

**BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON DC 20268-0001**

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

**TRIAL BRIEF OF
ALLIANCE OF NONPROFIT MAILERS
AMERICAN BUSINESS MEDIA
COALITION OF RELIGIOUS PRESS ASSOCIATIONS
DOW JONES & COMPANY, INC.
MAGAZINE PUBLISHERS OF AMERICA, INC.
NATIONAL NEWSPAPER ASSOCIATION
THE MCGRAW-HILL COMPANIES, INC.
TIME WARNER INC.**

(June 29, 2000)

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more than \$320 million annually. The extraordinary size of the proposed increase is driven, according to the Postal Service, by the Act's requirement that "each class of mail or type of mail service bear the direct and indirect postal costs of that class or type" 39 U.S.C. 3622(b)(3).

Periodicals Mailers maintain that the proposed Periodicals increase instead is driven by the Service's failure to: (1) reasonably project its future revenue needs; (2) acknowledge and implement mail processing, make-up, transportation, and other *operational efficiencies that will reduce periodicals costs by more than \$150 million in the 2001 Test Year*; and (3) accurately measure and attribute its costs associated with Periodicals mail. We also suggest several rate design changes that will improve postal operations.

I. WHY PERIODICALS MAILERS ARE ACTING COLLECTIVELY.

Periodicals Mailers here take the still unusual, although no longer unprecedented, step of acting in concert in an omnibus postal rate proceeding.² We have forgone testimony and arguments about various rate design issues that could benefit one segment or another of the Periodicals Class. Instead, we have joined together in this brief and in planning and coordinating testimony in this case – that sponsored jointly and by individual intervenors. We do so for two reasons.

First, despite testimony by Periodicals industry witnesses in past rate cases, admonitions by the Commission, increased (and costly) worksharing by the Periodicals industry,³ and identification by the Postal Service and Periodicals Mailers of substantial

² See Docket No. R97-1, Trial Brief of Alliance of Nonprofit Mailers, American Business Press, Coalition of Religious Press Associations, Dow Jones & Company, Inc., Magazine Publishers of America, National Newspaper Association, The McGraw-Hill Companies, Inc., and Time Warner Inc. at 4-8.

³ TW-T-1 at 11 (Stralberg); MPA-T-1 at 7-8 (Cohen).

savings that can be achieved through operational efficiencies,⁴ the Postal Service in this docket claims that Periodicals costs continue to increase at an alarming rate. According to the Postal Service, the trend continues unabated of Periodicals costs increasing faster than postal employee wages and faster than costs for all mail. In mail processing alone, according to the Postal Service, Periodicals costs have increased since 1983 at twice the rate of the same costs for all mail and of clerks' and mailhandlers' wage rates. TW-T-1 Exhibit 1.⁵ Clearly, this cannot be allowed to continue. As Time Warner witness Stralberg points out:

In this docket, the Commission has taken the lead in seeking explanations of why, at a time when the Postal Service claims unprecedented success in simultaneously lowering costs and improving service for letter mail, it continues to report ever-higher costs for flat mail, in particular Periodicals flats. But the record established on this issue so far is unhelpful and even rather misleading, because the Postal Service's response through various witnesses has mostly served to obscure the extent of the problem. (Emphasis added).

TW-T-1 at 9. We join together to clarify the record and establish that this unacceptable trend can, and will, be abated by the beginning of Test Year 2001.

Second, while the Postal Service claims its proposed average increase for Outside County Periodicals mail is 12.7 percent, USPS-T-32 at 32 (Mayes), USPS-T-38 at 6 (Taufique), virtually all Periodicals Mailers expect to face increases in the 14-16 percent range or more. This is true regardless of the size of the mailer, the nature of the publication, or the extent to which the mailer is able to take advantage of various

⁴ Report of the Periodical Operations Review Team, USPS-LR-I-193.

⁵ See also the testimony of MPA witness Little, "from fiscal year 1986 through fiscal year 1996, Periodicals mail processing unit costs have increased 71 percent." Docket No. R97-1, Tr. 15/14545.

worksharing discounts.⁶ The average Periodicals increase is more than twice the average increase proposed for all types of mail, three times the increase in the rate of inflation since the last postal rate increase, and more than twice what Periodicals Mailers believe is necessary or appropriate under the Act. We are all in the same boat, and some may drown unless the tide of inexplicably large Periodicals cost increases is turned. We ask the Commission to help the Postal Service and Periodicals Mailers turn that tide.

II. SYNOPSIS OF TESTIMONY

The Commission has expressed concern yet again in this docket about the inordinate Periodicals cost increases that the Postal Service says necessitate a large rate increase. It asked for an explanation from a Postal Service witness with “high-level managerial responsibility of flat handling operations” PRC Order No. 1289 (March 28, 2000) at 1. Unfortunately, the witnesses provided, O’Tormey (USPS-T-42) and Unger (USPS-T-43), afforded little help in understanding past cost trends. As witness Stralberg observed:

During their oral cross-examination, it became quite clear that Unger and O’Tormey having been drafted to help explain the rising costs, in reality have no idea why Periodicals costs have gone up. Neither witness knows how the Postal Service attributes costs. Both address the issue from the point of view of operations, and from that point of view it really makes no sense that Periodicals costs should have gone up. Unger in particular does not seem to believe that they have gone up. See, e.g., Tr. 15/8282, 8357

In summary, it appears that O’Tormey and Unger were chosen by the Postal Service to respond to Order 1289 without being fully informed of the problem faced by Periodicals Mailers, whose reported costs have increased at alarming rates for many years, and without knowing any more about the underlying causes than Postal Service witnesses chosen to address the issue in previous dockets.

⁶ See MPA-T-1, Attachment A.

TW-T-1 at 15, 18.

The testimony of our witnesses, however, explains the original and continuing causes and the severe impact the rate increases proposed by the Postal Service would have on the industry, and it establishes that increases of that size are unnecessary and unjustified the Postal Reorganization Act.

