

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 3-4 OF CHAIRMAN'S INFORMATION REQUEST NO. 3

The United States Postal Service hereby provides its responses to the above-listed questions of Chairman's Information Request No. 3, issued on January 23, 2015. Each question is stated verbatim and followed by the response. The response to Question 12 is still being prepared.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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3. Please explain why the unit costs for Standard Mail Flats increased by 9.4 percent from FY 2013 to FY 2014. *Compare* the Commission's FY 2013 Financial Analysis Report on page 53 *with* Library Reference USPS-FY14-1.

RESPONSE:

Broadly speaking, the sources for the overall increase in Standard Flats unit costs of 4.25 cents, a 9.4 percent increase between FY2013 and FY2014, can be seen below in Table 1, by comparing costs by function over the two years.² In addition, as explained in USPS-FY14-45, an analysis of IOCS tallies suggests that Standard Flats total attributable costs are potentially overstated. If FY2014 Standard Flats costs were adjusted downward to account for the potential overstatement relating to misidentification issues, the reported increase in Standard Flats unit costs would be reduced correspondingly.

Table 1: Attributable Costs by Function for Standard Flats, FY 2013 vs. FY2014 (Cents per Piece)						
Fiscal Year	Total Unit Cost	Mail Processing	Delivery	VSD	Contract Transportation	Other
FY2013	45.16	25.75	15.25	0.60	2.86	0.69
FY2014	49.40	28.05	16.49	0.84	3.31	0.70
FY14-FY13	4.25	2.30	1.24	0.24	0.45	0.01
Percentage Change	9.4%	9.0%	8.1%	40.1%	15.8%	1.5%

² Costs for each function include labor costs and indirect (or piggyback) costs for supervisor, equipment and facility-related, administrative and service-wide benefits costs. The calculation for this Table and the others below are shown in the spreadsheet attached to this response called CHIR No 3, Q3.Tables.xls.

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As shown in Table 1, much of the change, 2.30 cents of the increase, is due to mail processing. Mail processing unit labor costs rose by 8.0 percent, as shown in Table 2.³ As reported in USPS-FY14-45, there is an estimated potential overstatement of Standard Mail Flats mail processing costs by 2.5 percent. If this potential overstatement were removed, the result would be that Standard Flats mail processing labor unit costs rose by 5.3 percent between FY 2013 and FY 2014 as shown in Table 2.⁴ It is likely that this 5.3 percent increase could be explained, at least in part, by the

Table 2: Comparison of FY 2013 and FY 2014 Mail Processing Labor Unit Costs without and with IOCS Adjustment (Cents/Piece)			
	Unadjusted	Adjustment Factor	Adjusted
FY13	15.18		15.18
FY14	16.40	0.9750	15.99
Difference	1.22		0.81
Percentage Change	8.0%		5.3%

implementation of FSS Scheme requirements in January, 2014. This was a significant modification of mail makeup which required substantial adjustments, both by mailers in preparing the mail, and by the Postal Service in its processing operations.

Specifically, beginning on January 26, 2014 (within the second quarter of FY2014), mailers were required to use the FSS Scheme preparation for FSS 5-Digit Zip Codes. In an effort to ease implementation for mailers and mail service providers, an incremental approach was developed with the mailing industry to minimize the burden

³ The difference of the 9.0 percent increase shown in Table 1 vs. 8.0 percent shown in Table 2 is due to indirect or piggyback costs rising more than direct labor costs. In addition, there were increases in equipment depreciation and workers compensation. Please see USPS-FY14-24 and USPS-FY13-24.

⁴ It also should be noted that all of the IOCS-based costs have a standard error associated with them.

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of the transition to the FSS mail preparation and entry requirements. In conjunction with the mailing industry, solutions were developed to map existing prices and presort levels to the physical FSS schemed bundles, since rates were essentially left unchanged with introduction of the new flats preparation requirements. As a result, some of the cost increases that arose in FY2014 (as compared to FY2013) were due to the implementation of FSS Scheme requirements.

Of most notable significance was the formation of a liberal exception process for mailers and mail service providers, particularly software providers, due to the complexity of system changes and the inability to meet the implementation effective date. This exception period extended through quarter three. Because of these implementation challenges, some "growing pains" were felt, leading to inefficiencies and inaccurate reporting. Examples of issues include delays in implementing software requirements to meet the January 26, 2014 effective date, as well as a misalignment in revised label lists (which impacted properly prepared FSS schemed bundles, and mailers ability to prepare FSS containers and drop ship at the Destination FSS facility). As a result of these impacts, additional handlings were incurred.

