

ORDER NO. 2839

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

Before Commissioners:

Robert G. Taub, Acting Chairman;
Tony Hammond, Vice Chairman;
Mark Acton; and
Nanci E. Langley

Periodic Reporting
(Proposal Seven)

Docket No. RM2015-16

ORDER APPROVING ANALYTICAL PRINCIPLES
USED IN PERIODIC REPORTING
(PROPOSAL SEVEN)

(Issued November 25, 2015)

I. INTRODUCTION

The Postal Service filed a petition under 39 C.F.R. § 3050.11 proposing an analytical principle to estimate workshare cost avoidances and passthroughs for Presorted Flats Sequencing System (FSS) mail.¹ For the reasons discussed below, the Commission approves Proposal Seven.

¹ Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Seven), August 5, 2015 (Petition). The Postal Service concurrently filed a public library reference containing workbooks relating to both the mail processing cost section and the delivery cost section of Proposal Seven. Notice of Filing of USPS-RM2015-16/1, August 5, 2015.

In addition, consistent with past Commission practice, the Commission is concurrently filing a library reference consisting of the revised workshare cost avoidance models approved under Proposal Seven.² This Order provides background information, describes Proposal Seven, addresses related filings, and presents the Commission's analysis and conclusion.

II. BACKGROUND

On May 7, 2015, the Commission approved new Presorted FSS prices and workshare discounts for Standard Mail, Periodicals, and Package Services.³ The Commission also directed the Postal Service "to file a proposed methodology for determining the costs avoided for the Presorted FSS workshare discounts, as described in the body of [Order No. 2472], within 90 days of [May 7, 2015]." Order No. 2472 at 62.

On August 5, 2015, the Postal Service filed a petition seeking initiation of a proceeding to consider Proposal Seven. See *generally* Petition. On August 11, 2015, the Commission issued Order No. 2654 establishing the instant docket for consideration of the Petition, designating a Public Representative to represent the interests of the general public, and establishing deadlines for filing comments and reply comments.⁴ The Chairman issued, and the Postal Service responded to, an information request.⁵ The Public Representative⁶ and Pitney Bowes Inc. (Pitney Bowes)⁷ filed comments on

² See Notice of Filing of Library Reference PRC-LR-RM2015-16/1, November 25, 2015.

³ Docket No. R2015-4, Order on Revised Price Adjustments for Standard Mail, Periodicals, and Package Services Products and Related Mail Classification Changes, May 7, 2015, at 19 (Order No. 2472).

⁴ Notice of Proposed Rulemaking on Analytical Principles Used in Periodic Reporting (Proposal Seven), August 11, 2015 (Order No. 2654).

⁵ Chairman's Information Request No. 1, August 20, 2015; Responses of the United States Postal Service to Questions 1-5 of Chairman's Information Request No. 1, August 27, 2015 (Response to CHIR No. 1).

⁶ Public Representative Comments in Response to Order No. 2654 Concerning Rulemaking on Analytical Principles Used in Periodic Reporting (Proposal Seven), September 25, 2015 (PR Comments).

⁷ Comments of Pitney Bowes Inc., September 25, 2015 (Pitney Bowes Comments).

September 25, 2015. The Postal Service filed reply comments on October 16, 2015.⁸ No additional comments were received.

III. PROPOSAL SEVEN

A. Summary

The Postal Service proposes a methodology to estimate avoided costs for Standard Mail and Periodicals Presorted FSS mail. Petition, Proposal Seven at 1, 4. The Postal Service bifurcates Proposal Seven into mail processing and delivery cost avoidance elements. *Id.* at 1. Concerning Package Services Presorted FSS mail, the Postal Service identifies delivery costs for FSS and Non-FSS Bound Printed Matter (BPM), but does not provide a worksharing cost avoidance.⁹ The Postal Service states that Proposal Seven does not contain a BPM flats cost study because there is not currently a BPM flats mail processing cost model. Status Report at 1-2 n.1. The Postal Service notes that if it is feasible to develop a separate and distinct mail processing cost model for BPM flats and parcels, it will file a separate proposal with the Commission. *Id.*

B. Current Methodology

There is no current accepted methodology for measuring workshare cost avoidances or passthroughs for Presorted FSS mail. Order No. 2472 at 29.

⁸ Reply Comments of the United States Postal Service Regarding Proposal Seven, October 16, 2015 (Postal Service Reply Comments).

⁹ On August 5, 2015, concurrent with its filing in this docket, the Postal Service filed a Status Report in Docket No. R2015-4 informing the Commission of its response to the directives in Order No. 2472, which included the directive for the Postal Service to propose a methodology for determining the Presorted FSS workshare cost avoidances and passthroughs for BPM. Docket No. R2015-4, Status Report of the United States Postal Service in Response to Order No. 2472, August 5, 2015 (Status Report).

