

ORDER NO. 2180

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

Before Commissioners:

Ruth Y. Goldway, Chairman;
Mark Acton, Vice Chairman; and
Robert G. Taub

Periodic Reporting
(Proposals Three Through Eight)

Docket No. RM2014-6

ORDER ON ANALYTICAL PRINCIPLES
USED IN PERIODIC REPORTING
(PROPOSALS THREE THROUGH EIGHT)

(Issued September 10, 2014)

I. INTRODUCTION

This Order addresses a recent Postal Service petition filed pursuant to section 3050.11.¹ The Petition presents six proposals. For the reasons discussed below, the Commission approves each proposal in the Petition. The Commission issues recommendations in connection with Proposal Six and Proposal Seven. In addition, the Commission is concurrently filing a library reference supporting approval of Proposal Seven. The library reference consists of revisions to two Standard Mail cost models.

¹ See Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposals Three Through Eight), June 20, 2014 (Petition).

The following discussion addresses the comments of the Public Representative and the reply comments of the Postal Service.² These comments were filed in response to Order No. 2103 that established this proceeding.³ An Appendix to this Order provides a detailed procedural history and full citations to relevant documents.

II. SUMMARY OF PROPOSALS

Proposal Three seeks to revise the modeling of transportation costs for Parcel Return Service (PRS) Contract 4.

Proposal Four seeks to revise the costing methodology of the portion of Priority Mail International and International Surface Airlift that is not associated with a negotiated service agreement. It also seeks to extend the proposed methodology to several other international mail products.

Proposal Five seeks to revise the methodology for reporting financial results for the Inbound Market Dominant Express Service Agreement 1 product in the International Cost and Revenue Analysis report.

Proposal Six seeks to update the variabilities used to determine the levels of attribution for purchased highway transportation expenses in Cost Segment 14.

Proposal Seven seeks to revise the Standard Mail destination entry and parcel mail processing cost models.

Proposal Eight seeks to revise the methodology for allocating USPS Tracking costs and the sequence of calculations in related workpapers.

² Notice of Proposed Rulemaking on Analytical Principles Used in Periodic Reporting (Proposals Three through Eight), June 26, 2014 (Order No. 2103).

³ Initial Comments of the Public Representative, July 28, 2014 (PR Comments); and Reply Comments of the United States Postal Service, August 12, 2014, and Notice of the United States Postal Service of Revision to Reply Comments Cover Sheet–Errata, August 13, 2014 (Postal Service Reply Comments).

III. PROPOSAL THREE: REVISION TO PARCEL RETURN SERVICE FULL NETWORK COST MODEL

A. Postal Service Proposal

Summary. The Postal Service proposes to revise the methodology for modeling Parcel Return Service (PRS) Contract 4 transportation costs through an adjustment to the calculation of transportation costs for PRS Contract 4 pieces. Petition, Proposal Three at 1. This proposal responds to a recent Commission directive.⁴

Rationale. The Postal Service asserts that the proposed adjustment more closely aligns the contract partner's transportation costs with the cube of the contract partner's pieces⁵. Therefore, it is an improvement over the current methodology. Petition, Proposal Three at 2.

Current methodology. The current methodology uses Parcel Select non-presort transportation costs as a proxy for PRS Contract 4 transportation costs.⁶ The use of this proxy stems from PRS Contract 4's status as a new type of contract when it was introduced and the absence of supporting operational or cost data.⁷ At the time, the average cube of Parcel Select non-presort was approximately equivalent to the contract

⁴ In the FY 2013 ACD, the Commission found that FY 2013 PRS Contract 4 did not cover its attributable costs. Consequently, the Commission directed the Postal Service to either adjust the terms of PRS Contract 4 so rates cover attributable costs or develop a more accurate costing methodology. Docket No. ACR2013, 2013 Annual Compliance Determination, March 27, 2014, at 81-83 (2013 ACD).

⁵ In this proceeding, cube refers to the cubic-foot size of a package.

⁶ *Id.* at 1, citing Docket Nos. MC2013-46/CP2013-60, Request of the United States Postal Service to Add Parcel Return Service Contract 4 to Competitive Product List and Notice of Filing (Under Seal) of Unredacted Governors' Decision, Contract, and Supporting Data, April 29, 2013.

⁷ Under PRS Contract 4, the Postal Service uses the full postal network to deliver the contract partner's returned pieces to the contract partner's facility. Under previous PRS contracts, the Postal Service returned pieces to a designated postal facility and held the pieces until the contract partner retrieved them.

partner's pieces, so the Postal Service chose FY 2012 Parcel Select non-presort transportation costs as a proxy.⁸

According to the Postal Service, migration of former commercial Parcel Post pieces to the Parcel Select non-presort product increased the average size and weight of Parcel Select non-presort pieces in FY 2013.⁹ However, the average size and weight of PRS Contract 4 pieces did not significantly increase. Therefore, the Postal Service asserts that the proxy overstated the true transportation costs of PRS Contract 4 pieces in FY 2013.

Proposed methodology. Because cube is the primary cost driver for the ground transportation network, the Postal Service proposes that transportation costs for PRS Contract 4 be proportionally adjusted relative to the cube of the Parcel Select non-presort proxy. Petition, Proposal Three at 1-2. It asserts that if this proposal were approved, the FY 2013 cost coverage for PRS Contract 4 would increase from below 100 percent (as reported in the FY 2013 ACR) to above 100 percent. *Id.* at 2.

B. Comments/Reply Comments

1. Public Representative Comments

The Public Representative concludes that the proposed concept is reasonable, but expresses concerns about the precision of the costing methodology used for PRS Contract 4 because the average cube for the contract was developed using regression results rather than recorded information. PR Comments at 3. She suggests that the Postal Service use the recorded difference in weight instead of cube because there is a clear difference by pound, whereas the difference by cube is implied. *Id.* at 3-4.

⁸ *Id.* at 1, *citing* Docket No. ACR2013, Response of the United States Postal Services to Questions 1-3.b, 4-5, and 7-12 of Chairman's Information Request No. 5, February 11, 2014, Question 11.

