

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

ANNUAL COMPLIANCE REVIEW, 2014

Docket No. ACR2014

RESPONSES OF THE UNITED STATES POSTAL SERVICE TO
QUESTIONS 7, 9, 11, AND 14 OF CHAIRMAN'S INFORMATION REQUEST NO. 2

The United States Postal Service hereby provides its responses to the above-listed questions of Chairman's Information Request No. 2, issued on January 16, 2015. Each question is stated verbatim and followed by the response. Timely responses were filed to all other Questions on January 23, 2015.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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7. The following table details Periodicals Outside County Mail Processing Costs by Management Operating Data System (MODS) operation. The MODS operations are broken into processing functions using the methodology described on page 74 of the 2011 USPS/PRC Joint Periodicals Study. The data for each year is from USPS-LR-26, shpFYprc.xls. Workbook No. 1 attached to this CHIR contains the source data and calculations for this table.

| Periodicals OC Flats Mail Processing Cost 2007 to 2014 | | | | | | | | | Percent Change | |
|--|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|----------------|--------------|
| (Cents per Piece) | | | | | | | | | | |
| Type of Processing | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2007 to 2014 | 2009 to 2014 |
| Plant Manual | 1.10 | 1.02 | 1.26 | 1.19 | 1.20 | 1.21 | 1.09 | 1.28 | 38.44% | 1.16% |
| NONMods Facility | 4.73 | 5.19 | 5.74 | 5.10 | 4.71 | 4.89 | 4.53 | 4.54 | 2.57% | -20.92% |
| Plant Mechanized | 3.55 | 3.34 | 3.67 | 3.48 | 4.80 | 5.22 | 5.34 | 5.53 | 66.28% | 50.89% |
| Bundle Operations | 2.74 | 2.76 | 2.71 | 2.60 | 2.51 | 2.45 | 2.18 | 2.36 | -12.02% | -13.00% |
| Plant Allied | 4.62 | 4.54 | 4.54 | 4.34 | 4.10 | 4.30 | 3.94 | 4.26 | 2.72% | -6.20% |
| Other Allied | 1.11 | 1.63 | 1.68 | 1.91 | 1.81 | 1.83 | 1.66 | 1.72 | 67.51% | 2.05% |
| Total | 17.83 | 18.48 | 19.60 | 18.62 | 19.12 | 19.92 | 18.75 | 19.68 | 19.10% | 0.41% |

- a. Periodicals Outside County Mail Processing costs have increased by 19 percent since FY 2007, across all operational areas other than bundle processing. For each of the six listed processing functions, please explain the changes in operations that have led to unit cost increases.
- b. In FY 2011, the Postal Service ended the Hot2C program for manual processing Periodicals. Please explain why manual processing costs for Periodicals have not decreased concurrent with the removal of the Hot2C program.
- c. Plant mechanized unit costs have increased 51 percent since FY 2009. In FY 2014, the unit cost of the Flats Sequencing System (FSS) cost pool was 2.3 cents per piece, from USPS-LR-FY14-26 file "FY14-26.shp14prc.xls" tab "Flats(4)" cell F30. Is this increase in unit mechanized cost due to the implementation of FSS processing?
- d. In FY 2013, Periodicals Outside County Mail processing decreased 1.17 cents per piece from FY 2012. In FY 2014, unit costs increased by 0.97 cents per piece, leaving processing costs essentially flat since FY 2009. Please explain the oscillation in Periodicals mail processing costs since FY 2009.

RESPONSE:

Please note that the percentage change columns in the question have been incorrectly calculated for the period 2007 to 2014. The corrected percentages for this period are provided below, along with the percentages from 2009 to 2014 from above.

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Percent Change

| Type of Processing | <u>2007 to</u> <u>2014</u> | <u>2009 to</u> <u>2014</u> |
|---------------------------|-------------------------------|-------------------------------|
| Plant Manual | 16.43% | 1.16% |
| NONMods Facility | -4.07% | -20.92% |
| Plant Mechanized | 56.02% | 50.89% |
| Bundle Operations | -13.88% | -13.00% |
| Plant Allied | -7.71% | -6.20% |
| Other Allied | 55.08% | 2.05% |
| Total | 10.36% | 0.41% |

As a result, it is inaccurate to state that “costs have increased ... across all operational areas other than bundle sorting” Instead, costs over the periods specified have only increased in the operational areas of Plant Manual, Plant Mechanized, and Other Allied.

