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BEFORE THE
POSTAL RATE COMMISSION
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POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

REBUTTAL TESTIMONY OF
VINCENT GIULIANO
ON BEHALF OF THE
SATURATION MAIL COALITION

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AUTOBIOGRAPHICAL SKETCH

1 My name is Vincent Giuliano. I am Senior Vice President of Government
2 Relations for ADVO, Inc., reporting directly to the Chairman and Chief Executive Officer.
3 In this position, I deal with all governmental activities that might affect Advo, especially
4 matters concerning postal regulations, services, and rates.

5 Since starting with Advo in 1971, I have worked in a variety of areas in the
6 company's operations. I have been responsible for Advo's government relations
7 activities, focusing on postal-related matters since 1983. I served as Assistant to the
8 President from 1978 to 1983. Before that I served as Director of List Maintenance and
9 List Sales, and was Sales Manager/Senior Account Supervisor responsible for
10 marketing Advo's solo mail services to some of its largest customers. I am familiar
11 with Advo's operations and its marketing of mail services to customers.

12 I have participated in Advo's rate case preparation in every case since Docket
13 R80-1 and presented testimony on behalf of Advo in Dockets R87-1, C87-2, and C89-
14 3. I have long been active in mailing industry associations and organizations.
15 Currently, I am a director and Secretary of Post Com and a member of its Executive,
16 Postal Policy, Public Affairs, and Postal Operations Committees, a member of the
17 Direct Marketing Association's Government Affairs Committee, a member of the
18 Saturation Mail Coalition's Steering Committee, and a member of the U.S. Chamber
19 of Commerce and the Small Business Council. I received a B.A. degree in
20 Economics from St. Michael's College in 1970.

PURPOSE AND SUMMARY OF TESTIMONY

21 Advo has been in the mailing business for more than seven decades. In the
22 last three decades, newspapers have been our primary competitors. Over that time,
23 the marketplace and our business have gone through both evolutionary and

1 revolutionary changes -- often related directly to postal rates which constitute about
2 half of our company's costs. In the highly competitive market in which we and other
3 saturation mailers compete, the level of Enhanced Carrier Route saturation postal
4 rates and particularly the high pound rate are growing concerns. That is why we
5 support the Postal Service's proposed rates, which would slightly moderate the
6 pound rate.

7 Although the Postal Service's proposed ECR pound rate reduction is only about
8 half the size of the (also moderate) reduction proposed in Docket R97-1, the
9 testimonies of NAA witness Tye and AAPS witness White portray it as Armageddon for
10 the newspaper and private delivery industries. The purpose of my testimony is to
11 address their unsubstantiated contentions concerning the alleged impact on
12 newspapers and private delivery, and to demonstrate why their highly generalized
13 allegations are unfounded. In addition I show why the proposed rates are essential in
14 order to permit the Postal Service to maintain its ability to compete for the distribution
15 of preprints and other advertising materials that are part of its core services and why
16 this is beneficial to the Postal Service, its customers, the retail advertising community
17 and to consumers.

18 In Section I, I explain why the dichotomy Tye and White try to draw between
19 "mailers and competitors" is simplistic and inaccurate. Some mailers also own or
20 use private delivery operations, and vice versa; some newspapers use mail for their
21 nonsubscriber TMC programs while others use private delivery. Smaller
22 newspapers, in particular, make significant use of saturation mail for free papers and
23 advertising publications. Shifts between delivery alternatives can and do occur,
24 particularly in response to postal rate changes. Consequently, the beneficiaries of a
25 more rational pound rate are not just traditional "mailers" but also newspapers
26 (especially smaller dailies and weeklies) that use ECR mail.

1 In Section II, I place the proposed pound rate in its proper marketplace
2 perspective, describing the changes that have occurred in the market since 1970,
3 how the excessive pound rate distorts the marketplace, and why this is detrimental to
4 mailers and the Postal Service. I also show that Tye's contention that mail has
5 diverted substantial volumes from newspapers over the last five years is unfounded,
6 and that the swings have been in the other direction.