A. The impact of the proposed increases is severe for virtually all Periodicals Mailers, large and small alike.

We begin with Magazine Publishers of America (MPA) witness Cohen who points out that the true increase for most Outside County Periodicals is 14-16 percent, not the 12.7 percent claimed by the Postal Service. MPA-T-1 at 34-35. For the 147 MPA members who responded to MPA's most recent postal survey the average increase is 14.9 percent. Id. at 38-40. "[T]here is an unprecedented degree of consistency to the rate increase facing MPA's membership. Despite public statements by the Postal Service that smaller commercial mailers are facing modest increases, the average increase for smaller-circulation magazines within MPA is every bit as high as for larger-circulation magazines." Id. at 35. In fact, of the 147, only three anticipated increases of less than the 12.7 percent claimed by the Postal Service as the average. Ibid.

Several Periodicals Mailers witnesses describe the adverse impact of the proposed rates on smaller-circulation Periodicals. American Business Media (ABM) witness Morrow is Executive Vice President/ Operations of Crain Communications, whose core business is publication of Periodicals primarily intended for the business-to-business market. ABM-T-1 at 1. He reports that the weighted average proposed increase for 20 Crain publications with circulations of 6,000 to 65,000 (along with its consumer title) is

14.76 percent. Id at 3-4 and Attachment 1. He also states that Cahners reports an average increase of 14.62 percent for 45 of its publications. Id. at 4 and Attachment 2. Coalition of Religious Press Associations (CRPA) witness Stapert notes that more than half of the publications he represents have circulations of 20,000 or less. CRPA-T-1 at 2. He estimates that the rates proposed will result in an increase as much as 21.8 percent for a typical religious publication. Id at. 7. National Newspaper Association (NNA) witness Heath, vice president/executive editor for Landmark Community Newspapers, Inc., testifies that “[t]he announced average increases for regular rate periodicals were 13.5% and for in-county 8.5%. However, the true impact of the proposed rates upon newspapers within Landmark Communications newspapers ranges from 9.8 percent to in-county mail to 16.2 percent for regular rate mail.” NNA-T-1 at 18. According to Victor Navasky, publisher and editorial director of *The Nation*, the proposed rates would mean an 18.6% increase in postage costs for his magazine. NA-T-1 at 4. Alliance of Nonprofit Mailers (ANM) witness Milani, Senior Director – Business Affairs and Strategic Marketing, Consumers Union, expects a double-digit rate increase for this publication if the proposed Periodicals rates are approved. ANM-T-2 at 5.

All in all, if the Postal Service’s proposed Periodicals rates are approved the consequences will be severe:

Crain Communications is a successful company, and it is not my testimony that this postage increase, if approved, would be financially ruinous. But is it my testimony that an increase of this magnitude will have a significant impact on our operations and, perhaps most tellingly, could stifle the development of new periodical products that will benefit not only Crain but also the Postal Service.

ABM-T-1 at 5 (Morrow).

Since I became editor in 1986 [of the *Virginia United Methodist Advocate*, 15,000 subscribers], we have increased subscription rates from an initial \$7.50 per year for 26 issues to today's \$15.00 per year for 17 issues. That constitutes a 100% increase in cost for 27% less product. Since postage is a large part of our operating expenses, the significant increases religious and nonprofit publications have had to absorb in the last five years have been a substantial factor in our frequency reductions. . . We cannot simply absorb another postal increase of this magnitude. . . .

CRPA-T-2 at 5. (Horton).

Increases of this magnitude, particularly so soon on the heels of the increases from R97-1, can have no effect but to drive mail [newspapers] out of the mailstream that would otherwise be there. I believe that the benefit of the rising newspaper circulations discussed in Witness Elliott's testimony (NNA-T-2) will be lost to the Postal Service if increases of this magnitude continue to emerge from the Postal Service.

NNA-T-1 at 19 (Heath).

Consumers Union is a major customer of the Postal Service. We pay postage on approximately 200 million pieces of mail per year: roughly 70 million pieces of Periodical mail, 120 million pieces of Standard A mail, and ten million pieces of First Class mail. After salaries, postage is our largest expense, representing about \$30 million of our \$147 million annual budget. On average, each one-penny increase in postal rates increases our expenses by about \$2 million.

ANM-T-2 at 4 (Milani).

B. The Postal Service overstates its revenue needs and the contingency amount requested, particularly with respect to Periodicals.

Fortunately, the testimony of Periodicals Mailers witnesses provides the Commission with several opportunities to reduce the proposed Periodicals increase and to moderate these adverse impacts consistent with the evidentiary record. Apart from

reflecting the cost reductions, both confirmed and (as of now) not agreed to by the Postal Service, and the re-attributions addressed in the following sections, the Commission should reduce the Periodicals contingency allowance from the requested 2.5 percent to zero.

Witness Buc, DMA-T-1, testifying on behalf of the Periodicals Mailers and a broad range of parties with interests in other classes of mail, analyzes Commission precedent and the scanty support offered by the Postal Service for its 2.5 percent contingency request. He concludes that such request "is neither reasoned nor reasonable. . . ." Id. at 2. Office of Consumer Advocate (OCA) witnesses Burns, OCA-T-2, and Rosenberg, OCA-T-3, present a similar analysis of financial risk and need, and share Buc's conclusion that a contingency of 1 percent is appropriate in this proceeding.

Periodicals Mailers witness Morrow, ABM-T-1, advances this issue by proposing that, whatever level of contingency might be found to be appropriate for other classes of mail, "based upon the unique circumstances here, it would be appropriate to eliminate any contingency allowance in the costs attributed to periodicals." Id. at 3. An experienced accountant, Mr. Morrow explains first that there is no valid reason that a contingency allowance should be at the same level for all postal products (even though, historically, that has been the case). *See id.* at 2,3,5-7. He then shows that Periodical cost savings in the test year greater than those that can be readily quantified and incorporated into the test year cost-of-service should offset the unknown increases that might otherwise justify a positive contingency. Id. at 13-15. Witness Stapert, CRPA-T-1, supports the contingency proposals of both witnesses Buc and Morrow on the basis of the Postal Service's recent financial performance.

C. Joint industry/Postal Service efforts to reduce costs have identified steps that will reduce Test Year 2001 costs by more than \$150 million.

