpful to all parties if the Postal Service supported proposed methodology changes with background materials, such as spreadsheets, to explain its proposal. *Id.*

C. Commission Analysis

The Commission approves Proposal Ten. The Commission finds that the methodology change represents an improvement in the assignment of mail processing costs as it extends the application of the results of the mail processing model to the inbound international mail categories reported in the ICRA.

The proposed method for distributing attributable mail processing costs arising from supervisors and in-office city carrier activities to the country groups appears reasonable as well. Although the Commission accepts the Postal Service's assertion that excluding mixed tallies from the distribution key for attributable in-office costs has a "relatively small effect" on the distribution of those costs, it would have preferred that the Postal Service document that assertion.

Lastly, the Commission concurs with the Public Representative's suggestions that the Postal Service submit adequate supporting details when filing proposed methodological changes.

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[9] *See* Comments of the Public Representative in Response to Order No. 625, January 28, 2011; *see also* Corrected Comments of the Public Representative in Response to Order No. 625, March 7, 2011 (PR Comments).

III. PROPOSAL ELEVEN—SEPARATE REPORTING OF FINANCIAL RESULTS FOR INBOUND AND OUTBOUND IMTS

A. Postal Service Proposal

Proposal Eleven would implement the Commission's recommendation that the Postal Service report the financial results for IMTS-Outbound and IMTS-Inbound separately. The Postal Service currently combines financial results for the IMTS-Outbound and IMTS-Inbound products in the ICRA report and in the domestic Cost and Revenue Analysis (CRA) report in the single line item "International Money Transfer Service."[10] In Proposal Eleven, the Postal Service proposes to report results separately for IMTS-Outbound and IMTS-Inbound in the ICRA, but to continue to report only the combined results in the domestic CRA. Proposal Eleven at 1.

The Postal Service intends to rely on three data sources to develop the financial results for the two products. IMTS-Outbound and IMTS-Inbound revenues will be obtained from a technical manual prepared each year that describes the development of costs, volumes, and revenues for all international mail products reported annually in the ICRA.[11] However, the technical manual only provides transaction volume for IMTS-Outbound.[12] To identify IMTS-Inbound transaction volume, the Postal Service proposes to use data retrieved from the retail Point of Sale system.[13] With respect to

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[10] The IMTS-Outbound product features prices of "general applicability" for postal money orders cashed (and electronic transfers accessed) in foreign countries. The IMTS-Inbound product consists of agreements with 10 foreign postal administrations that pre-date the Postal Accountability and Enhancement Act and govern Postal Service payment of foreign money orders presented at post offices in the U.S. There is no charge to the recipient for receiving payment. *See* Docket No. MC2009-19, Order No. 391, Order Approving Addition of Postal Services to the Mail Classification Schedule Product Lists, January 13, 2010.

[11] For FY 2010, *see* Docket No. ACR2010, library reference USPS-FY10-NP5, FY 2010 ICRA Overview/Technical Description, December 29, 2010, chapter 9.

[12] The technical manual uses the IMTS volume reported in the Revenue, Pieces and Weight System (which only represents international money orders) and adjusts the volume to include electronic wire transactions for Dinero Seguro.

[13] *See* Responses of the United States Postal Service to Questions 1-6 of Chairman's Information Request No. 1, January 19, 2011, question 1 (Response to CHIR No. 1).

costs, the Postal Service will use IOCS tallies to distribute IMTS total attributable costs between the IMTS-Outbound and IMTS-Inbound products.

The Postal Service previously acknowledged that the use of IOCS tallies to develop IMTS attributable costs is problematic.[14] It explains that because the number of IMTS transactions is small, it is difficult to obtain enough IOCS tallies through sampling to reliably estimate attributable cost for IMTS.[15]

In response to CHIR No. 1, the Postal Service provided the number of IOCS tallies sampled for IMTS during FY 2009 and FY 2010. Response to CHIR No. 1, question 2. The Postal Service also stated that the coefficient of variation (CV) for the IOCS-based cost estimate for IMTS is about 30 percent, which indicates that the cost estimate for IMTS may vary from year to year.[16]

The Postal Service further explains that it plans to explore whether IMTS can be "sampled more heavily, in a manner similar to other International products." *Id.* In addition, the Postal Service states that it will "investigate alternatives to sampling, such as engineering-based estimates of the time required for IMTS-Outbound and IMTS-Inbound transactions." *Id.*

The Postal Service also provided a detailed worksheet under seal that showed the impact of separately reporting IMTS-Outbound and IMTS-Inbound. *Id.* question 3.