⁹ See Docket No. ACR2013, Response of the United States Postal Service to Chairman's Information Request No. 2, March 27, 2014, Question 3.

2. Reply Comments

The Postal Service emphasizes that the proposed methodology has been “employed by the Commission and the Postal Service for transportation costing purposes in many contexts.” Postal Service Reply Comments at 1. The Postal Service disagrees with the Public Representative’s suggested methodology because it would “overstate the cost adjustment factor, leading to an underestimate of transportation costs.” *Id.* at 2.

C. Commission Analysis

The Commission approves Proposal Three. The FY 2013 unit transportation cost for the proxy piece reflects a larger and heavier piece compared with the FY 2012 proxy piece. Because the cube and weight of contract partner's mail pieces have remained about the same, the FY 2013 proxy unit cost needs to be adjusted downward to reflect the smaller mail piece. The Postal Service appropriately adjusts the FY 2013 ACD transportation costs for PRS Contract 4 by multiplying the proxy transportation costs by the ratio of the contract partner’s cube to the proxy cube. This downward adjustment results in an improved estimate of the transportation costs for PRS Contract 4 pieces. There are no changes to mail processing, carrier/delivery, or other costs.

The Commission acknowledges the Public Representative’s concern with using information derived from a regression analysis, but agrees with the Postal Service’s adjustment based on cube. In Docket No. R2000-1, the Commission recognized cube as the primary cost driver for the ground transportation network.¹⁰ In addition, the weight ratio of the contract partner's pieces to the proxy pieces is smaller than the cube ratio of the contract partner pieces to the proxy pieces. Therefore, if weight were used to adjust transportation costs instead of cube, the downward adjustment would be larger and transportation costs for the contract partner pieces would be understated.

¹⁰ See PRC Op. R2000-1 at 167-169 (Docket No. R2000-1). Transportation costs are calculated using cubic-foot-miles, which are a function of cube and distance traveled.

IV. PROPOSAL FOUR: PROPOSED CHANGE IN INTERNATIONAL NEGOTIATED SERVICE AGREEMENT METHODOLOGY

A. Postal Service Proposal

Summary. The Postal Service proposes to revise the costing methodology of the portion of International Priority Mail (IPA) that is not associated with a negotiated service agreement (NSA), as well as the costing methodology of the IPA mail entered pursuant to negotiated service agreements (IPA NSAs). It also seeks to extend the proposed methodology to International Airlift (ISAL); ePackets; Priority Mail International (PMI) parcels; and PMI envelopes. Petition, Proposal Four at 1; 4-5. In addition, the Postal Service proposes to discontinue four tables in the International Cost and Revenue Analysis (ICRA) report that provide volume, revenue, and cost data on competitive outbound products disaggregated into four categories: Canada, Mexico, target system countries and transition system countries. *Id.* at 6. This proposal responds to a recent Commission directive.¹¹

Rationale. The Postal Service states that the proposed methodology addresses an issue (net versus gross weight) that underlies certain cost coverage and costing concerns. Petition, Proposal Four at 3.

Current methodology. Under the current methodology, the Postal Service develops the combined total costs for both the IPA product and IPA mail entered pursuant to NSAs (*i.e.*, IPA and IPA NSAs). *Id.* at 4. It calculates transportation costs and settlement charges by aggregating country-specific settlement charges and international air transportation costs estimated from gross weight data provided by the

¹¹ In its FY 2013 ACD, the Commission found that the IPA product did not cover its attributable costs. Consequently, the Commission found that the IPA product did not comply with the requirements of section 3633(a)(2). The Commission directed the Postal Service to recommend modifications to its current methodology of developing costs for the IPA product and, if necessary, to propose the modifications in a rulemaking. See 2013 ACD at 86.

System for International Revenue and Volume, Outbound (SIRVO).¹² *Id.* Costs per pound are calculated using gross pounds. *Id.* Domestic statistical systems provide estimates of mail processing, delivery and other costs incurred. *Id.* IPA product costs are developed by subtracting the costs of IPA NSA costs from the combined total cost for all IPA mail. *Id.* However, settlement charges and international transportation costs for IPA NSAs are developed from a dataset that generates only net weight data. *Id.* Costs developed using net weight exclude mail shipping container costs. *Id.* Consequently, the Postal Service contends that the costs for IPA NSAs are understated, while IPA product costs are overstated because all container costs are attributed to the IPA product. *Id.*

Proposed methodology. The Postal Service proposes to calculate the cost per pound for settlement charges and international transportation costs for all IPA volumes (*i.e.*, the IPA and IPA NSA) using net weight.¹³ *Id.* at 5. Because net weight is less than or equal to gross weight, when net weight is used as the denominator in the cost per pound calculation the resulting cost per pound is higher. *Id.* Settlement charges and international transportation costs for IPA NSAs will be calculated by multiplying per pound settlement charges and transportation costs by the net weight of IPA NSAs.

The effect of implementing the proposed methodology is to transfer some additional settlement and transportation costs from the IPA product to IPA NSAs. *Id.* For consistency, the Postal Service proposes extending this methodology to ePackets, PMI parcels and PMI envelopes. *Id.* This revision does not affect the costs of Priority Mail Express International or ISAL because SIRVO reports the net and gross weights the same for these products, respectively. *Id.*

¹² SIRVO is used to develop revenue, pieces, and weight estimates for outbound letterpost and parcels. SIRVO also provides country-specific data to support the settlement process with foreign postal operators concerning terminal dues (letterpost) and inward land rates (parcels).

¹³ The methodology assumes that the gross-to-net weight relationships are the same for the IPA product and IPA NSAs.