Spurred by urgings from the Commission⁷ and from the Periodicals industry, the Postal Service in 1998 established a joint industry/USPS Periodicals Operations Review Team (Team). Witness Cohen recounts the work of the Team, MPA-T-1 at 9-11,⁸ and Time Warner witness O'Brien reviews the Team's fifteen recommendations for improving both Postal Service and mailer practices in order to reduce Periodicals costs. TW-T-2 at 4-21; *see also*, Report of the Periodicals Operations Review Team, USPS-LR-I-193. The Team did not develop specific cost savings estimates related to its recommendations, TW-T-2 at 26, and Periodicals Mailers were disappointed when the Postal Service, with one exception, failed when it filed its rate request to quantify savings that will be achieved from implementation of these recommendations. O'Brien testifies that "it now appears that we have the full attention of Postal Service management and that change is taking place very quickly in an effort to implement many of these recommendations." TW-T-2 at 26. The Postmaster General has assured the Congress that at least \$150 million in operational cost savings will be achieved. MPA-T-1 at 18 n. 1.

D. Identified Test Year savings confirmed by the Postal Service and already established on this record.

There has been significant progress since the case was filed in identifying, on the record, Test Year 2001 cost savings that were not included in the Postal Service's initial filing. Witness Cohen describes seven cost reduction programs that the Postal Service has

⁷*See, e.g.*, PRC. Op. R97-1, para. 3148, 3187. "The presort mailers argue that the rapid growth in mixed mail and not handling costs reflects automaton refugees or other inefficiencies associated with automation. The Commission finds that circumstantial evidence for this inference is inconclusive, but *warrants systematic investigation*. It makes a similar finding with respect to the rising unit processing costs of periodicals mail. . . . The Commission urges the Postal Service to make a mores systematic inquiry into the rising not handling costs, as these witnesses suggest." (Emphasis added).

⁸ *See also* USPS-ST-43 (Unger).

already implemented or intends to implement by the 2001 Test Year, but for which it did not quantify expected savings in its direct case. See MPA-T-1 at 12-17. These initiatives, the Postal Service and Periodicals Mailers agree, will reduce Periodicals Test Year costs by *at least* \$77 million. Cohen, based on her work and that of witnesses Stralberg, TW-T-1, Buc, DMA-T-1, and Glick, MPA-T-2, believes that Periodicals savings from these initiatives will reach \$111 million. See MPA-T-1 at 3 (Table 1).

E. Bundle breakage mitigation, AFSM 100, rural carrier, transportation, and other identified Test Year savings.

There are a number of possible remedies that together could lead to substantial cost reductions, including better bundle strapping, use of pallets rather than sacks, improved bundle sorting methods, alternatives to today's SPBS feed systems, and better efforts at salvaging partially broken bundles.

Team Report at 24.

The Postal Service estimates that there will be savings of \$15 million in the Test Year from improved mail make up procedures. Response to MPA/USPS-ST-42-10. Witness Glick "quantifies the size of the bundle breakage problem, summarizes the Team's recommendations, describes Postal Service and Industry efforts in this area, and estimates the Test Year Cost savings that will result from reduced bundle breakage and improved bundle recovery methods." MPA-T-2 at 15; *see also* id. at 16-23. Glick estimates Test Year savings of \$21 million based on a 50 percent reduction in breakage as opposed to the 25 percent reduction anticipated by the Postal Service. Id. at 15. Cohen agrees that "a 50 percent reduction in bundle breakage is easily achievable." MPA-T-1 at 15.

According to Postal Service witness Kingsley, the Automated Flats Sorting Machine 100 (AFSM 100) “represents a first step into the future processing environment that is envisioned for flats. . . .The processing and technological capabilities of this machine are vastly superior to those [of earlier versions of flat sorters].” USPS-T-10 at 11 (Kingsley). Deployment of this equipment began in March 2000. Ibid. Witness Tayman projects Test Year cost savings from this deployment. USPS-T-9. Witness Buc establishes that Tayman has underestimated Test Year savings that are attributable to the introduction of the AFSM 100 by at least \$202.1 million. DMA-T-1 at 19-23; Direct Marketing Association, Inc., Notice of Revisions to Testimony of Lawrence G. Buc (DMA-T-1)(June 23, 2000). Witness Cohen shows that Buc’s correction “reduces Periodicals costs by an additional \$28 million in the Test Year.” MPA-T-1 at 17.

Witness Glick presents an improvement to the Postal Service’s rural carrier mail shape adjustment, which corrects for definitional differences between the National Mail Count (NMC) and the Rural Carrier Cost System (RCCS). MPA-T-2 at 2, 11-15. Cohen establishes that use of Glick’s methodology reduces Base Year Periodicals costs for rural carriers by \$13 million. MPA-T-1 at 31.

MPA witness Nelson presents a refinement of the analysis of driving time on motorized letter routes that was introduced by the Postal Service in Docket No. R97-1. It identifies and accounts for an interaction between volume-driven looping points and volume-driven dismounts that was not incorporated in the Docket No. R97-1 analysis. As a result, the volume variability of driving time is reduced from 40.99 percent to 32.15 percent. MPA-T-3 at 10-12.

CRPA witness Stapert points out disturbing increases in purchased transportation costs for Periodicals – an average annual increase of 6.5 percent per year from 1995-1998. CRPA-T-1 at 9-12. “Publishers, like nonprofit and religious organizations, which use the USPS transportation system for national distribution of their periodicals, require effective relief from this unfair burden now.” Id. at 12. MPA witness Nelson identifies significant transportation cost savings for Periodicals (and other mail) in Test Year 2001. MPA-T-3. Cohen supports his findings. MPA-T-1 at 31-33.

The savings identified by Nelson arise from two principal sources. First, he identifies a series of ways in which Postal Service costing methods do not accurately measure the surface transportation costs associated with different mail subclasses. MPA-T-3 at 4-10. Second, he identifies ways in which the transportation services procured by the Postal Service are unnecessarily costly in satisfying overall transportation requirements. Id. at 4-10.

Nelson’s testimony on costing methods focuses primarily on the determination of volume variability for purchased highway transportation. Nelson illustrates how Postal Service witness Bradley’s quantitative analysis of volume variability for purchased highway transportation costs is inconsistent with the Postal Service’s own description of its operating practices. He presents a corrected methodology that accounts for the fact that service and schedule requirements provide the Postal Service with a great deal of latitude to adjust transportation capacity by making comparatively inexpensive changes in vehicle sizes without changing the numbers of trips operated. Id. at 4-9; MPA-LR-5. Nelson concludes that the Postal Service methodology overstates volume variable highway transportation costs for BY 98 by \$87.8 million. Id. at 9.