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[14] Docket No. MC2009-19, Request of the United States Postal Service to Add Postal Products to the Mail Classification Schedule in Response to Order No. 154, March 10, 2009, Attachment H.

[15] Docket No. MC2009-19, Supplemental Response of the United States Postal Service to Order No. 154, July 15, 2009, at 3.

[16] *Id.* CV measures the variability of a data set in relationship to the average or mean value of the data set. A large CV (typically greater than 2.5 percent) indicates that there is a wide dispersion of the data around the mean, which suggests that IOCS-based cost estimate may not adequately represent the average cost for IMTS. The Postal Service also stated that the 95 percent confidence interval for the cost coverage is 50 percent to 160 percent. *Id.*

B. Participant Comments

The Public Representative, the only party to comment on Proposal Eleven, concludes that the proposed methodology is reasonable. PR Comments at 5. He notes, however, that if the Postal Service were able to produce more IOCS tallies, a better estimate of the cost distribution between the two products would be achieved. *Id*.

C. Commission Analysis

The Commission approves Proposal Eleven. The Postal Service's proposal is a reasonable method for separately estimating IMTS revenues and transaction volume for both products, and to distribute IMTS attributable costs between the IMTS–Outbound and IMTS–Inbound products.

However, the Commission is concerned about the reliability of the resulting unit cost estimates for IMTS. As the Postal Service observed previously, the small number of IOCS tallies for IMTS leads to volatile unit cost estimates. This creates two problems. First, unit attributable costs that increase and decrease from year to year make it difficult to price IMTS. These fluctuations can result either in volatile prices or, if prices are held steady, in volatile cost coverages. Second, small samples tend to have large CVs with corresponding large confidence limits. This makes it difficult to determine if year-to-year changes are due to changes in operations or to other factors. For this reason, the Commission recommends that the Postal Service enhance its sampling of IMTS transactions or develop an alternative method to provide reliable attributable cost estimates for the IMTS-Outbound and IMTS-Inbound products.

IV. PROPOSAL TWELVE—DEVELOPMENT OF ALTERNATIVE DATA INPUTS TO THE MEDIA/LIBRARY MAIL MAIL PROCESSING COST MODEL, BPM TRANSPORTATION COST MODEL, AND THE BPRS COST MODEL

A. Postal Service Proposal

Proposal Twelve seeks approval of alternate data inputs for

- the Media/Library Mail mail processing cost model;

- the BPM transportation cost model; and
- the BPRS cost model.

Previously, these models used data from the intra-BMC and inter-BMC Parcel Post cost model. When the Postal Service consolidated the intra-BMC and inter-BMC single-piece Parcel rate structure in Docket No. R2009-2, there was no longer a need for the Postal Service to file avoided cost models for Parcel Post. However, some of the data from these models are used as inputs in other models. Specifically, the Media/Library Mail mail processing cost model uses intra-BMC and inter-BMC volume distributions. The BPM transportation cost model uses single-piece Parcel Post zone related percentages, and the BPRS cost model uses transportation leg and cost data from the previous Parcel Post model.[17]

To accommodate these needs, the Postal Service first proposes that the previous Parcel Post intra-BMC input used in the Media/Library Mail mail processing avoided cost model be replaced by a method based on single-piece Parcel Post mail volume in zones 1, 2, and 3. The Postal Service states "the percentage of mail volume represented by those zones would be a good approximation for the Intra-NDC volume percentage." Proposal Twelve at 2.

Second, for the BPM transportation cost model, the Postal Service proposes to use the zone-related percentages found in cost segment 14.3. The Postal Service explains that these are the same zone related percentages that were used in the previous Parcel Post avoided cost models. *Id.*

Third, the Postal Service proposes to replace the outdated Parcel Post data used to calculate the transportation and delivery cost estimates for BPRS with similar data from the Standard Mail destination entry cost model (USPS-FY09-13). The Postal Service believes this change is appropriate because "(BPRS) parcels, by definition, are returned Standard Mail machinable parcels." *Id.* at 3.

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[17] Transportation legs are the segments of transportation a mailpiece must travel to get from origin to destination. For example, a transportation leg would be the Postal Service transporting a mailpiece from the network distribution center (NDC) to the destination sectional center facility (DSCF).

For transportation cost, the Postal Service proposes to modify its basis for calculating local transportation cost per piece. The proposed BPRS transportation cost per-piece estimate is calculated by multiplying the cost-per-pound estimate by the pound-per-cubic foot estimate for origin entered Standard Mail parcels and non-flat machinables (NFMs) by the average cubic feet per piece in the BPRS cost model.[18]

For delivery cost, the Postal Service proposes modifying the current calculation of BPRS delivery unit cost by approximating the local transportation leg as the cost savings between DSCF and destination delivery units cost per-pound estimates for Standard Mail parcels and NFMs, rather than Parcel Post transportation data. Except for this modification, which uses Standard Mail data as a proxy rather than Parcel Post data, the calculation of the BPRS unit delivery cost is unchanged.