7 In Section III, I address witness White's mischaracterizations of competition
8 between mail and private delivery, and his unsupported claims of competitive injury. I
9 describe how in White's Oklahoma City market, his daily newspaper/ private delivery
10 combination dominates the market, at least in part because of the high pound rate.
11 Contrary to his claim that private delivery is "disadvantaged" in competing with the
12 mail, I describe the significant advantages that private delivery enjoys -- most of which
13 are related to regulatory constraints that leave mailers with little or no control over the
14 rates or regulations that govern their mailing businesses, in contrast to the
15 substantial flexibility that private delivery companies have to tailor their operations,
16 costs, and procedures to fit marketplace needs.

17 Advo's own experience in private delivery demonstrates the substantially lower
18 costs of private delivery compared to mail -- a cost disparity that, because of the high
19 pound rate, widens as weight increases. Even at the proposed rates, this disparity
20 will be only modestly mitigated, disproving White's allegation that the proposed rates
21 will harm private delivery. I also describe Advo's expanding private delivery operations
22 which have been undertaken primarily because of the high pound rate. I explain the
23 effect that the substantially lower weight-related costs of private delivery have had on
24 Advo's mailed and privately delivered volumes, including reductions in Advo's mailed
25 volumes due to conversion to private delivery.

26 In Section IV, I address witness Tye's contention that "protecting monopoly
27 customers" requires that the cost coverages and rates of the most competitive and

1 price sensitive ECR mail should be increased even further. His logic would force
2 mailers and advertisers out of the mail, eliminating mail as a competitive alternative
3 along with the substantial contribution that this mail makes to institutional costs, to
4 the obvious detriment of "monopoly customers" and the Postal Service. It would turn
5 postal customers into competitors. For advertisers, it would reduce their media
6 choices. And small businesses and consumers would be deprived of the benefits
7 that targeted marketing through direct mail advertising brings to the marketplace.

8 Finally, I explain that Advo continues to prefer mail as its distribution medium of
9 choice, and hopes to use the mail as a vehicle for a number of market expansion
10 opportunities. However, the choice -- whether to expand through the mail or private
11 delivery, or even whether to continue using the mail -- is ultimately a function of the
12 marketplace and, most importantly, postal rates.

I. WHO ARE THE COMPETITORS IN THE MARKETPLACE?

13 The testimonies of NAA witness Tye and AAPS witness White give the
14 impression that there are two distinct groups of competitors for saturation advertising
15 distribution: saturation mailers versus newspapers and private delivery companies.
16 The reality is more complex.

17 Although not mentioned in White's testimony, for many "independent" private
18 delivery companies, the biggest competitor is the local daily newspaper, not mail. For
19 other private delivery companies that are owned by newspapers (like witness White's
20 Delivery Services of Oklahoma which is a division of the daily newspaper publisher),
21 there is no competition with the newspaper. Instead, the newspaper and its private
22 delivery arm in tandem compete with other private delivery companies and mailers.

23 Newspapers, large and small, also make use of ECR mail. While some
24 newspapers like the *Daily Oklahoman* use their own private delivery to distribute their
25 total market coverage (TMC) products, many daily newspapers use ECR high density

1 mail for their TMC products. Many smaller daily and weekly newspapers rely on ECR
2 mail not only for TMC distribution, but also use ECR saturation mail to distribute free
3 community newspapers and advertising publications. As National Newspaper
4 Association witness Max Heath concluded, referring to NNA-member newspapers'
5 usage of ECR mail:

6
7 "NNA-member TMCs are heavily skewed toward full-coverage
8 (Saturation) on another day of the week than their non-daily
9 [newspaper] product, contrary to the daily [newspaper] operation
10 of TMCs as supplementary to a daily issue. *Saturation mail is*
11 *very important to NNA members.*"

12 ADVO/NNA-T1-1, Attachment at p. 3 (emphasis added); Tr. ____.

13 There is also a mixture of use between mail and private delivery within the
14 saturation mail industry. A majority of shopper publishers use private delivery, but
15 some use ECR mail for a portion of their distribution. Other shopper publishers, like
16 SMC witness Bradpiece (SMC-RT-2), use saturation mail for some of their
17 publications and private delivery for others. Nor is saturation mail the exclusive mode
18 of distribution within the "shared mail" segment of the industry, as evidenced by
19 Advo's private delivery operations. Advo, in fact, is a member of AAPS.