Proposed change to ICRA report. In addition to the proposed change in methodology, the Postal Service proposes to eliminate the four pages from the ICRA report (A-3, A-4, B-3 and B-4).¹⁴ Petition, Proposal Four at 5. These pages contain breakouts of data for Canada, Mexico, target countries, and transition countries. The Postal Service asserts that the organization of data this way is a carryover from the classification schedule in effect prior to enactment of the Postal Accountability and Enhancement Act, and that these breakouts are not “products” that are reviewed for compliance. *Id.* at 6. The Postal Service also contends that the elimination of pages A-3, A-4, B-3 and B-4 will result in ICRA production cost savings. *Id.*

B. Comments/Reply Comments

1. Public Representative Comments

The Public Representative recommends that the Commission approve Proposal Four. She agrees that the proposal represents an improvement over the current methodology. PR Comments at 8. She concludes that the proposed methodology “corrects the distribution of certain weight-related settlement and international transportation costs used in the development of the IPA product and several other competitive products.” *Id.* In addition, the Public Representative agrees with the Postal Service that discontinuation of the outbound by country group tables will not inhibit regulatory review because the underlying data will still be available for special studies, if necessary. *Id.*

¹⁴ The Postal Service files the ICRA report with the Commission as part of its Annual Compliance Report. In FY 2013, the Postal Service filed the ICRA report in USPS-FY13-NP2-FY 2013 International Cost and Revenue Analysis (ICRA) Report, December 27, 2013.

2. Postal Service Reply Comments

The Postal Service states that the Public Representative recommends approval of Proposal Four. Postal Service Reply Comments at 2.

C. Commission Analysis

The Commission approves Proposal Four. It finds that the proposed methodology more accurately reflects the distribution of container costs and weight-related settlement charges between the IPA product and IPA NSAs. Similarly, the proposed methodology improves the accuracy of costing for ePackets, PMI parcels and PMI envelopes. The Commission also finds elimination of the ICRA Report pages A-3, A-4, B-3 and B-4 reasonable because the underlying data will continue to be filed with the Commission and the breakouts for Canada, Mexico, target countries, and transition countries are not required for the evaluation of compliance with section 3633 for competitive products.

V. PROPOSAL FIVE: PROPOSED CHANGE IN THE COSTING METHODOLOGY FOR INBOUND MARKET DOMINANT EXPRÈS SERVICE AGREEMENT

A. Postal Service Proposal

Summary. The Postal Service proposes to change the current methodology for reporting financial results for the Inbound Market Dominant Exprès Service Agreement 1 (Inbound Exprès Service) product in the International Cost and Revenue Analysis (ICRA) report.¹⁵ Petition, Proposal Five at 1-5.

¹⁵ The Inbound Exprès Service product consists of rates for delivery confirmation service for Inbound Exprès pieces from designated postal operators that have implemented the Exprès Service Agreement. The Exprès Service Agreement is a multilateral agreement with the designated postal operators of certain member countries of the Universal Postal Union (UPU), including the Postal Service. It establishes a delivery confirmation service for inbound letterpost at UPU terminal dues rates. See Docket No. R2011-6, Order No. 876, Order Adding Inbound Market Dominant Exprès Service Agreement 1 to the Market Dominant Product List, September 26, 2011.

Rationale. The Postal Service states that the Commission approved Inbound Exprès Service on September 26, 2011, but there was no activity for the product until the last quarter of FY 2013. Because of the time lag, the Postal Service inadvertently reported financial results for the product with the Inbound Letterpost product in the FY 2013 ICRA, instead of as a separate product. As a result, the Commission adjusted the FY 2013 ICRA to isolate the financial data for Inbound Exprès Service. This proposal is an alternative to the method the Commission used to identify the financial data for Inbound Exprès Service in its 2013 ACD. *Id.* at 1-3.

Current methodology. The current methodology is the approach the Commission adopted in its FY 2013 ICRA. Specifically, the Commission subtracted the number of inbound letterpost pieces tendered as Exprès from the total volume reported for the Inbound Letterpost product. The Commission also subtracted the delivery confirmation revenue and costs associated with inbound Exprès pieces from the total revenue and costs reported for the Inbound Letterpost product.

Proposed methodology. The Postal Service proposes to separately report the financial results for the Inbound Exprès Service product using a methodology that treats the Inbound Exprès Service product as a special service. Petition, Proposal Five at 3. The Postal Service states that only revenues and costs associated with delivery confirmation service should be included in the Inbound Exprès Service product because it is an add-on service to the host inbound letterpost piece. *Id.* Thus, under this proposal, the ICRA will report revenue and costs associated with the host inbound letterpost piece when tendered as Exprès with the Inbound Letterpost product, and it will report revenues and costs associated with delivery confirmation service with the Inbound Exprès Service product. *Id.* Additionally, the volume of inbound letterpost tendered as Exprès will be included in the total of the Inbound Letterpost product, and separately reported with the Inbound Exprès Service product. However, to avoid double counting, consistent with the current treatment for special services, the volume separately reported for Inbound Exprès Service product will not be added to the volume total of the Inbound Letterpost product. *Id.* at 3-4.

B. Comments/Reply Comments

1. Public Representative Comments

The Public Representative recommends approval of Proposal Five because it will be an improvement over the current methodology. PR Comments at 11. She notes that the proposed methodology will avoid the double counting of volumes in the Inbound Letterpost product and separately report volumes for the Inbound Express Service product. *Id.* She further notes that the proposal will ensure that revenues and costs associated with delivery confirmation service are removed from the Inbound Letterpost product and separately reported with the Inbound Express Service product in the ICRA. *Id.*

2. Postal Service Reply Comments

The Postal Service notes that the Public Representative recommends approval of Proposal Five. Postal Service Reply Comments at 2.

C. Commission Analysis

The Commission approves Proposal Five. The Commission finds that the new methodology will better report the financial data for the Inbound Express Service and Inbound Letter Post products in the ICRA. The proposal also provides a more accurate way to remove revenues and costs associated with delivery confirmation service from the Inbound Letterpost product so they can be separately reported with the Inbound Express Service product in the ICRA. Additionally, the proposal alleviates concerns identified by the Postal Service with the method used in the FY 2013 ACD by ensuring that adjustments to the Inbound Letterpost data are accurate.