C. Section One: Proposed Method for Calculating Mail Processing Cost Avoidances

The Postal Service seeks to modify the methodology used in the USPS-FY14-11 Standard Mail Flats Mail Processing Cost Model (Standard Flats Model) and the USPS-FY14-11 Periodicals Flats Mail Processing Cost Model (Periodicals Flats Model) in Docket No. ACR2014 to estimate the mail processing cost avoidances of Presorted FSS mail. Petition, Proposal Seven, Section One at 1–4.¹⁰

There are nine modifications proposed by the Postal Service in Section One of Proposal Seven, all of which apply to the Standard Flats Model. *Id.* at 4. Two of the proposed modifications also apply to the Periodicals Flats Model. *Id.*

1. Revision of the Methodology Used to Estimate the Proportion of Flats Processed in Mechanized Incoming Secondary Operations

The Postal Service proposes a process to estimate the proportion of flat-shaped mail processed in mechanized incoming secondary operations (proposed Modification One). *Id.* at 4–8. Although over 98 percent of flats destinate in the service territories of plants that have mechanized equipment, certain facilities choose to perform the incoming secondary sortation manually for a variety of reasons, including low volume, service commitments, and operating window/capacity restraints. *Id.* at 4–5. The Postal Service asserts that proposed Modification One would account for the two different technologies performing mechanized incoming secondary sortation—the Automated Flats Sorting Machine 100 (AFSM 100) and the FSS. *Id.* at 5. The Postal Service also represents that proposed Modification One would exclude letter-shaped mail worked in flat operations, pieces entered in Carrier Route bundles that have broken and therefore require incoming secondary sortation, pieces rejected from FSS operations, and pieces

¹⁰ The Postal Service filed proposed changes to the Periodicals Flats Model in Docket No. RM2015-18. See Docket No. RM2015-18, Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Nine), August 5, 2015, Proposal Nine at 2.

destinating in FSS zones but not sorted on the FSS. See *id.* at 5–8. Proposed Modification One applies to both the Standard and Periodicals Flats Models.

2. Changes to Bundle Processing Flows to Account for Increased Mechanized Incoming Secondary Piece Processing

The Postal Service proposes to adjust the bundle flow formulae to correspond to the mechanized incoming secondary piece distribution calculated under Modification One. See *id.* at 8–9. During the incoming primary bundle sort, the Postal Service proposes to isolate 5-Digit bundles poised for processing on mechanized incoming secondary sortation to prevent these bundles incurring an incoming secondary bundle sort. See *id.* The Postal Service explains that bundles for zones worked manually will incur an additional bundle sort at the delivery unit. *Id.* at 9. This proposed modification applies to the Standard Flats Model.

3. Introduction of FSS Bundle Flows

The Postal Service assumes that no FSS bundles will incur a sortation at the delivery unit. *Id.* Aside from this assumption, the Postal Service calculates the bundle flows for FSS bundles using the same methodology used for other bundle types. *Id.* This proposed modification applies to the Standard Flats Model.

4. FSS Presort Piece Model and Costs

The Postal Service states that Presorted FSS pieces flow directly into piece sortation on the FSS—bypassing outgoing primary, outgoing secondary, managed mail, and incoming primary operations. *Id.* The Postal Service represents that it models Presorted FSS pieces using the same basic methodology previously used to model piece flows. *Id.* This proposed modification applies to the Standard Flats Model.

5. Updating 5-Digit Piece Model and Costs

The Postal Service represents that 5-Digit pieces do not flow into FSS operations and proposes to update the 5-Digit piece model accordingly. *Id.* at 10. The Postal Service states that the relative incidence of manual incoming secondary sortation is higher for 5-Digit pieces by a factor of one over one minus the FSS coverage factor. *Id.* This proposed modification applies to the Standard Flats Model.

6. Updating Mixed ADC, ADC, and 3-Digit Models for Incoming Secondary Coverage

The Postal Service proposes to update the area distribution center (ADC), mixed ADC, and 3-Digit models to incorporate the recalculation of the mechanized incoming secondary sortation. *Id.* This proposed modification applies to the Standard Flats Model.

7. Explicit Modeling of Mail Preparation

The Postal Service represents that the current Standard Flats Model includes the hours associated with mail preparation for the FSS in the FSS productivities calculation. *Id.* at 11. However, because AFSM 100 preparation costs are included in the calculation of the AFSM 100 productivities, the Postal Service observes that a portion of the AFSM 100 preparation costs are allocated incorrectly to Presorted FSS pieces through the Cost and Revenue Analysis (CRA) adjustment factor. *Id.* The Postal Service proposes to model AFSM 100 preparation costs using the methodology used in the Periodicals Flats Model. *Id.* This proposed modification applies to the Standard Flats Model.