Also in the area of costing methods, Nelson developed corrections for errors in the Postal Service treatments of costs incurred for movement of "Roadrainers" on Amtrak, and movement of empty equipment via freight rail. "A Roadrainer is a type of trailer that can operate over the highway in a normal tractor/trailer combination, or be quickly adapted to ride on rails. . . ." Id. at 9. Roadrainer service is different from conventional Amtrak service. However, the TRACS process used by the Postal Service to distribute transportation costs does not sample Roadrainers, and thus simply assumes that Roadrainer movements are the same as conventional Amtrak movements. Nelson concludes that the Postal Service Base Year 1998 treatment of Amtrak Roadrainer movements overstates Periodicals costs by \$3.1 million. Id. at 10.

For empty equipment moving via rail, Nelson testifies that such movements include equipment that was or will be used for types of surface transportation other than rail. Because the Postal Service analysis of rail empty equipment movements treats these costs as if they were caused only by the mail that moves on freight rail and Amtrak, it overstates Periodicals Base Year costs by \$5.3 million. Id. at 10; *see also*, MPA-T-1 at 32-33 (Cohen).

In the area of efficiency improvements, Nelson identifies a series of cost reductions in transportation that would be attainable in the Test Year. These include the following:

- Highway Contract Renewal Process - The rates paid by the Postal Service to highway contractors increase to supra-competitive levels when contracts are renewed. Elimination of this unnecessary "premium" would produce Test Year savings for Periodicals of approximately \$3.9 million, and greater savings in the future. MPA-T-3 at 12-13.
- Highway Contract Obsolescence - On average 1.6 percent of highway contracts in effect at any given time are for service that is no longer needed. A program to

identify and renegotiate unneeded contracts prior to their expiration would produce Test Year savings for Periodicals of approximately \$2.0 million. Id. at 13-14.

- Amtrak Premium and Terms – Nelson analyzes the Postal Service’s use of Amtrak, and concludes that a substantial premium is being paid to Amtrak in comparison with the cost of equivalent highway transportation. He proposes three different mechanisms through which the Postal Service could rectify this situation, and concludes that \$15.4 million in savings for Periodicals could be achieved in the Test Year. Id. at 14-16.
- Freight Rail Rates – The Postal Service does not currently benefit from volume incentive rates or discounts in its use of freight rail, and changes in the transportation marketplace make it likely that such terms will be readily available to the Postal Service in the Test Year. Taking advantage of these terms could reduce freight rail costs for Periodicals by \$0.9 million in the Test Year. Id. at 16-17.

Nelson also itemizes a series of efficiency improvements that appear to be attainable in the Test Year, but for which specific savings estimates have not yet been developed. Id. at 18-19. Implementation of any of these improvements would have the effect of further reducing Periodicals costs.

F. Cost attribution and distribution changes.

In Docket No. R90-1, witness Stralberg drew attention to the alarming and seemingly inexplicable growth in mail processing costs for Periodicals (at that time called “second-class mail”) and other manually processed flats since FY 1986. He hypothesized that the phenomenon was a side-effect of the letter mail automation program: specifically, (1) that the Postal Service had allowed a sizable excess mail processing labor capacity to develop rather than capture the full potential savings of letter automation through a concomitant reduction in its labor complement, and (2) that the existing methodology for mail processing cost attribution and distribution (then the IOCS; subsequently, the IOCS plus MODS cost pools) failed to identify the real chains of causality that produced the excess capacity and wrongly attributed most of its cost to Periodicals and other manually processed flats.

Since that time, the subject has received much attention. Yet the trend of disproportionate and inexplicable growth in Periodicals mail processing costs has continued almost without abatement. A Commission rulemaking proceeding, Docket No. RM92-1,⁹ was initiated to seek answers but failed to produce any when the Postal Service refused to cooperate.¹⁰ Questions were raised about the continuing validity of the IOCS, leading to the Postal Service's introduction of a new, MODS-based methodology in Docket No. R97-1 and to the production in 1999 of the Kearney Data Quality Study under the joint sponsorship of the Commission, the Postal Service, and the General Accounting Office. A joint industry/Postal Service Periodicals Operations Review Team was formed to find ways of reining in costs (although the Postal Service refused to consent to the industry's proposal that the Team study issues of cost attribution as well) and, after extensive site visits to mail processing facilities and extensive discussion of its observations in the field, produced an important report that has been the basis for a variety of cost-saving operational measures discussed elsewhere in this brief. Time Warner witnesses O'Brien and Stralberg were members of that Team and MPA witness Cohen was its industry co-chair.

In this docket, as they did in Docket No. R97-1, witnesses Stralberg and Cohen raise serious questions about whether the Postal Service's proposed methodology for attributing and distributing mail processing costs accurately and adequately captures the complex web of causal relationships among various mail processing operations, and about whether it unfairly burdens Periodicals mail with costs for which it bears no causal responsibility or for which its responsibility is tenuously speculative at best. Stralberg testifies:

⁹ Docket No. RM92-1, Petition to Initiate a Rulemaking Proceeding to Consider the Costing of Automation-Related Mail Processing Costs (June 26, 1992). The petitioners were AMMA, Advo, DMA, Dow Jones, Harte Hanks Shoppers, MPA, MOAA, and Time Warner.

¹⁰ The PRC noted that "[t]he petitioners have advanced a disturbing theory that these cost increases have been caused by the automation of First-Class Mail. This Order describes *the actions of the Postal Service which have effectively prevented analysis of the effect of automation on these Postal Service costs.*" PRC Order No. 1002 (January 14, 1994) at 1.

My R97-1 testimony explained in detail my concerns about the numerous unverified assumptions underlying the method introduced by witness Degen and the potential systematic biases caused, for example, by treating pallets (which are used extensively by Periodicals mailers) in a manner inconsistent with the treatment of other containers. Most of the concerns I expressed then are just as relevant today.

TW-T-1 at 25.

Stralberg and Cohen extend and refine their Docket No. R97-1 critical analysis of Postal Service witness Degen's MODS-based cost distribution methodology, particularly with respect to operational evidence regarding the true causes of "not handling" and "mixed mail" costs in allied operations. Stralberg's conclusion is that

it is the mail that requires the most processing steps, generally the "working mail," that drives the need for high staffing levels in allied operations in order to: (1) get the arriving mail unloaded, "prepped" and entered into the processing stream as soon as possible; and (2) get the mail whose sorting has just been completed pulled down and sent to dispatch. It can therefore also be said that this mail is most responsible for the extensive amounts of "not handling" and the often rather slow work tempo that one observes in between these critical periods.