20 Over the years there have been many shifts between these distribution
21 alternatives, mostly motivated by changes in postal rates: daily newspapers have
22 moved into and shifted between mail and private delivery TMC distribution; weekly
23 newspapers (which are much more dependent on the mail) have shifted into mailed
24 TMC and saturation programs; and shopper publications and shared mailers have
25 switched between mail and private delivery.

26 Although not mentioned by witnesses White or Tye, all the newspapers that
27 use ECR mail would benefit from the lower pound rate proposed by the Postal
28 Service. Notwithstanding this benefit, the real interest of the major daily newspapers,
29 in my opinion, is to eliminate saturation mail competition.

1 For the smaller newspapers that use saturation mail to distribute free
2 community newspapers, TMC products, and advertising publications, the benefit of a
3 lower pound rate is obvious and unequivocal. In fact, the NNA survey data provided by
4 witness Heath in Docket R97-1 showed that (1) these smaller newspapers made
5 greater use of Standard A than Periodicals mail, mostly for nonsubscriber products;
6 (2) over 90% of their Standard A volumes were mailed at ECR rates; and (3) that of
7 those ECR volumes, 70% were saturation mail drop shipped to the destination post
8 office, and 60% weighed above the 3.3-ounce breakpoint. See Tr. 14778, 14781-82,
9 Docket R97-1.

10 Even among the larger NAA-member daily newspapers, a number use ECR
11 high density mail for their TMC products. According to the Postal Service's 1999
12 billing determinants, high density mail is growing more rapidly and has a higher
13 average weight than saturation mail. The lower pound rate will reduce their postage
14 costs. In fact, the Postal Service's proposed rates are more favorable to high density
15 mailers than to saturation mailers. They give the newspapers a substantial cost
16 advantage over saturation mail, allowing them to combine their low, weight-
17 insensitive newspaper insert rates for subscriber households with a reduced ECR
18 pound rate for nonsubscriber households. Saturation mailers must pay the still-too-
19 high pound rate for their entire distribution.

20 In sum, this issue is not about "mailers v. newspapers." A lower pound rate
21 also benefits many large and small newspapers, as well as large and small
22 advertisers. The real issue is about establishing reasonable, cost-based postal
23 rates, as opposed to maintaining artificial pricing barriers whose purpose is to protect
24 competitors.

II. THE MYTH OF "HARM TO COMPETITORS"

25 NAA witness Tye and AAPS witness White assert that the Postal Service's
26 proposed ECR rates, and particularly the modest reduction in the high pound rate, are

1 a threat to the newspaper and private delivery industries. Those assertions are wrong
2 and misleading. Noticeably absent is any evidence of what has been going on in the
3 marketplace for preprint advertising over the years. The newspaper industry, in fact, is
4 in a stronger position than at any time since the introduction of shared mail in the
5 early 1980s. The private delivery industry is likewise strong and growing, as
6 evidenced by Advo's continuing expansion of its private delivery operations.

A Historical Perspective

7 Over the three decades that I have been with Advo and involved in postal
8 matters, I have witnessed many changes in the marketplace. To understand the
9 nature of the competitive marketplace today, it is necessary to recognize those
10 changes -- particularly as they relate to postal rates.

11 In the early 1970s, mail was a more dominant choice of advertisers in the retail
12 preprint distribution market, competing with newspapers through the use of solo
13 saturation mail. However, by the mid-1970s, because of large postal rate increases,
14 mail was almost knocked out of the rapidly expanding preprint market. A number of
15 saturation mailers left the mail, some launching private delivery operations that
16 became competitors of the Postal Service. Although Advo stayed in the mail, its
17 volumes plummeted by two-thirds, from 2 billion pieces in 1970 to 680 million in 1978
18 -- at the same time newspaper preprint volumes soared from 3 billion to 28 billion
19 pieces.

20 In the early 1980s, with the introduction of the carrier route presort discount in
21 1978 and particularly the saturation shared mail concept in 1980, mail regained some
22 of the market. The competitive stimulus of shared mail forced complacent
23 newspapers to pay attention to their customers' needs, because new products and
24 services such as TMC programs allowed advertisers to obtain saturation coverage
25 through a combination of newspaper insert distribution to subscribers and mail or
26 private delivery distribution to nonsubscribers. These newly available competitive

1 price and service choices sparked a large growth in the preprint market. Preprint
2 volumes, both in the mail and in newspapers, grew rapidly. Significantly, a
3 substantial number of the preprints carried in shared mail were what I call "traditional"
4 multi-page preprints that weighed one or more ounces.