8. CRA Adjustment Factor Adjusted for the FSS

The Postal Service uses the CRA adjustment factor to calibrate the model to CRA costs and to distribute non-modeled costs to the appropriate rate category (proposed Modification Eight). *Id.* The Postal Service states that applying the CRA

adjustment factor as is done in the current methodology would distort measured cost avoidances by over-distributing non-modeled costs to Presorted FSS pieces. *Id.* at 12. The Postal Service states that the lower productivity and higher piggy-back factor associated with the FSS causes this distortion. *Id.* The Postal Service represents that it will calculate the CRA adjustment factor to ensure the non-modeled costs distributed to Presorted FSS pieces are equal to those distributed to 5-Digit pieces. *Id.* This proposed modification applies to the Standard Flats Model.

9. FSS Realization Factor

The Postal Service represents that the proposed FSS Realization Factor measures the proportion of FSS eligible mail that the Postal Service actually processes on the FSS. *Id.* at 12–13. According to the Postal Service, this FSS Realization Factor illustrates that mail destinating in a FSS zone and arriving after the end of first-pass processing may be processed on the AFSM 100, rather than the FSS, to avoid delay. *Id.* This proposed modification applies to both the Standard and Periodicals Flats Models.

D. Section Two: Proposed Method for Calculating Delivery Costs

The Postal Service proposes to disaggregate delivery costs for Periodicals Flats, BPM Flats, Standard Flats, and Carrier Route Flats (not including High Density or Saturation) between those destinating in FSS zones and those destinating in non-FSS zones. Petition, Proposal Seven, Section Two at 1. The proposed method would rely upon operational assumptions and models rather than data directly collected from cost systems. *Id.* at 3. Proposal Seven would disaggregate costs into FSS zone costs and non-FSS zone costs within three costs segments: Cost Segment 6, City Carrier In-Office Activities; Cost Segment 7, City Carrier Street Activities; and Cost Segment 10, Rural Carriers Office and Street Activities. *Id.* at 4–9.

IV. ADDITIONAL INFORMATION, COMMENTS, AND REPLY COMMENTS

A. Postal Service Responses to Chairman's Information Requests

The Postal Service's response to Chairman's Information Request No. 1 clarifies the rationale for Proposal Seven. See Response to CHIR No. 1, questions 1–5. The Postal Service represents that it lacks reliable measures of destinating volumes per 5-Digit zone by class and therefore currently uses volume per delivery point by 3-Digit zone to estimate volume per 5-Digit zone by class. *Id.* question 3. The Postal Service represents that it will not continue to make these estimates beyond FY 2015, after which the volume of mail destinating in FSS zones will be more readily ascertainable. *Id.*

B. Public Representative Comments

The Public Representative supports Proposal Seven. PR Comments at 2. The Public Representative supports the Postal Service's nine proposed modifications to calculating mail processing cost avoidances. *Id.* at 2–5. The Public Representative also supports the Postal Service's proposal to disaggregate delivery costs between flats destinating in FSS Zones and those destinating in non-FSS Zones. *Id.* at 5. The Public Representative suggests reporting the total proportion of flats not finalized on FSS equipment as 24 percent, rather than as 25 percent. *Id.* at 6.

C. Pitney Bowes Comments

Pitney Bowes takes no position as to whether Proposal Seven is appropriate in the FSS zones. Pitney Bowes Comments at 1. Pitney Bowes comments on the Postal Service's proposal to modify the CRA adjustment factor used in the Standard Flats Model to "insure the non-modeled costs distributed to FSS pieces are equal to those distributed to 5-Digit pieces." *Id.* (quoting Petition, Proposal Seven, Section One at 12). Pitney Bowes notes that the proposed change differs from the current Commission-approved assumption that the Postal Service incurs non-modeled costs

(e.g., allied, platform, inter-operational transit) in proportion to direct modeled costs (e.g., piece handling). *Id.* at 1–2.

Pitney Bowes contends that Proposal Seven lacks support on the record demonstrating that the assumption fails in FSS zones. *Id.* at 2. Specifically, Pitney Bowes observes that the Postal Service has not explicitly modeled allied and platform costs in FSS zones. *Id.* at 2. For these reasons, Pitney Bowes argues that if the Commission approves Proposal Seven, the Commission should limit Proposal Seven's application to FSS zones and order the Postal Service to adhere to the current methodology for all other workshare modeled costs, unless and until the Postal Service explicitly models allied and platform costs. *Id.* at 3.

