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

COMPLAINT OF TIME WARNER INC. ET AL.
CONCERNING PERIODICALS RATES

Docket No. C2004-1

COMPLAINT OF TIME WARNER INC.,
CONDÉ NAST PUBLICATIONS, A DIVISION
OF ADVANCE MAGAZINE PUBLISHERS INC.,
NEWSWEEK, INC.,
THE READER'S DIGEST ASSOCIATION, INC.
AND
TV GUIDE MAGAZINE GROUP, INC.
CONCERNING PERIODICALS RATES

January 12, 2004

TABLE OF CONTENTS

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(January 12, 2004)

Pursuant to 39 U.S.C. § 3662, Time Warner Inc. ("Time Warner"), Condé

Nast Publications, a Division of Advance Magazine Publishers Inc. ("Condé Nast"),

Newsweek, Inc. ("Newsweek"), The Reader's Digest Association, Inc. ("RDA"), and

TV Guide Magazine Group, Inc. ("TV Guide") ("Complainants" or "Time Warner Inc.

et al."), hereby request that the Commission: (1) establish a docket to investigate

the conformity of Periodicals Outside County (hereafter "Periodicals") rates with the

policies of the Postal Reorganization Act of 1970, 39 U.S.C. § 101 *et seq.* (the Act);

(2) conduct proceedings in conformity with section 3624 of the Act, including a full

hearing on the record; and (3) issue a decision recommending to the Governors of

the Postal Service adoption of the alternative Periodicals rate schedule proposed

herein, or one that follows similar principles of cost-based rate design, and/or such other relief as the Commission deems appropriate.[1]

I.   COMPLAINANTS

Time Warner provides internet service, publishes and distributes books and magazines, and is actively engaged in the fields of filmed entertainment, recorded music, music publishing, cable television programming, and cable television systems.

Time Warner is the nation's largest user of Periodicals mail and has participated in every omnibus rate case and major classification proceeding concerning Periodicals mail since postal reorganization in 1970.[2] Time Warner is a signatory to the Stipulation and Agreement adopted in the Commission's *Opinion and Recommended Decision* in Docket No. R2001-1, on which current rates are based.

The names and addresses of the persons who are to receive notices and correspondence concerning this Complaint are:

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[1] "In a Section 3662 complaint, the rate at issue need not be per se 'unlawful,' before changes may be recommended. In each case, the Commission will evaluate the relevant facts and circumstances, and determine whether the policies of the Act, on balance, call for the recommendation of a change in rates." PRC Op. C99-4, *Opinion And Recommended Decision On Complaint Of Continuity Shippers Association* (April 14, 2000), at 13.

[2] As Time Inc., Time Warner Inc., and AOL Time Warner Inc.

Condé Nast, a publisher of numerous consumer magazines covering fashion, lifestyle and other subjects, is a major user of all mail classes and delivers its publications to subscribers via Periodicals class.

The names and addresses of the persons who are to receive notices and correspondence concerning this Complaint are:

Howard Schwartz
Exec. Director of Distribution
    Sourcing & Postal Affairs
Advance Magazine Publishers Inc.
4 Times Square
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Barry Steiner
Sabin Bermant & Gould
4 Times Square, 22nd Floor
New York, NY 10036
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Newsweek publishes *Newsweek* magazine, with a mailed circulation of approximately 3.1 million copies per week. Newsweek is a user of all classes of mail, but primarily Periodicals Outside County mail.

The names and addresses of the persons who are to receive notices and correspondence concerning this Complaint are:

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Newsweek, Inc.
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Mountain Lakes, NJ 07046-0917
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RDA is one of the world's largest publishers, and a major user of Periodicals class mail.

The names and addresses of the persons who are to receive notices and correspondence concerning this Complaint are:

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Counsel
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TV Guide Magazine is the largest-selling weekly publication in the country with a total circulation of 9 million and readership of 28 million, and is a premiere source for entertainment news and information and TV listings. Since its debut on April 3, 1953, TV guide has been a major user of Periodicals class mail.

The names and addresses of the persons who are to receive notices and correspondence concerning this Complaint are:

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II.   BASIS OF THE COMPLAINT

This Complaint concerns fundamental reform of the Periodicals rate structure to achieve greater conformity with the ratemaking provisions of the Act. The need for such reform, and the deficiencies that underlie that need, have grown increasingly evident over the last two decades.