5 In the late 1980s, following the large Docket R87-1 rate increase (a 22%
6 increase in the minimum carrier route rate and a larger 26% increase in the pound
7 rate), carrier route mail volumes fell. Newspapers began shifting their nonsubscriber
8 TMC programs out of the mail and into less expensive alternate delivery programs.
9 Private delivery companies sprang up and expanded. Saturation mailers like Advo, on
10 the other hand, curtailed market expansion. In the aftermath of the R87 increases,
11 Advo began to explore private delivery alternatives and undertook several market tests
12 of private delivery operations.

13 The introduction of new worksharing discounts in the Docket R90-1 rate case
14 substantially mitigated what might otherwise have been devastating rate increases,
15 and allowed moderate growth in saturation advertising mail. But spurred by the shift
16 of newspaper TMC programs out of the mail, private delivery operations continued to
17 grow. By this time, it was becoming apparent that the high ECR pound rate was
18 inhibiting Advo's ability to remain price competitive for traditional multi-page preprints.
19 Advo's average preprint weights were declining and have continued to do so, due to
20 the combination of diversion of heavier preprints to non-postal competitors and
21 decisions by other customers remaining in the mail to reduce the sizes of their mailed
22 preprints.

23 Over the past decade, the large disparity between the high ECR pound rate and
24 the low cost of private delivery, coupled with the pressures of the competitive
25 marketplace, have forced Advo to look at the private delivery alternative. Advo
26 launched its first private delivery operation in late 1992 in the Philadelphia market,

1 both to reduce its distribution costs and to be positioned for further expansion in the
2 event that future postal rate increases threatened its ability to compete.

B. Tye's Claim Of Diversion From Newspapers To The Mail Is Unfounded

3 NAA witness Tye claims that newspapers have suffered substantial
4 diversion of preprint volumes to mail over the last five years because the pound rate
5 has not been increased. NAA-T1-1 at 44-46, Tr. 14734-36. However, he provided no
6 marketplace data to support his contention.

7 In fact, because of the high pound rate, shared mail today is less competitive
8 with newspapers and private delivery for the distribution of traditional multi-page
9 preprints than it was in the mid-1980s. Until the large Docket R87-1 rate increase,
10 Advo's shared mail carried a substantial number of preprints weighing more than an
11 ounce. Because of the pound rate, those heavier preprints are gone. In most cases
12 they were diverted to newspapers as inserts, although in some cases the advertisers
13 reduced the number of pages and weight of their inserts to make it affordable to
14 remain in shared mail (but with the tradeoff of carrying less advertising information).

15 Advo's experience since 1994 belies Tye's claim of diversion of substantial
16 volumes from newspapers. Advo's shared mail volumes peaked in FY 1995 at 3.176
17 billion pieces. In FY 1999, shared mail volume declined to 2.961 billion pieces, a
18 nearly 7 percent reduction. Half of this reduction, as I explain below, is due to Advo's
19 shift of shared mail into its expanded private delivery operations. Advo's preprint
20 insert volumes likewise reflect no diversion from newspapers. In the five years from
21 FY 1994 to 1999, our preprint volumes grew only 5 percent, peaking in 1997 and
22 falling since then.

23 Mail is less competitive today than it was in 1994, in large measure due to the
24 pound rate. As I discuss in the next section, this is a major reason why Advo has

1 become involved in private delivery: to make it more competitive with newspaper
2 distribution.

III. WHITE MISCHARACTERIZES THE COMPETITIVE TRADEOFFS
BETWEEN MAIL AND PRIVATE DELIVERY

3 AAPS witness White tries to portray the private delivery industry as small
4 beleaguered companies struggling to compete against the "unfair" advantages of a
5 monopolistic Postal Service that is attempting to drive them out of business. He also
6 implies, without substantiation, that private delivery companies would be harmed by
7 the proposed lower pound rate. The facts do not bear out his rhetoric. Based on
8 Advo's own experience in the mail and its growing presence in private delivery, it is the
9 Postal Service that is at risk of becoming non-competitive because of the high pound
10 rate.