TW-T-1 at 29.

This conclusion receives further support, on both operational and econometric grounds, in the testimony of witness Glick, MPA-T-2 at 3, 7-11, and from witness Cohen, who states:

After my experience on the Team, I am more convinced than ever that allied workload is dependent to a large degree on, and supportive of, the needs of the distribution operations. I concur with witness Stralberg's observations in this regard based on our joint field experience. My Test Year costs incorporate the analyses of witnesses Stralberg and Glick, which refine the distribution of mail processing costs.

MPA-T-1 at 21.

On this basis, Stralberg and Cohen and make several recommendations that, in Stralberg's words, "will not make the IOCS a perfect system [but] will, however, move the distribution of mail processing costs a little more in line with real cost causality." TW-T-1 at 22. Most important among these is "a broad distribution of not handling and mixed mail costs at allied operations . . . until the dynamics causing these costs are better understood." TW-T-1 at 29.

Based on their extensive field observations and experience in the analysis of postal operations and costs, Cohen and Stralberg strongly support Postal Service witness Bozzo's conclusion that mail processing volume variability is less than 100 percent and differs substantially from operation to operation. MPA-T-1 at 21-23; TW-T-1 at 21, n. 16. As witness Cohen explains, Bozzo's testimony also lends support to operational demonstrations of witnesses Stralberg, Glick, and Degen that piece-distribution support is a substantial portion of allied workload. *See* MPA-T-1 at 23-28 ("Based on my experience, I am not surprised that witness Bozzo's empirical evidence demonstrates that volumes at the piece-distribution operations are the primary drivers of allied costs.") *Id.* at 27.

It bears emphasizing, however, that Cohen's and Stralberg's recommended improvements to the Postal Service methodology for distributing mail processing costs do not depend on Bozzo's econometric analysis and are unaffected by the decisions the Commission may make on volume variability of mail processing costs. TW-T-1 at 22.

G. The flawed data from the Engineered Standards/Delivery Redesign project are not reliable and should not be used for costing purposes.

In addition to the problems already identified, the Postal Service in Docket No. R2000-1 attempts to justify the extraordinary increase in Periodicals costs on the basis of its interpretation of the results of an Engineered Standards/Delivery Redesign Project (ES

Study) that is fundamentally flawed, and was, moreover, neither designed nor appropriate for attributing postal costs. *See generally* MPA-T-5 at 2-5.

As MPA witness Hay points out, “[t]he cost of mistaken decisions based upon inappropriate cost estimates” could be “severe” for both mailers and the “credibility” of ratemakers because, “[w]hile the desire for a quick fix” (provided by a “new” study) is understandable, “the risk of making a mistaken decision is much greater to the shareholders and American consumers than any benefit of a quick answer derived from applying non-random and judgmental statistical procedures.” MPA-T-4 at 4. And the ES Study – as witnesses Hay and Crowder demonstrate – was not only conducted in a “non-random and judgmental” way, but, additionally, had “no study design” or “training manuals for enumerators or great concern about consistency of data collection,” lacked “pre-set confidence limits,” showed “weak adherence to consistent random sampling,” followed “no statistical cost study questionnaire,” and was interpreted using “variable decision rules.” MPA-T-4 at 4. For these reasons, witness Hay concludes, its “results must be treated very warily.” *Ibid.*

Instead, however, the Postal Service – which elected to use the ES study only as a *costing* device at the eleventh hour of its preparation of the current case, *see* MPA-T-5 at 6¹¹ – has treated this elusive study¹² not only without wariness, but as the justification for

¹¹ In early March, Witness Raymond testified that the date on which he was made aware that the USPS might “use the ES data in its calculation of postal rates” was “[s]ome time in the August – September 1999 time frame.” Tr. 18/7607. *See also* Tr. 18/7403 (Response to ADVO/USPS-T-13-19 (in which witness Raymond states that “all discussions” regarding the use of the ES study for costing purposes “were verbal, and no records were kept of the content of these discussions”). The Postal Service, however, recently stated that it had originally developed its proposal for a rate increase so that it could be *filed* “in the fall of 1999” – or, according to witness Raymond, at the very same time that the Service decided for the first time to use his ES data as part of the filing. *See* Reply Comments of the United States Postal Service in Response to Notice of Inquiry No. 2 at page 6 (May 15, 2000)(“it must be noted that the Postal Service’s Request was originally developed to *file* in the fall of 1999, and that the decision to postpone filing until after the holidays was made relatively late”).

approximately 23 percent of the overall increase in costs for Periodicals. And it has done so, as witnesses Crowder and Hay make clear, despite the facts that:

- “for samples to contain worthwhile and reliable information about the population, *each* unit of the sample must be selected at *random*, requiring that each element of the population has a known probability of appearing in the sample,” MPA-T-4 at 7, *but* “[t]he sample of routes from which the ES data were collected is exceptionally small. . . was not randomly selected” and “is biased toward large metropolitan areas and areas with relatively higher delivery point growth rates,” MPA-T-5 at 3; *see also id.* at 20-33;
- for a statistical study to be reliable, it must establish “acceptable confidence limits for the desired results,” MPA-T-5, *but* “[n]o confidence levels can be ascribed to [the data of the ES Study] because no sample design was made,” MPA-T-5 at 19; and
- for a statistical survey to be reliable for costing purposes, the questions to be answered must be precisely framed, MPA-T-4 at 12-13; MPA T-5 at 13, *but* “none of the questions that [USPS witness] Raymond answers in his cost study were posed to enumerators” and “[a]ll answers recorded [by the enumerators] were based on a different ‘unspecified’ set of criteria.” *Ibid.*¹³

Additionally, as witness Crowder makes clear:

- the work sampling that was done by witness Raymond’s enumerators “was not a central focus” of the ES Study, and, indeed, “it appears that the time

¹² The testimony of USPS witness Raymond (USPS-T-13) – the author of the ES Study – has been the subject of unfortunately contentious motions practice since March. Despite orders from the Commission in response to successful motions to compel answers to interrogatories directed to witness Raymond, it was not until June (more than a month after witness Raymond was cross-examined) that intervenors received the last of his answers to interrogatories – most of which were originally posed to him in February and March. Moreover, even when compelled, witness Raymond’s answers to interrogatories often confused issues more than clarified them – and, in some instances, sent intervenors on what turned out to be pointless peregrinations, the uselessness of which did not become apparent until May 9, when witness Raymond took the stand. For example, it was not until April 28 that the parties and the Commission were advised – through an answer to an interrogatory that had been posed on March 15 – that more than one set of data existed. *See Tr.* 18/7940-41. And it was not until May 9 – during the first day of witness Raymond’s already delayed cross-examination -- that the parties and the Commission learned that witness Raymond had answered interrogatories using not one, but instead a series of data sets (a third one of which was revealed to exist that day), interchangeably, with no notice either to other parties or the Commission.