For the past seventeen years, Periodicals mail processing costs have been rising and Periodicals mail processing productivity has been falling, despite extensive efforts by both the Postal Service and mailers to bring about more efficient

Periodicals handling.[3] The Postal Service has long believed that changes in rate

design are also needed in order to address the inefficiencies of the Periodicals

class, and it has repeatedly advanced rate and classification proposals with that end

in view.[4] These proposals have not found favor with the Commission, although it

too has recognized the seriousness of this issue. The Commission has agreed with

mailers that important questions surrounding Periodicals mail processing operations

and the attribution and distribution of costs to Periodicals are unresolved and have

remained so for too long. It has responded to mailers' concerns about these

questions by mitigating their impact through successive reductions in Periodicals

cost coverage. But with coverage barely above 100 percent since the R97-1 rates

went into effect, virtually no leeway remains for the Commission to shield mailers in

this way from the problems of the subclass or deficiencies in its rate structure.

However, the Commission does possess the authority to remedy deficiencies in the

Periodicals rate structure that prevent mailers from taking steps to help themselves,

steps that would reduce the costs and increase the efficiency of the Periodicals

subclass overall. Nothing in the Act requires the Commission to leave mailers

powerless to respond to the seemingly intractable trend.

[3] *See* Exhibit A, appended to this Complaint.

[4] *See* Dockets No. R77-1, R87-1, R90-1, and MC95-1.

1.

Because they are substantially inconsistent with cost incurrence as now understood, the signals sent to mailers in Periodicals rates are significantly inefficient, so much so that they impair the value of Periodicals mail service by raising costs and failing to recognize the mail's preparation, neither of which results is contemplated by the Act. Improvements in cost analysis in the past decade, along with advances in mechanization, have shown that costs are determined in meaningful and systematic ways by the makeup of bundles, sacks, and pallets and associated interactions, including entry points. The extent to which these factors are recognized in rates is extremely limited, despite notable progress in recognizing worksharing activities. Complainants are prepared to present evidence that pertinent improvements in rate elements would bring about efficient changes on the part of mailers and would bring rates into closer conformity with the Act. The improvements proposed are meritorious in their own right, quite apart from other factors affecting mailers. But the unprecedented and unexplained Periodicals cost and rate increases of recent years make it all the more important to explore every available path of progress.

Periodicals flats are prepared in bundles, which are placed either in sacks or on pallets and entered into the postal system. In preparing a Periodicals mailing, choices are made that substantially affect how many bundles, sacks, and pallets the Postal Service must handle and how much they will cost to handle. More than half of Periodicals mail processing costs in today's environment are incurred handling the bundles, sacks, and pallets in which mail is entered. Yet the rates provide little information concerning what these costs might be, and, accordingly, there is no way that mailers can make efficient decisions. *Lacking clear price signals, mailers make*

inefficient choices that make postal costs higher than they would be in the presence of such signals.

For example, as shown in witness Stralberg's proffered testimony, it costs the Postal Service from $1 to over $3 to handle a sack, depending on how far the sack must travel through the postal system. Yet there exists a widespread practice among Periodicals mailers, large and small, of sending "skin sacks" containing only one or two pieces. While mailers undoubtedly have their reasons for this practice, such sacks would become rare if their rates reflected the associated cost incurrence.

As another example, mailers often have the opportunity to help the Postal Service reduce bundle sorting costs by creating more finely presorted pallets, e.g., creating 3-digit instead of ADC pallets or 5-digit instead of 3-digit pallets. But they do not bother to do so, because it is less convenient and because the price structure provides no indication of what the costs might be and no benefit for taking the trouble to reduce them.

These and other inadequacies in the current rate structure can be addressed today, using cost models and data that already exist. Complainants propose some simple remedies that will make Periodicals rates far more reflective of the associated costs than they are at present:

- instead of deriving all Periodicals revenues from piece and pound rates, as is the case today, there should be separate charges for the bundles, sacks, and pallets used in each mailing;

- the rates should recognize both bundle and container presort levels, as well as the effect of entry point on costs incurred;

- the rates should recognize the importance of AFSM-100 machinability for non-carrier route flats; and

- while preference for editorial content in Periodicals should continue, the opportunity to earn lower rates by entering mail closer to its final destination should be extended to publications with high editorial content.

The unit costs per piece, bundle, sack, and pallet and corresponding volume data needed to develop a rate structure based on the above principles are presented in witness Stralberg's testimony. Witness Mitchell uses that information to develop an alternative rate structure, revenue neutral with current rates, with the potential to reduce Periodicals costs significantly.