A. The Oklahoma City Market

11 Even in his own market, Oklahoma City, where Distribution Services of
12 Oklahoma (DSO) serves as the private delivery arm for the *Daily Oklahoman*
13 newspaper, witness White declined to provide information about the market share
14 held by the Oklahoman/DSO, and professed to know little about the newspaper's
15 market share and pricing. In fact, the Oklahoma City market is a good example of the
16 dominance of combined newspaper-private delivery distribution.

17 Advo started a shared mail program in the Oklahoma City market in the mid-
18 1980s, competing with the *Daily Oklahoman*. However, our ability to compete was
19 substantially impaired by the large 25% postal rate increase in the Docket R87-1 rate
20 case. Then in 1991, the *Daily Oklahoman* launched a privately delivered TMC
21 program, using its newly created sister company, DSO, to distribute preprints to
22 nonsubscribers to achieve saturation total market coverage. Shortly thereafter, Advo
23 discontinued its Oklahoma City shared mail program. Advo no longer offers a shared
24 mail program and has no sales force in the market. Our only involvement is through a

1 small independent shopper publication, the Buyers Guide, which distributes some
2 nationally-generated advertising inserts for Advo (mostly single-sheet ads from
3 companies like Blockbuster) and once a month Advo's four-page shared mail wrap.

4 The *Daily Oklahoman*/DSO combination dominates the market, distributing
5 every major multi-page preprint advertiser. As witness White acknowledged, the *Daily*
6 *Oklahoman*/DSO carries a number of preprints that weigh in excess of one ounce,
7 whereas he knew of none carried by competitors. Tr. 22/10032-33.

8 Even with respect to lighter weight pieces -- the one market segment where
9 shared mail can still compete -- witness White mischaracterized the market. His
10 claim that postal rates have driven private delivery out of the market for light-weight
11 pieces (Tr. 22/9986) is disingenuous. In fact, the *Daily Oklahoman's* TMC program
12 includes a substantial number of inserts weighing under one ounce, including single-
13 page inserts weighing a fraction of an ounce. Tr. 22/10044; AAPS-LR-2.

14 This alleged inability of private delivery companies to compete for light-weight
15 pieces is nonsense. Almost all private delivery companies compete by carrying
16 multiple-piece advertising sets, just like shared mailers, shopper publications and
17 newspapers do. Many, if not most, private delivery companies distribute shoppers or
18 newspaper TMC products that serve as the vehicle for carrying multiple preprint
19 inserts. In all these cases, the private delivery company offers advertisers saturation
20 coverage, either by itself or in conjunction with newspaper distribution to subscribers
21 as part of a TMC program. In all cases, these saturation vehicles allow private
22 delivery companies to compete on equal footing with mail for light-weight advertising
23 inserts.¹

¹ White's light-weight claim is based on an apples-to-oranges comparison. The only circumstance where DSO arguably would be "non-competitive" with shared mail would be in the highly unusual case of an advertiser who wanted saturation coverage entirely in private delivery, choosing not to use the newspaper as the vehicle to reach subscriber households. In that case, DSO's delivery to subscriber households would

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B. The Advantages of Private Delivery

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Although not mentioned in White's testimony, private delivery has

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important advantages over mail distribution. DSO's rate card, for example, touts the

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"Advantages of DSO Delivery Over Mailing Services and the Post Office," which include

5

"no label or handling charges" and "lower per piece delivery charge." Tr. 22/9982.

6

Among other advantages:

7

- Private delivery does not require address labels, avoiding the costs of list maintenance and label production.

8

9

- Private delivery involves only minimal preparation and administrative requirements -- far less cumbersome and costly than the complex mail preparation requirements, multiple mailing forms, and postage payment and audit trail documentation required by postal regulations.

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- Private delivery eliminates the expense of transporting drop shipped mail to postal facilities, as well as the cost of managing a transportation network and scheduling drop ship appointments. Carriers pick up the delivery materials at the plant.

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- Private delivery generally avoids the capital investment and expense of mechanically inserting advertising pieces into shared mail packages, a function usually performed by the private delivery carriers.