VI. PROPOSAL SIX: UPDATING HIGHWAY TRANSPORTATION VARIABILITIES

A. Postal Service Proposal

Summary. The Postal Service proposes to update the variabilities used to determine the levels of attribution for purchased highway transportation expenses in Cost Segment 14. Petition, Proposal Six at 1-5.

Rationale. The Postal Service asserts that this proposal addresses the possibility that some or all purchased transportation variabilities may have changed since this topic was last examined more than 10 years ago, noting that operational changes (such as contract restructuring and network rationalization) have occurred during that time. *Id.* at 1.

Current methodology. Highway Transportation variabilities are currently based upon an econometric study developed in Docket No. R2000-1. In that study, the Postal Service estimated 17 variabilities, comprised of combinations of seven account types and four transportation activities, using data from the Highway Contract Support System.

Proposed methodology. The Postal Service proposes to update highway transportation variabilities using FY 2013 data from the Transportation Contract Support System (TCSS), a database that also contains account and transportation activity data. The proposal employs an estimation method similar to the one employed in Docket No. R2000-1. Both use a translog function to regress the mean-centered cost of 17 different contract/route types against mean-centered cubic foot mile variables, route length variables, route length-cubic foot mile cross term variables, and geographic dummy variables that are not mean-centered.¹⁶ Both remove unusual outlying observations, and both use the same method to correct for heteroskedasticity.¹⁷ After normalizing

¹⁶ The updated model has six rather than 10 geographic dummy variables.

¹⁷ See USPS-RM2014-6/1, Tech.Append.Hwy.Variab.Updat.docx, June 20, 2014, at 9 and Docket No. R2000-1, USPS-T-18 at 30.

Docket No. R2000-1 variabilities using the share of contract types in FY 2013, rather than those from the Docket No. R2000-1 study, the Postal Service's calculations show that of the five contract types that are comprised of multiple transportation activities, variability increased 4.3 percent for Intra P&DC and 1.3 percent for Intra District, but declined for the other three transportation types. *Id.* at 31.¹⁸

B. Comments/Reply Comments

1. Public Representative Comments

The Public Representative concludes that the "overall methodology for calculation of highway volume variabilities is consistent with the previous study approved by the Commission in Docket No. R2000-1." PR Comments at 17. However, she describes two primary concerns about the updated study. First, she notes that the Postal Service did not explain why nearly 300 contract cost segments (contained in five contracts) were excluded from the econometric analysis; however, she also acknowledges that if the excluded accounts "are not related to any account groups selected for econometric analysis ... the total number of contract cost segments would be correct." *Id.* at 17-18. Second, she notes that the Postal Service did not sufficiently justify removing unusual observations from the data set, and further observes that the removal increased highway transportation variabilities and their corresponding attributable costs. *Id.* at 19-20. She states that relying on a statistical measure of influential outliers (Cook's D) to identify "candidates for removal ... is convenient,...but arbitrary and might not produce the best economic results." *Id.* at 20. The Public Representative suggests the Postal Service's method of handling unusual observations could be improved by investigating why an observation is unusual; investigating whether different model specifications that do not require removing unusual observations might

¹⁸ See USPS-RM-2014-6/1, Rpt.Updat.PHT.Cost.Cap.Variab.docx at 31. The Commission used the difference between FY 2013 variabilities and adjusted R2000-1 variabilities using the data contained in Table 10.

produce better results; and using robust regression techniques to retain unusual observations by assigning them lower weights. *Id.* at 20-21.

2. Postal Service Reply Comments

The Postal Service addresses the Public Representative's first concern (about highway transportation variabilities) by confirming that the five excluded contracts "cover activities other than the highway transportation being analyzed." Postal Service Reply Comments at 3. It explains that when the extract from the TCSS database was produced, it included a few contract cost segments from accounts that are not relevant for econometric analysis. *Id.*

The Postal Service raises several points in response to the Public Representative's second concern. It first observes that the Public Representative's concern would be valid "if the estimated variabilities changed materially upon the removal of randomly determined small subsets of the data," but asserts the use of Cook's D allows it to remove a targeted subset of data, namely data that have an undue amount of influence on variabilities. *Id.* at 5. Next, with respect to the Public Representative's concern that removing observations with a Cook's D value greater than 0.1 was convenient but arbitrary, the Postal Service states its "summary makes clear that the determination of unusual observations was based upon careful review of every single candidate observation," which involved visual inspection and the use of formal econometric measures. *Id.* at 6.

The Postal Service also states that the technical appendix associated with this proposal explains that the deleted observations had unusually large or small costs, route lengths, or cubic-foot-miles of transportation. The Postal Service cites the Inter-Cluster tractor-trailer data set as an example of its examination of unusual observations. *Id.* at 7, *citing* USPS-RM2014-6/1, Rpt.Updat.PHT.Cost.Cap.Variab.docx. at 24 n. 12.

C. Commission Analysis

The Commission approves Proposal Six. The Postal Service has sufficiently described its method of identifying and removing outliers. The Postal Service's method of setting the Cook's D threshold for removing an observation equal to 0.1 is reasonable.

A review of the SAS Log shows that of the 786 observations meeting the values that are often considered potential influential outliers (4 divided by the number of observations); only 80, or 10.2 percent, were removed by setting the threshold at 0.1. Overall, only 0.5 percent of initial observations were excluded.¹⁹ The Postal Service has also sufficiently described its model specification. The Postal Service has employed the same specification the Commission approved in Docket No. R2000-1 and has used a current highway transportation database appropriate for the Commission-approved model. The Postal Service should describe the nature of excluded observations when it uses this method, as it did in the case of excluded Inter-Cluster tractor-trailer observations. See Postal Service Reply Comments, at 7 n. 9. By categorizing excluded observations according to the number or percent falling into the relevant "unusual categories," such as extremely high or low costs, mileage, or cubic foot miles, the unusual nature of excluded observations would be immediately obvious, and the additional effort would be minimal.