For example, because FSS scheme bundles are designed to match the actual ZIP Codes combined in a single sort program on the machine, any misalignment in the ZIP Codes combined will prohibit processing on the FSS. The bundles also cannot be sent directly to the delivery units because the ZIP Codes may not be located in the same facility and the mail is randomized within the bundles. Processing on the AFSM 100 separates the ZIP Codes and sorts to a specific carrier route, but the mail will still require casing by a carrier. Misaligned schemed bundles thus resulted in increased

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cost in mail processing, and still required casing by a letter carrier to sequence for delivery. These factors coupled with the software system challenges, had a direct correlation with reported costs. Such transitional “growing pains” were at their worst in the quarters immediately following implementation, and then apparently began to ease as actual operations moved closer into alignment with the intended new procedures.

As also shown in Table 1, delivery unit costs for Standard Flats increased by 1.24 cents to 16.5 cents in FY 2014, which is an 8.1 percent increase. As shown in Table 3, included in this estimate is an 8.1 percent increase in city carrier in-office labor unit costs. If this were adjusted to remove the potential overstatement of in-office city carrier labor costs of 1.8 percent identified in USPS-FY14-45, then the rise in city carrier in-office labor unit costs would be 6.1 percent.

The increase in city in-office costs is explained by two factors. One, Standard Flats volume on city routes declined by 6.3 percent in FY 2014 as compared to a 9.2 percent decline in originating volume. Since city carriers handled a higher proportion of

Table 3: Comparison of FY 2013 and FY 2014 City Carrier In-Office Labor Unit Costs without and with IOCS Adjustment (Cents/Piece)			
	Unadjusted	Adjustment Factor	Adjusted
FY13	6.93		6.93
FY14	7.49	0.9820	7.36
Difference	0.56		0.43
Percentage Change	8.1%		6.1%

Standard Flats in FY 2014 than FY 2013, unit costs increased (especially in the office time, which has a much higher elasticity than street time). Two, Standard Flats FSS

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volume on city routes decreased by 11.2 percent as compared to a 9.2 percent decline in originating volume. Standard Flats not processed on FSS equipment are manually cased in the office. Thus, FY 2014 had city carriers casing a higher proportion of Standard Flats, resulting in higher in-office unit costs.

Also, city carrier street costs and rural carrier costs for Standard Flats each increased by two-tenths of a cent in FY 2014. City carriers handling a higher proportion of Standard Flats in FY 2014 also drove the increase in street costs, but the magnitude is less due to the lower elasticity of street time. Rural carrier costs also rose two-tenths of a cent. Rural carrier costs rose because they were compensated more for both cased and FSS flats. In FY 2014, rural carriers received 7.51 and 1.57 cents per delivered cased and FSS flat respectively, as compared with 7.33 and 1.53 cents in FY 2013.

Increases in costs of contract transportation, along with VSD and Other, contributed a total of 0.70 cents to the increased unit costs. As shown in Table 1, there were significant rises in percentage terms for contract transportation and VSD. The issues described in the preface of USPS-FY14-37 (IOCS Documentation) and in USPS-FY14-45 may be a factor explaining some of these increases.

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4. In its FY 2013 Annual Compliance Report (FY 2013 ACR), the Postal Service stated that “[the Flats Sequencing System (FSS)] has increased the mail processing costs of Flats as the sequencing activity has moved from delivery to mail processing. However, these increased costs are offset by lower delivery costs.” FY 2013 ACR at 23. From FY 2013 to FY 2014, mail processing costs for Standard Mail Flats rose approximately 9 percent. *Compare* Library References USPS-FY14-11 *and* USPS-FY13-11. Over this same period, delivery costs for Standard Mail Flats rose approximately 8 percent from FY 2013 to FY 2014. *Compare* Library References USPS-FY14-19 *and* USPS-FY13-19.
- a. Please explain why both mail processing and delivery costs for Standard Mail Flats rose from FY 2013 to FY 2014.
 - b. To the extent the rise in mail processing costs was driven by FSS implementation, please explain why these increases were not offset by decreases in delivery costs.

RESPONSE:

- a-b. Please see the response to Question 3 of this Chairman’s Information Request.