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- By simplifying or eliminating mail preparation steps and eliminating drop shipment, private delivery can accommodate later deadlines for receipt of preprints from customers, an important competitive consideration for time-sensitive advertisers.

21

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24

- Private delivery allows total control over service and delivery dates, assuring the ability to achieve delivery on a specific day.

25

be on a "solo piece" basis, at a higher cost than the normal newspaper/TMC insert rate. But in this case of an advertiser wanting "solo" distribution, the appropriate comparison is the postal rate for solo mail distribution. Yet DSO's published rate for solo distribution, ranging from 7.3¢ to 10.8¢ per piece depending on quantity (Tr. 22/9982), is lower than the Postal Service's lowest proposed saturation ECR rate of 12.0¢ for mail drop shipped to the destination post office.

- 1 • Private delivery allows deliveries to be made on Sunday, as Advo does in
2 the Cincinnati market, which is the primary day for newspaper preprint
3 distribution.

4 Another major advantage is that private delivery companies have greater control
5 over their distribution costs, and greater flexibility to adapt their operations,
6 procedures, and prices in response to the market. Because postal rates and
7 regulations are set through regulatory processes, mailers have no control over the
8 rate they pay for mail distribution, or the rules and regulations that dictate their mailing
9 operations.²

10 However, the biggest advantage of private delivery, as I discuss below, is its
11 significantly lower cost in relation to ECR saturation postal rates, particularly due to
12 the high pound rate.

C. Advo's Private Delivery Experience

13 From shortly after its founding in the 1920s until the early 1950s, Advo
14 was primarily a private delivery company. From that time until 1992, Advo used the
15 mails exclusively as its distribution medium of choice. Today, Advo still believes in the
16 efficacy of the mail, and would like to expand its mailing operations. Nevertheless, as
17 a business operating in a highly competitive market, Advo can stay in the mail only so
18 long as postal rates allow it the opportunity to remain competitive and profitable. This
19 is true for all saturation mailers. The high pound rate impairs the competitiveness of
20 mail compared to newspaper and private delivery distribution, and is the major

² Private delivery does have some potential disadvantages compared to mail, but in Advo's experience these are more a matter of perception than reality. Some gated neighborhoods and communities restrict access by private carriers, but in those instances Advo simply uses the mail to reach those addresses. There is also a perception that private delivery results in lower consumer readership due to lack of access to the mailbox, but Advo's internal surveys reveal that in some markets private delivery has higher readership than mail or newspaper advertising. The primary determinant is the quality of the delivery service, not the mailbox.

1 reason why Advo has entered into -- and is continuing to expand -- its private delivery
2 operations.

1. The Lower Cost Of Private Delivery.

3 At current postal rates, the cost of private delivery is significantly
4 lower than mail delivery. Moreover, because private delivery costs are less weight-
5 sensitive, the cost disparity widens as mail piece weight increases.

6 In our private delivery operations, the distribution cost for a 4-ounce package is
7 less than 12¢ per package, or \$120 per thousand.³ This includes the total delivery
8 cost plus all costs for inserting preprints into the package, plastic bags, and carrier
9 supervision. In contrast, at current rates for saturation mail drop shipped to the
10 destination post office, the postage cost alone is 13.725¢ or \$137.25 per thousand --
11 not including the additional costs for (1) address labels, (2) mechanical insertion of
12 preprints into the package, (3) bundle and facing slips, and other documentation
13 requirements imposed by postal regulations, and (4) drop ship transportation, all of
14 which are avoided in private delivery.

15 For an 8-ounce package, the postal versus private delivery cost differential
16 widens substantially. In private delivery, the total distribution cost is less than \$170
17 per thousand. The current postage cost alone, excluding the other additional mail-
18 related costs mentioned above, is \$271.50 per thousand. In private delivery, a
19 doubling of the piece weight results in only about a 40% increase in distribution cost
20 (and in many cases substantially less). But in the mail at current rates, this doubling
21 of weight results in a 98% increase in postage -- effectively doubling the cost.
22 Moreover, for this 8-ounce piece, the postage cost alone is 60% greater than the *total*

³ Advo's actual private delivery costs vary by market, and are confidential. The above figures represent the high end of our private delivery costs.