The proposed rates would include more rate elements but would allow simplification of the ever more complex mail preparation requirements. They will lead to improvements in mail preparation software, so as to take the fullest advantage of the new incentives to minimize combined costs to mailers and the Postal Service by, for example, balancing the piece-sorting costs saved by producing more finely presorted bundles against the extra costs of handling more bundles, and the bundle-sorting costs saved by producing more finely presorted pallets against the cost of handling more pallets.

These proposals are not a surprise to the Postal Service, which several years ago undertook a study to develop the types of cost data needed for a cost-based rate structure. Witness Stralberg started with the Postal Service's cost model described in LR-I-332 from Docket No. R2000-1 and modified that model to bring it into conformance with the wage rates, piggyback costs, productivity rates, mail flow and entry point information, and the Commission's costing methodology from the most recent rate case, Docket No. R2001-1**.**

Complainants do not assert that their proposal is a complete solution. For example, the Postal Service may possess more recent cost and mail-characteristics data with more accurate unit cost estimates. However, the remedy proposed, which is based on the most complete, accurate, and current information available that has been tested in record Commission proceedings, and on the Commission's methodologies and institutional cost assignments as established in the most recent

omnibus rate case, would go a long way towards sending better price signals to mailers and thereby reducing Periodicals costs.

<div align="center">2.</div>

The unzoned pound rate for editorial matter in Periodicals ("unzoned editorial rate"), created by Congress in 1917, is a substantial impediment to the development *of* a more efficient Periodicals rate structure and an anomalous element that complicates and sometimes defeats coherent Periodicals rate design. The Postal Service has repeatedly sought to eliminate the unzoned editorial rate (*see* Dockets No. R77-1, R87-1, and R90-1) or to ameliorate its impact, for example by dividing Periodicals into two less heterogeneous subclasses, one with and one without an unzoned editorial rate (*see* Docket No. MC95-1). The Commission too has recognized that the unzoned editorial rate imposes costs in the form of lost efficiencies but has nonetheless declined to approve proposals for change, citing its understanding of the purposes underlying the original creation of the unzoned editorial rate, its interpretation of sections 101(a) and 3622(b)(8) of the Act as favoring "the widespread dissemination of information" as a means of "bind[ing] the Nation," and its concerns for the welfare of small, high-editorial publications. These matters were last extensively addressed by the Commission in Docket No. R90-1, at which time the evidentiary record on the contribution of the unzoned rate to binding the nation was not well developed. As discussed below, Complainants are prepared to build a far more comprehensive record, including expert testimony by John Steele Gordon regarding how a century of technological, economic, and social progress have transformed the conditions that were originally thought to justify an unzoned editorial rate.

In addition to the need for a more complete record, several changes in circumstances since Docket No. R90-1 cast doubt on whether the unzoned editorial

rate currently generates policy benefits that outweigh the burdens it imposes in derogation of other policies of the Act, or even advances the policies of the Act at all. Moreover, other, longer-term developments since the establishment of the unzoned editorial rate in 1917 raise questions about the need for and efficacy of policies specifically aimed at fostering the widespread geographical dispersion of publications and, indeed, even about the meaning of "widespread dissemination" in today's society. These historical, cultural, technological, and legal developments are not adequately addressed by the record in previous Commission proceedings.

The most recent of these changes--and the most salient in demonstrating why Commission reconsideration of these issues is justified at this time--is an extraordinarily encouraging one for Periodicals. Namely, an opportunity exists today, in the form of widespread access to long-haul transportation of magazines (pool shipments by printers and consolidators) that is much cheaper than what the Postal Service is able to offer (so much cheaper, in fact, that monthlies with average or less-than-average advertising content that used to be entered near their origin are finding it to their advantage to join these pool shipments, even though the postal savings are realized only on the advertising portion, while the pool shippers must be paid for the total weight).[5] High editorial publications are being denied these savings opportunities. The unzoned editorial rate is the most important obstacle holding them back.[6]

Second, over the course of the 20th century mass media of universal reach and systems of rapid and inexpensive transportation were developed in the United States, followed in the past decade by the burgeoning "information revolution" that

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[5] Participation in such pool shipments has the added advantage of making delivery more predictable than if the mail has to make its way through a series of postal facilities.