VII. PROPOSAL SEVEN: MODIFICATION OF THE STANDARD MAIL DESTINATION ENTRY COST MODEL AND THE STANDARD MAIL PARCEL MAIL PROCESSING COST MODEL

A. Postal Service Proposal

Summary. The Postal Service proposes five changes to the Standard Mail destination entry cost model filed with its FY 2013 Annual Compliance Report (FY 2013 ACR) library reference USPS-FY13-13, and one change to the Standard Mail parcel

¹⁹ See USPS-RM-2014-6/1, Tech.Append.Hwy.Variab.Updat.docx, June 20, 2014.

mail processing cost model filed with its FY 2013 ACR library reference USPS-FY13-12.²⁰ Petition, Proposal Seven at 1.

The five changes to the Standard Mail destination entry cost model are: (1) consolidating three Excel workbooks into one workbook; (2) correcting an input error; (3) eliminating obsolete operations and input data; (4) incorporating more recent productivity data into the model; and (5) adding a new parcel mail characteristics profile to separately estimate parcel cost avoidances. The sole change to the Standard Mail parcel mail processing cost model, which is directly related to the fifth change to the destination entry model, is to add a worksheet to the model that contains parcel mail characteristics developed from data already included in the model. To facilitate the analysis, the changes to the Standard Mail destination entry model and the parcel cost model, which result from using parcel mail characteristics data, are discussed together.

1. Cost Model Consolidation

The Postal Service proposes consolidating three Standard Mail destination Excel workbooks (letters, flats, and parcels/total) into one workbook, Excel file "PROP.7.USPS-FY13-13.xlsx." The Postal Service asserts that this change is purely cosmetic and does not affect the cost avoidance estimates. *Id.* at 3.

2. Error Correction²¹

The Postal Service explains that the input value representing the average number of letters (in trays) that a Standard Mail pallet contains has been incorrect in past ACRs. It notes that the FY 2013 destination entry model showed that the average

²⁰ See 2013 ACD, PRC-ACR2013-LR2-FY 2013 Standard Mail, March 27, 2014.

²¹ The Petition lists two errors in the FY 2013 Standard Mail destination entry cost model. *Id.* at 3. However, in its response to a Chairman's information request, the Postal Service explained that one of the identified errors was, in fact, not an error and should not have been listed as an error. See Response of the United States Postal Service to Questions 1-8 of Chairman's Information Request No. 1, July 21, 2014, Question 6 (Postal Service Response to CHIR No. 1).

Standard Mail pallet contained 3,501 pieces for both letters and flats. The Postal Service explains that the figure represented only the number of flat-shaped pieces that the average pallet contained in FY 2013.²² Petition, Proposal Seven at 3.

The Postal Service states that the average Standard Mail pallet contained 6,653 letter-shaped pieces in FY 2013. *Id.* The Postal Service proposes that this statistic be incorporated into the mail characteristics ACR library reference in the future and relied upon to estimate the letters non-transportation costs. Additionally, in response to a Chairman's information request, the Postal Service provides the derivation of the 6,653 figure for letter-shaped pieces and clarifies that it plans to update this figure each fiscal year.²³

3. Obsolete Operations/Data Removal

The Postal Service proposes three operations/data deletions in the Standard Mail destination entry cost model. First, the Postal Service states that the Standard Mail destination entry cost model contains cost estimates for mail processing operations that are no longer relied upon to process and deliver mail.²⁴ Petition, Proposal Seven at 3-4. The Postal Service explains that the data and worksheets concerning these operations have been removed from the model.

Second, the Postal Service notes that cost estimates for NDC tasks have historically been multiplied by an NDC realization factor that appears to be obsolete. The Postal Service avers that it is unclear what this factor represents, that the factor is

²² See 2013 ACR, Library Reference USPS-FY13-14, Mail Characteristics Study, December 27, 2013. Library reference USPS-FY13-14 documents the development of a number of volume and parameter estimates used in the preparation of the 2013 ACR.

²³ Response of the United States Postal Service to Question 1 of Chairman's Information Request No. 4, August 7, 2014.

²⁴ The Postal Service states that the obsolete operations include bedloading activities, sorting of letter trays using sack sorting machines (SSM) at network distribution centers (NDC), the use of SSMs to sort sacks at processing and distribution centers (P&DC), and the manual banding of letter trays.

not developed every fiscal year, and that the factor's value (0.971) is essentially one.²⁵ Therefore, the Postal Service proposes to eliminate the NDC realization factor from the proposed model. Petition, Proposal Seven at 4.

Third, the Postal Service states that the cost model has historically relied upon a flow proportion value for mail that is transported from originating delivery units (DUs) directly to NDCs that appears to be obsolete. *Id.* It further states that one goal of the NDC activation process was to eliminate direct transportation between NDCs and DUs.²⁶ *Id.* Consequently, the Postal Service proposes that this flow proportion factor be changed to 0.0 percent in the proposed model. *Id.*

4. More Recent Productivity Data

The Standard Mail destination entry cost model (USPS-FY13-13) relies on methods time measurement (MTM) predetermined time system data developed 20 years ago. The parcel mail processing cost models, however, now rely on productivity data collected during a 2009 field study. The Postal Service proposes to replace the MTM data with the 2009 productivity data in the model. In addition, the Postal Service proposes incorporating a tray sorting machine productivity value into the model to reflect the fact that both NDCs and P&DCs now use tray sorting machines to process letter mail. The Postal Service states that these productivity values would be used to

²⁵ The NDC realization factor is a measurement of efficiency at an NDC that is calculated as the total direct labor hours earned for all mail processing operations divided by total direct labor hours clocked for the same operations over the same time period. This factor was last updated in Docket No. R94-1 and it was previously known as the Bulk Mail Center (BMC) realization factor. See Docket No. R2000-1, Response of the United States Postal Service Witness Crum to ADVO Interrogatories (ADVO/USPS-T-27-1), March 7, 2000. See also Docket No. R97-1, Response of United States Postal Service to Interrogatories of the American Business Press (ABP/USPS-1-15), ABP/USPS-10, September 3, 1997.