¹³ *See* MPA-T-5 at 12 (“for costing purposes, it is imperative to have clear and precise definitions of terms that equate to the costing distinctions intended to be measured”) and 13 (“A survey conducted for costing purposes should start with clearly defined terms that correspond to the costing categories to be measured”).

studies, conducted at the same time as the work sampling, were a more important part of the project," MPA-T-5 at 7-9;¹⁴

- the poorly trained enumerators had multiple duties that resulted in long workdays, raising "questions about the reliability of the observations for costing purposes," MPA-T-5 at 9-10; and
- the ES code definitions "were broad, imprecise, and contained no specific breakpoints (i.e., between driving a vehicle, parking it, getting out and moving around it, moving to or away from it; between accessing a mail receptacle and loading it; between actually loading a vehicle and moving containers to it)," making it "virtually impossible that all the data collectors could have applied the codes consistently, or that anyone could identify from the ES tallies what the carrier was actually doing when he was observed."

MPA-T-4 at 17.

The "method by which [witness] Raymond conducted his enumeration of data for the Engineering Standards study was generally acceptable for *that species of study*." MPA-T-4 at 14 (*emphasis added*). See USPS-T-13 at 5 (Raymond) (ES study was originally designed *not* for costing purposes, but "to collect actual activities of the city letter carrier and to develop engineered methods and time standards to establish a workload managing system"). Where, as here, however, "that species of study" is offered at the last minute, for costing purposes bearing no relationship whatsoever to the "workload managing system" for which it was designed and conducted -- *and* as the basis for a substantial increase in the postage rates Periodicals and other mailers will be required to pay, it is unacceptable, and should not be used.

¹⁴ As witness Hay points out: "There is a remarkable difference between quantifying the number of sufficient time and motion segments for an *engineering study* of time use, versus quantifying the appropriate number of routes, by route type to develop a statistically valid sample for purposes of cost estimation and rate-making decisions. Industrial Engineers use sampling techniques to measure distinct pieces of work, which are not necessarily the same as those used in cost estimates. . . . In addition, [Industrial Engineers'] estimates often exclude any time measure for inefficiencies or low productivity [but] [a]s cost estimates capture these two elements it is essential that the sampling for cost studies be constructed so as to avoid any bias from these factors." MPA-T-4 at 13-14.

H. Improvements in Periodicals rate design.

Periodicals Mailers witnesses demonstrate several improvements in Periodicals rate design related to cost avoidance and provide a model, MPA-LR-2, to implement these improvements. Initially we show that “the USPS flats cost model (USPS-LR-2) contains many incorrect and inconsistent assumptions, including those regarding bundle breakage, bundle and piece-sorting productivities, and optical character reader accept rates. Therefore, witnesses Stralberg and Glick have developed an improved version (MPA-LR-2) that better reflects the reality of postal operations.” MPA-T-1 at 36 (Cohen); *see also* TW-T-1 at 53-56 (Stralberg); PostCom-T-1 (Glick). Stralberg also identifies a mistake in the Postal Service’s calculations of the Destination Delivery Unit (DDU) cost avoidance for Periodicals mail and shows that correcting this mistake will lead to 0.5 cent larger per-piece and per-pound discounts. MPA-T-1 at 37 (Cohen); TW-T-1 at 56-58 (Stralberg). We also “recommend that the Commission maintain witness Taufique’s [USPS-T-25] greater-than-100 percent passthroughs of automation-related costs.” MPA-T-1 at 36 (Cohen).

Witness Stalberg recommends a two-cent per-piece 5-digit pallet discount. TW-T-1 at 53. He demonstrates this will save significant costs. TW-T-1 at 58-62. And, he points out, it is desired by postal facility managers: “Just about very (sic) facility manager I have met in recent years expressed a wish for more 5-digit pallets, which can simply be cross-docked to the appropriate delivery unit.” *Id.* at 58. Cohen supports this proposal. MPA-T-1 at 37. Finally, NNA witness Elliot demonstrates that the DDU discount provides a reasonable estimate of the costs avoided by exceptional dispatch. NNA-T-2 at 8-9. “Under current Postal Service regulations, publishers are able to receive the Destination

Delivery Unit (DDU) discount for periodicals that are dropped at the delivery unit under additional entry. However, publishers are not able to receive the DDU discount for periodicals that are dropped at the delivery unit under exceptional dispatch.” Id. at 8.

However, “[t]he same mail processing and transportation savings result when publishers drop their mail at the delivery unit, whether that mail is dropped under additional entry or exceptional dispatch.” Id. at 9. Thus a discount is warranted.

III. WHAT WE ASK THE COMMISSION TO DO

In this docket we are asking the Postal Rate Commission to recommend a decision that will challenge the Postal Service to achieve (1) the Test Year Periodicals cost savings it has already confirmed on the record, and (2) the additional Test Year Periodicals cost savings that our witnesses have demonstrated can be achieved. We are asking the Commission to recommend those rate design and methodological changes we have demonstrated will improve postal rate costing and postal operations and will lead to an average postal rate increase for Periodicals that is no greater than the overall average increase for all mail. As discussed above, the Commission in this docket and past dockets has indicated its desire to do so. We believe it has ample authority to do so.