[6] This issue will be addressed by the proffered testimony of Joe Schick (*see* Section V, below).

has brought a proliferation of inexpensive means of communication and a previously unimaginable diversity of information sources that are entirely independent of geography. These developments have reinforced and accelerated other 20th-century historical and cultural trends, which had already dramatically reduced, and perhaps reversed, dangers of regionalism or "Balkanization" that existed in 1917 and that may have partly motivated Congress's decision in that year to retain an unzoned rate for the editorial content in periodical publications.

"Balkanization" today is not so much based on geographic distance but often exists within city or county boundaries in the form of divisions based on ethnicity, national origin, language, religion, or similar factors, and this is an argument for supporting, rather than discriminating against, local and regional publications. The same technological wave that has fostered a common national culture (to the point that concerns are now far more often expressed about the sameness of things across American culture and the erosion of regional distinctiveness--of accent, cuisine, dress, occupation, manners, music, popular culture, and more) has greatly diminished, and very possibly made vestigial, any role played by the unzoned editorial rate in achieving "the widespread dissemination of information."[7]

Finally, the first legal challenge to be brought against the unzoned editorial rate was adjudicated in *Mail Order Ass'n. of America v. United States Postal Service*, 2 F.3d 408 (D.C. Cir. 1993) (*MOAA*), an appeal of the Docket No. R90-1 rate case. While the Court upheld the rate as within the permissible bounds of the Commission's policymaking judgment, it nevertheless undercut the Commission's traditional rationale for the policy, and it indicated skepticism about the depth and

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[7] These issues will be addressed by the proffered testimony of John Steele Gordon (*see* Section V, below).

cogency of the Commission's analysis and the congruence between its means and its ends.

   MOAA held that section 3622(b)(8)--one of the two provisions of the Act that the Commission had always interpreted as favoring an unzoned editorial rate to promote the "widespread dissemination of information"--"lends no support to the Commission's outcome," 2 F.3d 408 at 436, leaving the continuing status of the Commission's R90-1 policy and statutory analysis in considerable uncertainty. In its Docket No. R90-1 Opinion, based on a record that was inadequately developed with respect to both the economic costs of the unzoned editorial rate and its putative public policy benefits, the Commission concluded that section 101(a)'s injunction to "bind the Nation" and section 3622(b)(8)'s recognition of the "educational, cultural, scientific, and informational [ECSI] value" of mail matter both militate in favor of an unzoned editorial rate, and that on balance these "public policy" benefits outweighed the economic inefficiencies caused by the unzoned rate.[8] Whether the Commission would have reached the same conclusion if it had viewed § 101(a) as the only provision weighing in favor of the unzoned rate, or if it had, like the *MOAA* Court, viewed whatever benefits derived from the unzoned rate as being purchased only *at the expense* of the values embodied in § 3622(b)(8), is impossible to know.[9]

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[8] The Court in *MOAA* ruled that the unzoned editorial pound rate "may diminish the flow of information," that "the generic interest in spreading information may cut the other way" (i.e., in favor of a zoned rate) and that § 3622(b)(8), which recognizes "educational, cultural, scientific, and informational value to the recipient of mail matter;" "lends no support to the Commission's outcome." 2 F.3d 408 at 436.

[9] The *MOAA* Court assumed (under the highly deferential standard of review it was bound to apply) that if the Commission had considered the matter in light of the Court's interpretation of the Act it would nonetheless have arrived at the same result, retaining an unzoned editorial rate to foster "widespread dissemination of information" based solely on its interpretation of § 101(a), as the Commission had the legal authority to do. 2 F.3d 408 at 437.
   An examination of other Commission precedents addressing the same issue, however, shows the Court's assumption to be questionable, for in dockets previous to Docket No. R90-1 the Commission had repeatedly relied on § 3622(b)(8) alone to justify its policy, making no reference at all to § 101(a). *See* PRC Op. R77-1 at 350; PRC Op. R87-1 at 548-49, ¶¶ 5041, 5043; and PRC Op. MC91-3 at 112-13, ¶¶ 4059-60. Uncertainty regarding the continuing status of the Commission's

A reconsideration of these issues in light of current knowledge and circumstances, Complainants submit, will demonstrate that: (1) maintenance of an unzoned editorial rate for the purpose of fostering "widespread dissemination of information" is no longer a useful, or even explicable, way of recognizing or promoting the "educational, cultural, scientific, and informational value" of periodical publications; (2) maintenance of an unzoned editorial rate provides a rate benefit to long-haul publications only at the cost of imposing complementary rate burdens on similarly situated short- and average-haul publications, in derogation of the recognition owed to the ECSI value of those publications under § 3622(b)(8) and of § 3621's, § 3622(b)(1)'s, and § 3623(c)(1)'s requirements that rates and classifications be fair and equitable; (3) maintenance of an unzoned editorial rate imposes substantial operational and pricing inefficiencies on the Postal Service and the Periodicals subclass as a whole; and (4) maintenance of an unzoned editorial rate creates substantial obstacles to a rational, comprehensible, economically coherent Periodicals rate design, in derogation of § 3622(b)(7). Therefore, the policies of the Act are not currently well served by maintaining the unzoned editorial rate.