It should also be noted that in answering the below questions, the unit costs in the above table cover processing labor (clerk and mail handler) and the processing indirect or piggyback costs (covering supervision, equipment and facility-related costs, administrative and service-wide benefits). In answering these questions, the focus is on the labor costs, which are the bulk of the costs. In addition, many factors change over the period in question, in terms of mail makeup and operational changes. Of course, there is also sampling variation, which will lead to year-to-year fluctuations and a degree of variation that would not be caused by operational or other identifiable factors.

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A last preliminary comment is to note that the rise in total unit costs for Periodicals Outside County was less than the rise in the clerk and mail handler productive hourly rate for both the 2007-2014 and 2009-2014 periods, over which the productive hourly rates rose 12.4 percent and 0.9 percent, respectively.

- a. Plant Manual unit costs have increased at a slightly higher rate than the cost per work hour. This is most likely driven by the removal of most of the UFSM 1000s, which would have increased the volumes of Periodicals Outside County requiring manual sorting. The declines in NONMODS Facility unit costs since FY2010 reflect the greater automation/mechanization of incoming secondary sorting, due to FSS operations, plant consolidations, and ending the Hot2C program. The rise in Plant Mechanized unit costs is discussed in response to part c. The decline in Bundle Operations costs may reflect a combination of shifts to mechanization (from opening and pouching to APBS and APPS – as shown by the unit costs for these activities over the years), and the reduced need for bundle sorting due to FSS operations. Plant Allied unit cost declines may reflect greater dropshipping. The last category (“Other Allied”) is really best thought of as “Other Miscellaneous” operations (which are bulk mail acceptance and CFS). This unit cost trend is mostly unchanged between 2008 and 2014.
- b. As noted above, the rise in Plant Manual unit costs is most likely driven by the removal of most of the UFSM 1000s.
- c. Changes in Plant Mechanized unit costs since FY 2010 are primarily driven by FSS. FSS operations were first significant in FY2011 with the deployment of

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most of the FSS machines occurring in that year. In FY2014, the total FSS unit costs for Periodicals Outside County is 2.54 cents (combining FSS sorting at the plant and NDCs), which is larger than the total increase in Plant Mechanized unit costs between FY 2010 and FY2014. The rise in FSS unit costs has been offset by the decline in AFSM 100 unit costs, as FSS sorting does lessen the need for AFSM 100 sorting for non-carrier route presort. The removal of the UFSM 1000s also reduced mechanized sorting as well. While the growth in FSS sorting has led to increases in mechanized costs, this work has replaced much work in other areas of processing and in delivery, leading to offsetting cost decreases in other categories. Like letter automation, where the DPS operations replaced processing operations (such as automated and manual incoming secondary) and reduced in-office carrier work, FSS has a similar impact. FSS operations, apart from reducing the need for AFSM 100 sorting, have likely led to reductions in NONMODS Facility (delivery unit) and bundle sorting costs as noted above. Of course, the main benefit of FSS is to obtain carrier in-office savings.

d. There are at least two factors that can be identified. First, as previously reported, the FY2009 unit costs were high (for most products), since that was the year of the largest volume drop due to the Great Recession, and the Postal Service was not able to adjust resources as fast as volumes dropped. There were lower unit costs in FY2010 as resources adjusted to lower mail processing workloads. Second, there was a general decline in unit costs for many products in FY2013, due to plant consolidations and retirement incentives. This led to declines in total workhours, but also in cost per workhour. Cost per workhour

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declined by 3 percent, a direct result of changes in the workforce mix, driven by career attrition of higher paid workers and the growth of the lower wage non-career workforce. The Postal Service added several thousand PSEs and MHAs over the course of FY 2013. Any career hires were into the new, lower career pay schedules. .

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9. The following table details Standard Mail Flats Mail Processing Costs by MODS operation. The MODS operations are broken into processing functions using the methodology described on page 74 of the 2011 USPS/PRC Joint Periodicals Study. See http://www.prc.gov/Docs/76/76767/Periodicals%20Mail%20Study_final_2131_2149.pdf. The data for each year is from Library Reference USPS-FY14-26, shpFYprc.xls. Workbook No. 1 attached to this CHIR contains the source data and calculations for this table.