B. Participant's Comments

Only the Public Representative commented on Proposal Twelve. The Public Representative makes three observations: (1) the new data inputs, like the old data inputs, are proxies; (2) the inputs and proxies are similar in function and thus the current and proposed mail processing cost models produce similar cost estimates; and (3) certain data are not documented. He concludes that whether the proposed methodology is an improvement is unclear. PR Comments at 6.

C. Commission Analysis

The Commission finds that the Postal Service's proposed data input replacements are reasonable and have a minimal impact on the effected cost models. Since the Postal Service is not proposing to collect new data, the Public Representative is correct that the change may not result in a material improvement in accuracy. However, because direct data are not available and the proposed inputs to the models

[18] In algebraic terms, the formula is as follows: cost/piece = cost/pound x pounds/cubic foot x cubic feet/piece.

reflect the best available replacement data, the Commission approves Proposal Twelve, modified to make the cost pool allocation methodology for Media/Library Mail consistent with the general approach that was approved in Docket No. R2006-1 (with respect to letter mail processing), and was applied to parcels in Docket No. RM2010-12 (Proposal Seven) and RM2011-6 (Proposal 13).

In CHIR No. 3, questions 1 and 2, the Commission asked the Postal Service if the mail processing cost pool allocation used for letters and flats in Docket No. R2006-1 should be applied to the Media/Library Mail mail processing cost pool allocation.[19] 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 response to CHIR No. 3, the Postal Service refers to its responses to CHIR No. 2, Proposal Seven, questions 1 and 2, in Docket No. RM2010-12 and to its initial comments in Docket No. RM2010-13. 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." Docket No. RM2010-13, Initial Comments of the United States Postal Service, February 18, 2011, at 20. 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

[19] Chairman's Information Request No. 3, March 1, 2011 (CHIR No. 3); Reponses of the United States Postal Service to Questions 1-2 of Chairman's Information Request No. 3, March 7, 2011 (Responses to CHIR No. 3); *see also* Docket No. RM2010-12, Responses of the United States Postal Service to Chairman's Information Request No. 2, December 22, 2010 (Docket No. RM2010-12, Responses to CHIR No. 2), Proposal Seven, questions 1 and 2; Docket No. RM2010-13, Initial Comments of the United States Postal Service, February 18, 2011, at 11-13. The Postal Service filed a Motion for Late Acceptance of Responses of the United States Postal Service to Chairman's Information Request No. 2 on February 25, 2011. The motion is granted.

particular kind of "unexpected" cost is appropriate to "piggyback." Non-modeled costs mostly include allied costs, support costs, and "unexpected" costs. "Unexpected" costs are those appearing in cost pools where costs would not be expected to be incurred by a particular category of mail.

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. The Postal Service objects to piggybacking unexpected costs of this type.

Currently, 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 flat mail costs. This methodology for allocating unexpected letter and flats costs was adopted for unexpected parcel costs for Standard Mail Parcels and NFMs (Proposal Seven) and for Parcel Select and Parcel Return Service (Proposal Thirteen).[20]

In this proceeding, the Postal Service has not advanced new arguments to support a different result for allocating non-modeled parcel costs. Accordingly, for reasons set forth in Order Nos. 658 and 719, the Commission approves Proposal Twelve with the following modification of the cost pool allocation. The Commission assigns parcel sorting cost pools as proportional; a group of cost pools is treated as fixed;[21] and allied, support, and unexpected costs are piggybacked.[22] 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.

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[20] *See* Docket No. RM2010-12, Order on Analytical Principles Used in Periodic Reporting (Proposals Three through Eight), January 28, 2011 (Order No. 658); *see also* Docket No. RM2011-6, Order Concerning Analytical Principles for Periodic Reporting (Proposals Thirteen and Fourteen) (Order No. 719).

[21] *See* PRC-RM2011-5-LR1 Excel File: PRC-LR-1_MEDIA_MAIL_MP.xls, tab: Costs by Shape.

[22] *See* PRC-RM2011-5-LR-1 which is an illustration of how the application of the accepted methodology in the letter and flats cost models should be applied to the Media/Library Mail mail processing cost model.

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 Proposals Ten through Twelve in Docket No. RM2011-5 as set forth in the body of this Order.

By the Commission.

Shoshana M. Grove
Secretary