1 distribution cost in private delivery. The disparity widens even further as weight
2 increases.

3 I would emphasize that even at the Postal Service's proposed rates, the
4 modestly lower pound rate would still leave a significant disparity compared to private
5 delivery and newspaper distribution. Under the proposed rates, the postage cost
6 would become \$140.50 per thousand for a 4-ounce piece, and \$253.00 for an 8-
7 ounce piece. A doubling of weight would still result in a large 80% postage increase
8 -- a cost/weight ratio that would still be about twice as high as the ratio in private
9 delivery, but at least moderately lower than the irrational 98% ratio under current rates.
10 Moreover, the postage cost alone for the 8-ounce piece would still be almost 50%
11 higher than the total private delivery cost,.

12 This, of course, explains why the allegations of harm by witnesses Tye and
13 White are couched in generalized assertions (such as Tye's claim that the proposed
14 rates will "continue to divert mail" from newspapers, Tr. 14732 and following).
15 Noticeably missing are any supporting cost data or concrete evidence of harm. As the
16 above comparisons show, even at the proposed rates, mail distribution will still pay a
17 substantial cost premium over the competitive alternatives. Those rates cannot
18 possibly cause any major shift in the marketplace. Rather, they will allow a moderate
19 reduction in the currently distorted cost relationships, enable mailers to stem volume
20 erosion and once again compete at the margins for a segment of the market. In
21 addition, by marginally narrowing the cost disparity between mail and private delivery,
22 they will lessen the necessity for mailers to convert to private delivery and become
23 Postal Service competitors.

24 2. Advo's Private Delivery Initiatives.

25 Advo's initial involvement in private delivery came in late 1992 in
26 the aftermath of the Docket R87-1 rate increase. Advo acquired a private delivery
company in Philadelphia, and initially provided both shared mail and private

1 distribution in the same zones, using private delivery to distribute heavier preprints
2 that Advo could no longer compete for in the mail due to the high pound rate. Advo
3 has since converted its shared mail program in these overlapping zones into the
4 private delivery operation, which now serves 775,000 homes weekly. In 1993, Advo
5 expanded its private delivery operations to the Boston market, which currently serves
6 200,000 homes weekly. In mid-1995, Advo acquired a private delivery company in
7 Cincinnati, and has since converted a substantial part of its shared mail volume in
8 that market to private delivery, reaching 650,000 homes weekly. In January of this
9 year, Advo launched private delivery in the central New Jersey market, converting
10 distribution to 350,000 homes weekly from the mail to private delivery. In February,
11 Advo converted distribution to 300,000 homes in the Denver market from mail to a
12 TMC program with the *Denver Post* newspaper. In total, Advo's private delivery
13 operations currently serve 2.3 million homes weekly.

14 In each of these markets, Advo has shifted shared mail out of the postal
15 system and into private delivery. Since 1994, Advo's privately delivered volumes have
16 nearly tripled to more than 120 million pieces annually, while our shared mail
17 volumes have declined by 120 million pieces -- a 4% reduction in postal volume.
18 Privately delivered volumes now constitute about 3.7% of Advo's total shared mail
19 program distribution.

20 These conversions to private delivery have had a number of positive effects for
21 Advo. No longer constrained by the high postal pound rate, Advo has been able to
22 compete successfully in those markets for a share of the mid-to-heavier weight multi-
23 page preprints that had been priced out of the mail. Our privately delivered volumes
24 average 40% more preprint inserts per package than our mailed volumes, and those
25 privately delivered preprints have a higher average weight than those in the mail. In
26 fact, the mailed preprints have declined in weight over the last six years, due to the

1 high pound rate. Although private delivery accounts for 3.7% of Advo's total shared
2 mail volume, it accounts for a larger 4.7% of our preprint volume.

3 These markets have become more profitable to Advo as a result of their
4 conversion to private delivery, due to the combination of the lower distribution cost of
5 private delivery and the enhanced ability to compete for heavier traditional preprint
6 volumes. Overall, these conversions to private delivery have saved Advo millions of
7 dollars annually in distribution costs, all of which has gone directly to Advo's bottom
8 line, substantially enhancing our company's profitability.