The Commission was established to ensure that the Postal Service meets its statutory duty to “provide adequate and effective postal services at fair and reasonable rates and fees.” 39 U.S.C. 403(a). It is charged to make a recommended decision that will result in “the establishment and maintenance of a fair and equitable schedule.” 39 U.S.C. 3622(b)(1). The Commission serves in the public interest. The Commission’s initial rules of practice and procedure, issued in 1971, were modeled after those of the Federal Power

Commission (FPC).¹⁵ As one court had noted at that time with respect to the FPC, “[t]his role [serving as a “representative of the public interest”] does not permit it to act as an umpire blandly calling balls and strikes for adversaries appearing before it; the right of the public must receive active and affirmative protection at the hands of the Commission.” *Scenic Hudson Preservation Conf. v. FPC*, 354 F.2d 608, 619 (2nd Cir. 1965). “Rather, it has an affirmative duty to inquire into and consider all relevant facts.” *Ibid.*

More recently, the United States Court of Appeals for the District of Columbia Circuit pointed out:

The [Postal] Service makes projections about its costs and revenue that may or may not come to pass; projections are no more than educated guesses. The use of projections for future costs and revenues necessarily will involve some imprecision when actual data becomes available. Of course, the Service must make its estimates in good faith. In addition, the [Postal Rate] Commission has a duty to evaluate the Service’s proposal independently. . . Nevertheless, the Postal Service’s request for a rate change “shapes the Commission’s power to recommend.”

UPS v. USPS, 184 F.3d 827, 834 (DC Cir. 1999)(citations omitted). The Commission may indeed “[adjust] its figures as new data [become] available.” *Id.* at 835. “In reviewing the record, the court must determine whether there was substantial evidence for the Commission to rely on the Service’s original cost estimates in calculating the revenue required for the Service to break even.” *Id.* at 834 (citations omitted).

In this docket we urge the commission to “adjust its figures” to take into account “new data” that show Test Year 2001 Periodicals cost savings.

¹⁵ See 36 Fed. Reg. 396 (January 12, 1971).

- A. Recommend changes in the Postal Service's revenue request to reflect only a "reasonable" amount for contingencies and to take into account other overstated revenue needs.

As described more fully above, the Commission should reduce the revenue requirement associated with Periodicals mail by eliminating the contingency allowance for that class. The Postal Service, at the urging and with the full support of the Postmaster General, has engaged in an all-out effort to reduce the costs of processing Periodicals by the Test Year. Only a portion of the anticipated savings can be quantified for inclusion in the Test Year revenue requirement. Under these circumstances, it is inappropriate to assume the existence of "unknown" costs equal to 2.5 percent, or indeed any percentage, of Test Year Periodicals costs. Further, we point out that the volume of Periodicals mail varies little throughout the year, and is quite predictable, given the nature of Periodicals mail. A contingency factor, to the extent appropriate at all for the Postal Service as a general proposition, is appropriate only for contingencies, that is, unforeseeable or unpredictable events. Periodicals mail is not the part of the mailstream that generates unforeseeable or unpredictable events for the Postal Service. Therefore, Periodicals mail should not be assigned any portion of the contingency factor allowed by the Commission. If the Commission determines that it is not appropriate to assign a separate contingency to Periodicals, it should adopt the proposal of witness Buc (and others) for an overall contingency allowance of 1 percent.

- B. Recognize (1) the identified Test Year cost savings that have been confirmed by the Postal Service and (2) the additional Test year cost savings identified by Periodicals Mailers, and recommend appropriate changes in the revenue requirement.

In parts II C., D., and E. above we discuss significant Test Year 2001 Periodicals cost savings that we believe will be achieved. We urge the Commission to recognize

these savings, which are supported in this record, and recommend changes in the Postal Service's request to reflect them.

C. Recommend the improvements in the attribution and distribution of costs presented by witnesses Stralberg, Cohen, and Glick.

Periodicals Mailers urge the Commission to recommend the improvements in the attribution and distribution of costs presented by witnesses Stralberg, Cohen, and Glick – specifically:

- to distribute “not handling” costs at allied MODS cost pools broadly over the direct plus distributed mixed mail costs at all MODS Function 1 cost pools, as the Postal Service proposes, because “the large allied not handling costs are mostly driven by the need to serve piece distribution operations;” *ibid*;
- to distribute “mixed mail” costs at allied MODS cost pools, including empty equipment costs, broadly over the direct costs at all MODS Function 1 cost pools, as the Commission did in its Docket No. R97-1 Opinion and Recommended Decision;
- to distribute “not handling” and “mixed mail” costs at allied non-MODS and BMC cost pools broadly over all pools within the respective facility categories;
- to distribute “not handling” and “mixed mail” costs at allied and support pools, as well as Function 4 pools, by specific shape and sorting technology, when that is made possible by IOCS Question 19 data;
- to distribute the over \$80 million of direct costs in so-called “support” pools, e.g., “migrated” window service costs, according to the subclass or special service identified by the IOCS tallies.

D. Decline to recommend use of the Engineered Standards/Delivery Redesign project data presented by witnesses Raymond and Baron, but if not also use the corresponding volume variabilities derived from the same sample.

For the reasons outlined above in part II. G and detailed in the testimony of witnesses Hay and Crowder, Periodicals Mailers urge the Commission to decline to recommend use of the ES Study in this ratemaking procedure.

Expert analysis – conducted through a comparison of ES Study tally records with ES Study videotapes – demonstrates that among the ES study's most glaring flaws is its

“large and statistically significant” miscalculation of “load time” – the tallies for which “include activities which are not true load time.” MPA-T-5 at 44. This error “is the result of data collectors recording non-load carrier activities with codes which [witness] Raymond allocated to load time.”¹⁶

Following the analysis of the records and videotape, “MPA developed a route-level regression model of ES load tallies with possible deliveries and other variables.” MPA-T-5 at 44. The Postal Service also developed and presented “a route level regression model of ES load time with volumes, possible deliveries, and other variables.” Ibid. (citing USPS-LR-I-310). In both models, witness Crowder noted, “the intercept and intercept-related terms are large and statistically significant,” demonstrating that “the ES load tallies include activities which are not true load time.” Ibid. This is because both models produced “coefficient values” that were “large and statistically significant,” id. at 45, although “[i]f the activities encompassed by the ES load time data only included true load time, then the intercept value and the coefficients for the other related terms would be close to zero and statistically insignificant,” because “zero possible deliveries should produce zero load time.” Ibid.