| Standard Mail Flats Mail Processing Cost 2006 to 2014 | | | | | | | | | | Percent Change | |
|---|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|----------------|--------------|
| (Cents per Piece) | | | | | | | | | | | |
| Type of Processing | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2006 to 2014 | 2009 to 2014 |
| Plant Manual | 0.65 | 0.66 | 0.77 | 1.04 | 0.90 | 0.84 | 0.89 | 0.98 | 1.00 | 54.55% | -3.74% |
| NONMods Facility | 4.40 | 4.69 | 5.41 | 6.09 | 5.76 | 6.25 | 5.72 | 5.97 | 6.29 | 42.99% | 3.28% |
| Plant Mechanized | 5.33 | 6.33 | 8.00 | 9.16 | 9.19 | 10.07 | 10.40 | 9.29 | 10.74 | 101.50% | 17.25% |
| Bundle Operations | 2.25 | 2.27 | 2.68 | 2.87 | 2.80 | 2.68 | 2.66 | 2.57 | 2.66 | 18.31% | -7.16% |
| Plant Allied | 4.10 | 4.42 | 5.74 | 6.39 | 5.83 | 6.09 | 6.29 | 6.50 | 6.90 | 68.34% | 7.97% |
| Other Allied | 0.18 | 0.22 | 0.29 | 0.40 | 0.48 | 0.49 | 0.50 | 0.43 | 0.45 | 147.06% | 13.48% |
| Total | 16.91 | 18.58 | 22.89 | 25.95 | 24.97 | 26.42 | 26.46 | 25.75 | 28.05 | 65.86% | 8.09% |

- a. Standard Mail Flats Mail Processing costs have increased by 66 percent since FY 2006, across all operational areas. For each of the six listed processing functions, please explain the changes in operations that have led to unit cost increases.
- b. Plant mechanized unit costs have increased 1.58 cents per piece, or 17 percent, since FY 2009. In FY 2009, the unit cost of processing flats on the FSS was not explicitly measured. In FY 2014, the unit cost of the FSS cost pool was 2.75 cents per piece, from Library Reference USPS-FY14-26 file "FY14-26.shp14prc.xls" tab "Flats(4)" cell F25. The increase in Standard Mail Flats mechanized processing from FY 2009 to FY 2014 was less than the increase in cost associated with the FSS.
 - i. Did the cost of processing Standard Flats on mechanized piece equipment other than the FSS, such as the AFSM100, decrease from FY 2009 to FY 2014?
 - ii. Has the increase in mechanized cost due to the FSS surpassed the decrease in costs in other operations, or has there been a shift in processing from other piece equipment to the FSS during this time frame?
 - iii. In FY 2013, Standard Mail Flats Mail processing decreased 0.7 cents per piece from FY 2012. In FY 2014, unit costs increased by 2.30 cents per piece, with processing costs up 8 percent since FY 2009. Please explain the oscillation in Standard Mail Flats mail processing costs since FY 2009

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RESPONSE:

It should be noted that in answering the below questions, the unit costs in the above table cover processing labor (clerk and mail handler) and the processing indirect or piggyback costs (covering supervision, equipment and facility-related costs, administrative and service-wide benefits). In answering these questions, the focus is on the labor costs, which are the bulk of the costs. In addition, many factors changed over the period in question, in terms of mail makeup and operational changes. Of course, there is also sampling variation, which will lead to year-to-year fluctuations and a degree of variation that would not be caused by operational or other identifiable factors.

In addition, evaluation of the analysis of IOCS tallies for Standard flat mail described in the Notice of the Postal Service of Filing Partial Supplemental Information in Response to Order No. 2313 (January 15, 2015) is still underway. The responses below are provided without reference to that analysis, but its results will likely be relevant to the topics addressed. As one last preliminary comment, it is worth noting that the growth in the clerk and mail handler productive hourly rate rose 14.1 percent over 2006-2014, and 0.9 percent over 2009-2014.

a. Plant Manual unit costs have increased at a higher rate than the cost per work hour.

This is most likely driven by the removal of most of the UFSM 1000s, which would have increased the volumes of Standard Flats requiring manual sorting. The NONMODS Facility unit costs are essentially unchanged, which runs counter to expectations that there was greater automation/mechanization of incoming secondary sorting due to FSS operations and plant consolidations. The rise in Plant

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Mechanized unit costs is discussed in the response to part b. The recent decline in Bundle Operations unit costs reflects shifts to mechanization (from opening and pouching to APBS and APPS – as shown by the unit costs for these activities over the years), and the reduced need for bundle sorting due to FSS operations. The reasons for Plant Allied unit cost increases are not known. The last category (“Other Allied”) is really better thought of as “Other Miscellaneous” operations (which are bulk mail acceptance and CFS). It is not known why these costs rose.