D. Postal Service Reply Comments

The Postal Service agrees with the Public Representative's observation that the delivery model formula could be modified, but maintains that the formula reasonably approximates the estimated total proportion of flats not finalized on FSS equipment to 25 percent. Postal Service Reply Comments at 1. In response to Pitney Bowes' proposed limitation, the Postal Service asserts that there is a compelling need to deviate from the Commission's established general methodology for distributing allied and support cost to appropriately present the costs of and costs avoided by mail in the new category of FSS flats. *Id.* at 2. The Postal Service clarifies that it does not propose any global change in the Commission's general approach to avoided costs. *Id.* at 2-3. The Postal Service asserts that it has sufficiently supported Proposal Seven and urges the Commission to approve Proposal Seven without alteration. *Id.* at 3.

V. COMMISSION ANALYSIS

Accepted analytical principles may be changed to improve the quality, accuracy, or completeness of the Postal Service data or analysis underlying the ACR. See 39 C.F.R. § 3050.11(a). Based upon a review of the Postal Service's filing, supporting workpapers, response to the information requests, and comments, the Commission

finds that Proposal Seven improves the completeness of the Postal Service's data and analysis by providing formal methodologies to estimate the costs avoided by the new Presorted FSS mail categories approved in Order No. 2472. The avoided costs models will facilitate the Commission's evaluation of the new Presorted FSS workshare discounts in the Annual Compliance Determination for compliance with 39 U.S.C. § 3622(e) and Commission regulations.¹¹ The Postal Service has modified the worksharing cost models to estimate avoided costs by rate category, consistent with the approach required for use in compliance evaluations.

The Commission is not persuaded by Pitney Bowes' arguments concerning the calculation of the CRA adjustment factor in proposed Modification Eight to the Standard Flats Model. As noted in the Postal Service's Reply Comments, the modification is only intended to account for Presorted FSS mail, and the Postal Service is not proposing a global change to how the CRA adjustment factor is calculated for other mail categories. Postal Service Reply Comments at 2. The CRA adjustment factor distributes non-modeled costs on the basis of the modeled costs. In practice, this means that a rate category with a modeled cost of 8 cents will be allocated twice the non-modeled costs as a rate category with a modeled cost of 4 cents. This practice works well when all rate categories are processed using similar operations with similar productivities. The FSS operation is primarily used for Presorted FSS mail, and has comparatively higher per-sortation cost than other forms of sortation. The high modeled cost of the FSS operation means that the proportional approach for allied costs may not be appropriate. Consequently, the Commission finds that the Postal Service's approach reasonably details the costing relationship between 5-Digit and FSS flats. The Commission encourages the Postal Service to continue to analyze the use of non-

¹¹ The Public Representative notes that the proportion of flats destinating in FSS Zones that are not finalized on FSS equipment should be corrected by rounding down to 24 percent rather than the Postal Service's proposed 25 percent. PR Comments at 6. The Commission adopts the correction, as it will improve the accuracy of the avoided costs model.

modeled operations by AFSM 100 and Presorted FSS mail after the new pricing categories go into effect.

Concerning the accuracy of the FSS operations, the Commission also encourages the Postal Service to continue to improve the model as better data become available. The new Presorted FSS workshare discounts went into effect near the end of FY 2015. In its Response to CHIR No. 1 and in its reply comments, the Postal Service acknowledges data limitations with its models estimating the workshare avoided costs of Presorted FSS mail. Specifically, FSS volumes by 5-Digit zone are not currently available and will need to be estimated. Response to CHIR No. 1, question 3. Additionally, a significant amount of volume previously mailed at Carrier Route product prices will shift to Standard Flats product prices due to the new FSS pricing requirements. *Id.* question 5. The Commission will carefully review the workshare avoided costs models in future Annual Compliance Review proceedings to examine the impact of the new FSS prices and related mail preparation requirements to ensure that the models continue to appropriately reflect the Postal Service's operations and the best available data.

In conclusion, the Commission approves the Postal Service's proposed methodology to estimate the workshare avoided costs for the new Presorted FSS mail categories approved in Order No. 2472 by: (1) modifying the Standard and Periodicals Flats Models to estimate the mail processing avoided costs for Presorted FSS mail; and (2) disaggregating the delivery costs for Standard Flats, Carrier Route Flats, Periodicals Flats, and BPM Flats between those destinating in FSS zones and those destinating in non-FSS zones to estimate the delivery avoided costs of FSS mail. In Library Reference PRC-LR-RM2015-16/1, the Commission is filing the mail processing and delivery avoided costs models approved under Proposal Seven.

VI. ORDERING PARAGRAPH

It is ordered:

For purposes of periodic reporting to the Commission, the Commission approves the changes in analytical principles, with the slight modification described in the body of this Order, proposed by the Postal Service in Proposal Seven.

By the Commission.

Stacy L. Ruble
Secretary