²⁶ The NDC activation was the process of transforming BMCs to NDCs. One goal of the transformation was to consolidate the processing of originating mail into fewer sites to increase efficiency and reduce transportation costs. This process began in FY 2009. See NDC description at <https://www.usps.com/business/network-distribution-centers.htm>. See also 75 Fed. Reg. 9343 (March 2, 2010).

estimate the non-transportation costs in the model using a format that is more consistent with other mail processing cost models. Petition, Proposal Seven at 5.

5. Mail Characteristics Profile

The Postal Service proposes to modify the Standard Mail parcel mail processing cost model (USPS-FY13-12) to include a worksheet that contains a mail characteristics profile developed from arrival profile data already contained in the model. *Id.* at 6. The Postal Service also proposes to incorporate the mail characteristics profile into the proposed Standard Mail destination entry cost model and use the data to estimate the Standard Mail parcel non-transportation costs. *Id.*

B. Comments/Reply Comments

The Public Representative raises concerns with the fourth change (use of more recent productivity data). She states that while the current MTM productivities are out of date, the Postal Service's mail processing network has changed significantly since the 2009 parcel field study. PR Comments at 27. She suggests that the Commission request additional data before implementing the proposal.²⁷ *Id.*

The Postal Service states that it is unclear what additional data the Public Representative believes would enhance the proposal's evaluation process. Postal Service Reply Comments at 9. The Postal Service also elaborates on its proposal to replace the MTM productivity data with the 2009 productivity data. *Id.* at 9-13. The Postal Service states that the MTM productivity values were developed approximately 20 years ago and represent time standards that reflect the time it takes an average operator working at a "normal" pace to complete a specific task. *Id.* at 9-11. The Postal Service explains that in contrast to the MTM productivity values, the 2009 productivity values were developed using time study methods designed to reflect actual costs rather

²⁷ The Public Representative also highlights that the impact of the non-transportation costs changes may have an effect on the passthroughs for dropshipped Standard Mail Flats.

than theoretical “normal” costs. *Id.* at 13. Therefore, the Postal Service believes that the 2009 productivity values are better predictors of the actual costs and should replace the MTM data. *Id.* The Postal Service notes that while future refinements to the model are possible, it requests that the Commission approve Proposal Seven as filed in this docket. *Id.* at 14.

C. Commission Analysis

The Commission approves Proposal Seven. With the issuance of this Order, the Commission also concurrently files library reference PRC-LR-RM2014-6/1 containing the approved Standard Mail destination and mail processing cost models.

Proposal Seven involves five changes to the Standard Mail destination entry cost model and a related change to the Standard Mail parcel mail processing cost model. The following three changes are straightforward and do not require further discussion: (1) consolidating three Excel workbooks (letters, flats, parcels/total) into one workbook; (2) correcting an input error; and (3) adding a new parcel mail characteristics profile in the destination entry cost and parcel mail processing cost models. These changes improve the mechanics of the spreadsheet, correct the inadvertent input error, and update mail characteristics. The changes combine to improve the mechanics and accuracy of the calculations. For these reasons, the Commission approves these three changes.

The other two proposed changes, which relate to (1) eliminating obsolete operations and input data, and (2) incorporating more recent productivity data into the model, as discussed below.

1. Eliminating Obsolete Operations and Input Data

The Postal Service proposes to eliminate three operational or data elements: (1) obsolete mail processing operations; (2) NDC realization factor; and (3) flow proportion factor for direct transportation between NDCs and DDUs.

The Commission approves the Postal Service's proposal to eliminate obsolete operations and input data from Standard Mail's destination entry cost model. The Postal Service has shown that the identified mail processing operations and flow proportion factor are obsolete and should be deleted from the model.

With respect to the proposal to eliminate the NDC realization factor from the destination entry cost model, the Commission notes that while a full explanation of what this factor represents is lacking, the factor's value is 0.9713 and does not have a major impact on Standard Mail's destination entry cost avoidances. Therefore, the Postal Service's assumption that the NDC realization factor is obsolete and may no longer be necessary is reasonable. Under these limited circumstances, the Commission grants the Postal Service's request to eliminate the NDC realization factor from its destination entry cost model.

2. More Recent Productivity Data

The Commission approves the Postal Service's proposal to replace the MTM productivity values with the values developed from the 2009 parcel field study. The Commission approved the use of the 2009 productivity values in Docket No. RM2010-12.²⁸ The Commission subsequently approved the use of the same productivity values in parcel mail processing cost models for Media Mail/Library Mail and Parcel Select/Parcel Return Service.²⁹

The Commission approves the use of the 2009 productivity values in the Standard Mail destination entry cost model because they are the best-available productivity values. However, as the Public Representative suggests, it is possible that

²⁸ See Proposal Seven from Docket No. RM2010-12, Order on Analytical Principles Used in Periodic Reporting (Proposals Three through Eight), Proposal Seven, January 28, 2011 (Order No. 658).

²⁹ See Docket No. RM2011-6, Order Concerning Analytical Principles for Periodic Reporting (Proposals Thirteen and Fourteen), Proposal Thirteen, April 28, 2011 (Order No. 719). See also Docket No. RM2012-1, Order Concerning Analytical Principles for Periodic Reporting (Proposals Nine through Fifteen), Proposal Thirteen, January 20, 2012 (Order No. 1153).

the productivity values could be further refined to reflect current operations. The Postal Service should investigate ways to update its productivity values to ensure that the values best represent its mail processing operations. The Commission will revisit this issue in future considerations of costing and costs.

VIII. PROPOSAL EIGHT: CHANGES IN ATTRIBUTABLE COSTS RELATED TO USPS TRACKING

A. Postal Service Proposal

Summary. The Postal Service proposes revising its methodologies for attributing the costs of USPS Tracking by replacing the use of In-Office Cost System (IOCS) tallies with Point of Service (POS) retail system data. Petition, Proposal Eight at 1. This is a Postal Service-initiated proposal.