- b. i. FSS operations were first significant in FY2011, with the deployment of most of the FSS machines occurring in that year. In FY2014, the complete or full total of the FSS unit cost for Standard Flats is 3.03 cents (combining FSS sorting at the plant and NDCs), which is larger than the total increase in Plant Mechanized unit costs of 1.56 cents between FY 2010 and FY2014. This is because FSS operations have replaced AFSM 100 incoming secondary sorting in FSS zones. Thus, the rise in FSS unit costs has been offset by the decline in AFSM 100 unit costs. The removal of the UFSM 1000s also reduced mechanized sorting as well.
- ii. While the growth in FSS sorting has led to increases in mechanized costs, this work has replaced work in other areas of processing and in delivery, leading to offsetting cost decreases. Like letter automation, where the DPS operations replaced processing operations (such as automated and manual incoming secondary) and reduced in-office carrier work, FSS has a similar impact. FSS operations, apart from reducing the need for AFSM 100 sorting, have likely led to

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reductions in NONMODS Facility (delivery unit) and bundle sorting costs as noted above. Of course, the main benefit of FSS is to obtain carrier in-office savings.

iii. Please see the response to Question 7, part d of Chairman's Information Request No. 2.

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11. Please refer to page 4 of Library Reference USPS-FY14-29.
- a. Please explain why the percent on-time performance for First-Class Mail Flats was below the performance target for FY 2014.
 - b. Please discuss whether the Postal Service has a plan to increase the percent on-time performance for First-Class Mail Flats and, if applicable, explain such plan.

RESPONSE:

- a) The Postal Service attributes its service performance scores to the extreme weather experienced during the winter of 2014. The number and severity of the winter storms resulted in volumes which were processed by any means possible to provide service to our customers. The Postal Service also diverted mail volume scheduled for air transportation to available surface transportation in an effort to mitigate weather delays. This decision had a greater impact on our 3-5 day percent on time achievement. Service improvements were made during Quarters 3 and 4.

Year-to-Date Performance Result Aggregation for First-Class™ Flats

Mailpieces Delivered Between 10/01/2013 and 09/30/2014

| Nation | Origin / Destination | | | Origin / Destination | |
|----------------------|----------------------|-----------------|-----------------|----------------------|-----------------|
| | Year-to-Date | Quarter I | Quarter II | Quarter III | Quarter IV |
| | Percent On Time | Percent On Time | Percent On Time | Percent On Time | Percent On Time |
| FCF Overnight | 84.9 | 83.6 | 83.8 | 85.7 | 86.5 |
| FCF 2 day | 82.5 | 81.6 | 80.5 | 84.1 | 83.7 |
| FCF 3-5 day | 72.6 | 69.5 | 69.4 | 74.9 | 76.4 |

- b) While First-Class Mail Flats did not meet their applicable service standards, the Postal Service's continued use of root cause diagnostic tools and continuous improvement projects will allow operating managers to improve processing and transportation flows, which should improve service performance. Lean Mail Processing (LMP) has been deployed to all of our processing plants and network distribution centers and we will be implementing more projects in phases as this

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is an ongoing cycle. The LMP concepts standardizes mail processing operations and requires plants to complete specific Lean Six Sigma projects aimed at cycle reduction and increased productivities.

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14. Please refer to page 15 of Library Reference USPS-FY14-29.
- a. Please explain why the percent on-time performance for Periodicals was below the performance target for FY 2014.
 - b. Please discuss whether the Postal Service has a plan to increase the percent on-time performance for Periodicals and, if applicable, explain such plan.

RESPONSE:

- a) The Postal Service attributes its service performance scores to the extreme weather experienced during the winter of 2014. The number and severity of the winter storms resulted in volumes which were processed by any means possible to provide service to our customers. Service improvements were made during Quarters 3 and 4 compared to Quarters 1 and 2.

Year-to-Date Result Aggregation for Periodicals

Mailpieces Delivered Between 10/01/2013 and 09/30/2014

| Nation | Outside County Origin / Destination | | Outside County Origin / Destination | | |
|-----------------------|-------------------------------------|-----------------|-------------------------------------|-----------------|-----------------|
| | Year-to-Date | Quarter I | Quarter II | Quarter III | Quarter IV |
| | Percent On Time | Percent On Time | Percent On Time | Percent On Time | Percent On Time |
| Outside County | 80.8 | 77.7 | 79.2 | 83.4 | 83.2 |
| In-County | 80.9 | 77.8 | 79.2 | 83.4 | 83.3 |

- b) In January of 2015 the Postal Service made changes to its operational processing windows to better align our network. In addition, Flats mail will be moving from an Area Distribution Center sortation to a Sectional Center Facility level. Both of these initiatives are being done to help improve mail flow and service performance for Periodicals.