This statistically demonstrable error – combined with the myriad design, execution and analytic errors outlined in part II. G above – requires exclusion of the ES study from consideration by the Commission for ratemaking purposes. Fresh data should not be given Commission imprimatur simply because they are new.

¹⁶ The ES Study’s hypothesis of a dramatic increase in load time accounts for much of the dramatic increase in costs at 45. And the attributed to Periodicals by the Postal Service. Indeed, as witness Crowder points out, “[b]oth the MPA and USPS ES [regression] models” show that the ES Study estimate of accrued load time is 92.3 percent greater than the LTV estimate of load time.” MPA-T-5 results derived from the ES Study by the Postal Service account for 23 percent of the overall increase sought by it for Periodicals mail.

Should the Commission decide to recommend use of the ES Study, however, the “load time” analyses conducted by witness Crowder and the Postal Service appear to dictate that the Commission also adopt the corresponding ES Study volume variabilities. The two factors go hand-in-glove.

As witness Crowder notes, the “lower LTV estimate of accrued load time is associated with 64.0% variability while the substantially higher ES estimate is associated with a 45.2% variability.” MPA-T-5 at 45. This, she concludes, “is precisely what is expected when the load time estimate being used contains a high proportion of fixed time that cannot be true load time. If the ES time proportions are used to disaggregate out-of-office costs, then there is no question that the variability estimate from the USPS ES model produces a more reasonable estimate of variable load time.” MPA-T-5 at 45.

In other words, if the Commission adopts the ES study for costing purposes, it should also adopt the corresponding ES volume variability figures, lest it mix apples and elephants. “The necessity to match accrued costs and variability models” is “extremely important” in order to “avoid severe errors and distortions of volume variable costs,” because “[w]hen variability is derived from a functional model that only explains half of the estimated accrued time for that function, there is *an extremely high probability* that the estimated accrued time includes *much more* than what was modeled,” and “to apply the *modeled* variability to the *estimated* accrued time would produce” not only a result that “cannot be explained” and has “no meaning,” but “a greatly overstated estimate of variable functional costs.” Id. at 46.

- E. Recommend the Periodicals rate design improvements presented by witnesses Cohen, Stralberg, and Elliott.

Periodicals Mailers urge the Commission to adopt the improved flats cost model developed by witnesses Stralberg, TW-T-1, and Glick, PostCom-T-1, and presented in MPA-LR-2. This model should be used to calculate automation and presort discounts. We also urge the Commission to approve the greater than 100 percent passthroughs of automation-related cost avoidances proposed by witness Taufique. USPS-T-38. Finally, we urge the Commission to recommend the 5-digit pallet discount and the DDU rate discount proposed by witnesses Stralberg, TW-T-1 at 55-61, and Cohen. MPA-T-1 at 37. In addition, the DDU discount should be extended to mail entered both under additional entry and under exceptional dispatch as proposed by witness National Newspaper Association witness Elliot. NNA-T-2 at 9.

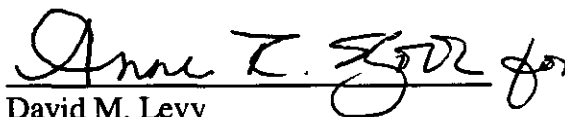
- F. As it has done in the past, recommend a reasonable, moderate cost coverage for Periodicals consistent with the requirements of the Act.

Several sections of the Act have informed the Commission's decisions on cost coverage for Periodicals and should continue to do so. Section 101(a) of title 39, United States Code, provides that "[t]he Postal Service shall have as its basic function the obligation to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people." Section 101(d) directs the Postal Service to "apportion the costs of postal operations to all users of the mail on a fair and equitable basis," and section 403(a) directs it to "provide adequate and efficient postal services at fair and reasonable rates." And particularly relevant to Periodicals,

section 3622(b)(8) requires that in recommending rates the Commission consider the
“educational, cultural, scientific, and informational value to the recipient of mail matter.”

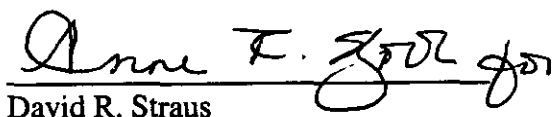
The Commission has broad discretion in applying the pricing factors of section
3622(b) of the Act. The low cost coverages it recommended for Periodicals in the past
three rate cases in part reflected, in addition to the policies of the Act discussed above,
the uncertainties about the reliability of Postal Service costing data and methodologies.
See PRC Ops. R90-1, para. 5246; R94-1, para. 4055; R97-1, para. 5816-5817. Periodicals
Mailers urge the Commission to recommend again a Periodicals cost coverage
sufficiently modest to ensure that average rate increase recommended for Periodicals is
no larger than the average recommended for all classes of mail.

Respectfully submitted,




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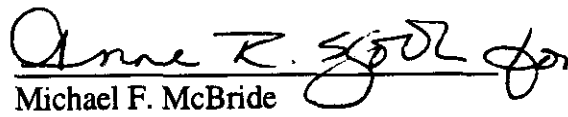
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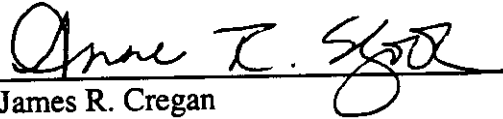
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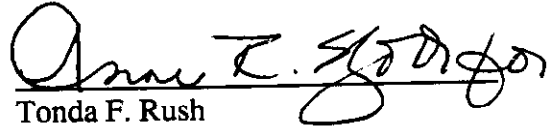
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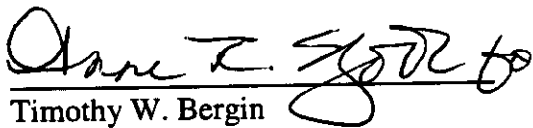
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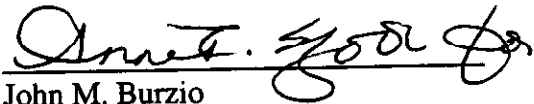
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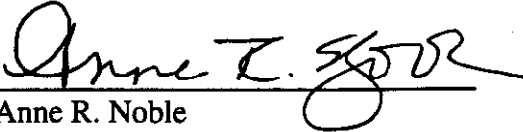


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CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with sections 12, 25(a), and 26(a) of the Rules of Practice.


Anne R. Noble

Washington, DC

June 29, 2000