Rationale. The Postal Service states that in addition to purchasing USPS Tracking as an optional service for an additional fee, customers can now obtain USPS Tracking for certain shipping products as part of the product, at no additional charge.³⁰ *Id.* The Postal Service also routinely applies a USPS Tracking barcode for its own purposes, even if the customer does not purchase the extra service. The Postal Service states that the expanded use has caused difficulties for IOCS data collectors in terms of identifying whether additional revenue was obtained for USPS Tracking, but deployment of Point-of-Sale retail data terminals provides an alternative means of data collection and cost assignment. *See generally id.* at 1-2.

Current methodology. Currently, the Postal Service uses a three-step process to assign costs to USPS Tracking (a domestic special service) or a host mail piece. First, it collects USPS Tracking costs through four systems³¹ and assigns them to either

³⁰ USPS Tracking provides the mailer with information about the date and time an article was delivered or the date and time of a delivery attempt. Products that now obtain USPS Tracking at no extra charge include Priority Mail, Parcel Select (including Parcel Select Lightweight), Standard Post and First-Class Package Service.

³¹ The IOCS, the Rural Carrier Cost System, the City Carrier Cost System, and the POS system.

USPS Tracking or the host mail piece.³² This step is reflected in the Cost and Revenue Analysis (CRA) “B” workpapers. Petition, Proposal Eight at 2. Second, the Postal Service uses the USPS Tracking cost model³³ to calculate the delivery (or attempted delivery) scanning costs for city carriers, rural carriers, box section clerks and window clerks to USPS Tracking or the host mail piece.³⁴ Third, the Postal Service reassigns the applicable USPS Tracking costs (window acceptance and mail processing costs, and city and rural scanning costs) to the host mail piece. This step is currently reflected in the CRA “D” report.³⁵ Proposal Eight at 3.

Proposed methodology. The Postal Service proposes using data from its POS retail system to assign postal retail window acceptance costs to either USPS Tracking or the host mail pieces. *Id.* at 2. To assign the costs of USPS Tracking not purchased at a postal retail window, the Postal Service proposes reassigning the en-route and final destination scans, as well as the non-window acceptance costs, to the host product. *Id.* This will occur as part of the IOCS data collection process.

The Postal Service states that due to expanded barcode use, most of the scanning activities for First-Class Parcels and Media Mail/Library Mail are performed whether or not the customer purchases the USPS Tracking service, and are used for operations management and service measurement. *Id.* at 2. It concludes that these scans should be assigned to the host product, not the USPS Tracking Service in Ancillary Services. *Id.* at 2-3. However, the Postal Service also asserts that its data

³² *Id.* at 3. See also Postal Service Responses to CHIR No. 1, July 21, 2014, Question 8, filename ChangestoSpreadsheets.CHIR.No1.Question.8b_NP.xls.

³³ This model is included in the Postal Service’s Annual Compliance Report 2013, USPS FY13NP26_Rev2.6.14.xls.

³⁴ This impacts cost segments 3, 6, 7, and 10. The allocation impacts Priority Mail, Parcel Select, First-Class Package Service, First-Class Mail Parcels and Standard Post in the FY2013 ACR. See also USPS FY13NP26_Rev2.6.14.xls.

³⁵ Data from the CRA “B” workpapers are used to prepare the CRA “C” report. The CRA “C” report identifies costs by segment and component. Currently, the CRA “C” report does not include the reassignment of USPS Tracking costs to the host mail piece, making the product costs in the CRA “C” report incomplete.

systems have matured, and it is now possible to use POS data to determine the percentage of USPS Tracking barcodes for which revenue was received. *Id.* at 3. The Postal Service characterizes POS data as a census-type system, and therefore considers it preferable to a sampling system. *Id.*

For window-related tracking costs, the Postal Service proposes using the percentage of volume from the POS retail system that paid an additional fee for USPS Tracking. *Id.* The Postal Service asserts that using POS data³⁶ to identify the retail purchase of USPS Tracking, which is the criterion used for assigning retail revenue and costs to USPS Tracking, allows the postal data systems to clearly identify which window acceptance costs to assign to USPS Tracking and which costs to reassign to the host mail piece. *Id.* at 1. It asserts that this change in methodology eliminates the need for the USPS Tracking final adjustments currently reported in the CRA “D” report. Instead, these adjustments will occur in the CRA “B” workpapers. Consequently, the Postal Service notes that the USPS Tracking cost model that has been included in the Postal Service’s ACR library reference NP26 (USPS-FY13-NP26) will not be needed to prepare the final adjustments currently performed in the CRA “D” report.³⁷ As an added benefit, the Postal Service asserts that the CRA “C” report will correctly report product costs, making the analysis of cost segments less complex than if USPS Tracking final adjustments are in the CRA “D” report. Petition, Proposal Eight at 2.

B. Comments/Reply Comments

1. Public Representative Comments

The Public Representative's review of Proposal Eight and the Postal Service's response to CHIR leads her to conclude that consideration of Proposal Eight should be

³⁶ Data for POS comes from the Retail Data Mart. Library reference USPS.RM2014-6.2.zip, filename IOCSDelConChanges_Prop8.xls, worksheet POSDATA.

³⁷ The cost model identifying the USPS Tracking costs that are to be reassigned to the host mail piece is currently included in library reference USPS-FY13-NP26.

postponed until more data is available. PR Comments at 2. She bases her position (and a related data request) on the assertion that after review of the proposal and the Postal Service Responses to CHIR No. 1, the Postal Service has provided insufficient data to justify the proposal.³⁸ PR Comments at 29. In particular, she states she is unsure about how the new methodology work and the cause of the differences in the distribution keys. *Id.* at 28. In response to the Motion, the Commission issued, and the Postal Service responded to a Chairman's information request, which concerns the requested distribution key data.