9 For the Postal Service, the result has been a corresponding loss of high-
10 contribution saturation mail volume. The impact of this diversion on the Postal
11 Service is greater than the volumes alone imply, because our private delivery
12 operations tend to be concentrated in the lowest-cost, easiest-to-deliver areas of
13 these markets. In higher-cost delivery areas within these markets, such as outlying
14 areas with longer distances between deliveries, Advo continues to use the mail. This
15 is precisely what common economic sense suggests: that the volumes most
16 vulnerable to diversion are the lowest cost volumes that provide the highest
17 contribution to Postal Service institutional costs.

IV. "MONOPOLY CUSTOMERS" WILL BE HARMED, NOT "PROTECTED" BY
FURTHER INCREASING THE RATES FOR COMPETITIVE ECR MAIL

18 At the current pound rate, private delivery is an increasingly attractive alternative
19 to the mail. I am not suggesting that shifting to private delivery is an easy undertaking,
20 or that it can be entered into quickly. To be effective, a private delivery operation must
21 provide a high quality of reliable delivery, must be well-managed, and must have
22 stringent quality controls. One of the advantages of mail is that the mailer does not
23 have the demanding task of managing a delivery network. Another advantage is that
24 the mail system is a universal, six-day-a-week service (although Sunday service can
25 only be accomplished through private delivery). Compared to private delivery, a mailer

1 can more rapidly enter or exit markets, expand or contract its geographic coverage,
2 and change or add delivery days. These are the reasons why Advo's expansion of
3 private delivery has been selective and carefully planned. To be successful, private
4 delivery must be done right. But that can be done.

5 For these reasons Advo is willing to pay some reasonable premium for mail
6 service. All else being equal, Advo would much prefer to focus its efforts and energies
7 on its traditional advertising marketing and mailing business, rather than entering the
8 delivery business. But the current premium, particularly the high pound rate, is
9 excessive and out of balance with the marketplace -- a fact well known by our
10 newspaper and private delivery competitors, who want to maintain and even increase
11 the artificial postal pricing barrier that insulates them from competition. Depending on
12 where postal rates head in the future, private delivery may, unfortunately, become a
13 business necessity not only for Advo but for significant segments of the saturation
14 mail industry.

15 Ironically, NAA witness Tye argues that ECR mail should be hit with an even
16 higher cost coverage and higher rates in order to "protect monopoly customers" by
17 "increasing the contribution from competitive classes such as ECR." Tr. 14742. He
18 claims this will also "arrest the past increases in volume of competitive classes due
19 to diversion" from non-postal competitors. Given the fact that saturation mail is price
20 sensitive and faces substantial competition, and because saturation postal rates are
21 near or at the point where a shift to private delivery becomes feasible, Tye's "solution"
22 for "protecting monopoly customers" will have the opposite effect. Even higher rates
23 will force that mail out of the system -- either by diverting advertisers to newspapers
24 and private delivery competitors, or by causing mailers themselves to leave the postal
25 system and become competitors of the Postal Service. Neither outcome is in the best
26 interest of "monopoly customers" or the Postal Service's universal delivery system.
27 What the Postal Service needs -- at a time when it is facing inevitable non-price-


1 related diversion of core mail volumes due to changing technology -- is the opportunity
2 to generate new volumes of profitable mail in all of its product categories, including
3 First Class mail.

4 This also exposes witness White's claim that all AAPS is seeking is a "level
5 playing field." What NAA and AAPS are really seeking is to maintain an artificially high
6 pound rate to insulate competitors from effective competition. The best way to set
7 rates that are fair to both mail users and competitors is to make them cost-based.
8 The current high pound rate is not only not cost-based, but has the effect of turning the
9 USPS's best customers into competitors

10 Advo wants to expand its shared mail operations, and we strongly prefer to do
11 so through the mail rather than private delivery. We are currently considering a
12 number of potential market opportunities to expand existing market coverages, add
13 second weekly programs in existing markets, and enter new markets, because of an
14 unmet demand in the marketplace. The major impediment to these initiatives is
15 postal rates, and especially the pound rate. That is why we must continue to explore
16 the possibilities of expanded private delivery.

CERTIFICATE OF SERVICE

I hereby certify that I have on this date served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.



Thomas W. McLaughlin

August 14, 2000