2. Postal Service Reply Comments

The Postal Service states that the Public Representative offers no theoretical objections to Proposal Eight, but indicates a need for more information than was available when her comments were filed. Postal Service Reply Comments at 14. The Postal Service asserts that it provided the type of additional information the Public Representative sought in its response to CHIR No. 3, and that her concerns have been met. *Id.*

C. Commission Analysis

The Commission approves Proposal Eight. The Commission agrees that costs related to USPS Tracking need to be divided between the costs that belong to the host piece and costs that belong to the USPS Tracking service. This division, as the Postal service proposes, should be based on whether the service is provided because it is included as part of the product feature (at no additional charge) or is purchased separately, at the option of the customer, for an additional charge. When USPS

³⁸ See Public Representative Motion for Issuance of Information Request, July 28, 2014. The Commission issued Chairman's Information Request No. 3, July 30, 2014 (CHIR No. 3). The Postal Service filed a response on August 1, 2014. Responses of the United States Postal Service to Questions 1-3 of Chairman's Information Request No. 3, August 1, 2014.

Tracking is provided because it is included in the product, the Tracking cost is properly assigned to the host mail piece because it is part of the product offering. When USPS Tracking is purchased separately as an optional service, it is not part of the product for which postage is paid; therefore, the cost and the Tracking fee revenue properly belong to the special service.

The Commission finds that using the POS retail data system to identify the number of retail transactions in which USPS Tracking is purchased and to determine the number of transactions by product is an improvement over relying on IOCS data collectors, who have difficulty differentiating between a USPS Tracking service purchased at a postal retail window, versus those applied for management of operations, or included in the product for no additional fee. Moreover, as POS data is effectively a census system, it should be an improvement over a methodology based on sampling.

The Commission also finds that eliminating the final adjustment for USPS Tracking from the CRA "D" report and moving the proposed methodology into the CRA "B" report simplifies the procedure for calculating product attributable costs reported in the CRA "C" report. Because the Commission finds that this change eliminates the need to include USPS Tracking final adjustments in the CRA "D" report, it also finds that the USPS Tracking cost model (in USPS-FY13-NP26) used to calculate the distribution of USPS Tracking costs to the host product is no longer necessary.

Finally, the Commission finds that the Postal Service's responses to CHIR No. 3 adequately address the Public Representative's concerns about the sufficiency of data supporting Proposal Eight.

IX. ORDERING PARAGRAPH

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 Three through Eight as set forth in the body of this Order.

By the Commission.

Shoshana M. Grove
Secretary

DOCKET NO. RM2014-6
PROCEDURAL SUMMARY

On June 20, 2014, the Postal Service filed a petition pursuant to 39 C.F.R. § 3050.11 seeking initiation of a proceeding to consider six proposals for changes in analytical principles.¹ Section 3050.11 is a periodic reporting rule in 39 C.F.R. part 3050, which implements 39 U.S.C. § 3652 (concerning annual reports to the Commission). Section 3050.11 requires 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 it applies in preparing periodic reports to the Commission required by section 3652.²

In conjunction with its Petition, the Postal Service filed related supporting materials.³ For five of the proposals (Proposals Three, Four, Five, Six, and Eight), the Postal Service filed the supporting materials under seal. For Proposal Six, the Postal Service also filed a corresponding public version. Additionally, for Proposal Seven, the Postal Service filed only a public version of the supporting materials because this proposal does not involve non-public data.

The Petition noted that Proposal Six, which concerns updates to the variabilities for purchased transportation costs, encompasses a subject which has been discussed as part of the Strategic Rulemaking in Docket No. RM2011-3. Petition at 1.

On June 26, 2014, the Commission issued Order No. 2103 in response to the Petition.⁴ The Order established Docket No. RM2014-6 as a rulemaking proceeding for

¹ See Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposals Three Through Eight), June 20, 2014 (Petition).

² See Docket No. RM2008-4, Order No. 203, Notice of Final Rule Prescribing Form and Content of Periodic Reports, April 16, 2009.

³ See Notice of Filing of USPS-RM2014-6/1, USPS-RM2014/6NP1, NP2, NP3, and NP4, and Application for Nonpublic Treatment, June 20, 2014 (Notice). There was no opposition to the Notice.

⁴ Notice of Proposed Rulemaking on Analytical Principles Used in Periodic Reporting (Proposals Three through Eight), June 26, 2014 (Order No. 2103).

consideration of the Petition; solicited comments and reply comments; and, pursuant to 39 U.S.C. § 505, appointed a Public Representative to represent the interests of the general public.

The Commission issued four Chairman's Information Requests (CHIRs).⁵ One — CHIR No. 3 — was issued in response to a Public Representative's motion seeking additional information with respect to Proposal Eight, which concerns USPS Tracking.⁶

The Postal Service filed timely responses to the CHIRs.⁷

The Public Representative filed comments in response to Order No. 2103 on July 28, 2014.⁸ No other comments responding to Order No. 2103's solicitation were filed.

The Postal Service filed reply comments on August 12, 2014.⁹ No other reply comments were filed.

The proceeding culminated in the Commission's issuance of this Order approving each of the proposals in the Petition; making recommendations with respect to Proposals Six and Seven; and concurrently issuing a library reference supporting the approval of Proposal Seven. The library reference consists of the approved Standard Mail destination entry and parcel mail processing cost models.

⁵ See Chairman's Information Request No. 1, July 14, 2014 and Chairman's Information Request No. 1 (Revised) July 15, 2014; Chairman's Information Request No. 2, July 29, 2014; Chairman's Information Request No. 3, July 30, 2014; and Chairman's Information Request No. 8 [sic], August 1, 2014; and Notice of Erratum, August 4, 2014 (changing the caption from Chairman's Information Request No. 8 to Chairman's Information Request No. 4).

⁶ See Public Representative Motion for Issuance of Information Request, July 28, 2014.

⁷ See Responses of the United States Postal Service to Questions 1-8 of Chairman's Information Request No. 1, July 21, 2014; Response of the United States Postal Service to Question 1 of Chairman's Information Request No. 2, July 30, 2014; Responses of the United States Postal Service to Questions 1-3 of Chairman's Information Request No. 3, August 1, 2014; and Response of the United States Postal Service to Question 1 of Chairman's Information Request No. 4, August 7, 2014;

⁸ See Initial Comments of the Public Representative, July 28, 2014.

⁹ See Reply Comments of the United States Postal Service, August 12, 2014, and Notice of the United States Postal Service of Revision to Reply Comments Cover Sheet—Errata, August 13, 2014.