Docket No. R90-1 policy analysis are reinforced by the fact that in Docket No. MC95-1, where it rejected a proposal to divide Periodicals into two subclass, only one of which would have retained an unzoned editorial rate, the Commission: (1) made only passing reference to the issue of editorial zoning (*see* PRC Op. MC95-1 at V-122-23, ¶¶ 5286-87); (2) did not cite editorial zoning but rather a variety of other grounds for its rejection of the proposal (*see, e.g., id.* at V-124-28, ¶¶ 5290-97 and II-39, 42, 44, 45, ¶¶ 2119, 2127-28, 2135, 2139); and (3) did not even mention the recently decided *MOAA* case.

III.   BACKGROUND

Notwithstanding serious review of Periodicals cost increases by the industry, the Postal Service, and the Commission over more than a decade, Periodicals costs continue to increase in excess of CPI and postal wage increases.

The Periodicals cost problem first came to light in Docket No. R90-1, when documentation accompanying the Postal Service's rate proposal revealed that between FY86 and FY89 second-class regular rate (2RR) mail processing unit costs increased by 41% (volume adjusted) and were $59 million higher than they should have been *based on FY86 productivity rates*, despite increased drop shipping, palletization, and deployment of mechanized flat sorters that should have produced $29 million in 2RR mail processing cost reductions.[10]

In subsequent years, worksharing by Periodicals mailers continued to increase and the Postal Service introduced and a series of new technologies whose higher maintenance and capital costs were supposed to be recovered by higher sorting productivity.

Some of the ways in which Periodicals mailers have improved their mail preparation include:

- The percent of regular rate Periodicals entered at the destinating SCF, which bypasses all earlier transportation and handling steps, was only 15.4% in FY86. In FY02 it was 45% of pieces and 50% of pounds.

- The percent that is palletized has increased from around 28%, as estimated in R87-1, to over 60%.

- Carrier route presort has increased from 26% in FY89 to about 40%.

- Pre-barcoding was unknown in FY89. By FY02, 78% of non-carrier route Periodicals pieces were pre-barcoded. To qualify

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[10] *See* Docket No. R90-1, Direct Testimony of Halstein Stralberg (TW-T-2) at 6: Tr. 27/II/13284.

for barcode discounts, mailers must participate in programs to assure address quality and accuracy.

- The volume and complexity of regulations for mail preparation and entry that mailers must comply with (per the DMM) has increased dramatically.

The technological advances introduced by the Postal Service to reduce the cost of processing Periodicals and other flats include:

- In the late 1980's, more than 800 flat sorting machines (FSM's) were deployed, and during the 1990's they received a number of enhancements, including being equipped with BCR's and later OCR's.

- By FY99, the Postal Service had also added 300 FSM-1000's, a type of machine that was believed to be able to sort almost all flats, and to have the potential of eliminating manual sorting.

- The Postal Service installed large numbers of small parcel and bundle sorters (SPBS), equipped with advanced "feed systems," in order to reduce the cost of bundle sorting.

- In FY2000, the Postal Service started deploying a new generation of flats sorting machines, the AFSM-100's, a significant technological advance over the FSM-881's (which now have been retired). Flats processing today is organized around the AFSM-100.

But throughout the late 1980's and 1990's and into the current decade, Periodicals mail processing costs continued to increase more than postal wages.

In Docket No. R97-1, the magazine publishing industry put aside its traditional differences to present the Commission with a united plea for attention to the unresolved problem of Periodicals costs. In their joint Trial Brief, the Alliance of Nonprofit Mailers, American Business Press, the Coalition of Religious Press Associations, Dow Jones & Company, Inc., Magazine Publishers of America, the National Newspaper Association, The McGraw-Hill Companies, Inc., and Time Warner Inc. informed the Commission that they had joined together "in order to focus on a single overriding issue that has an immense, continuing adverse effect on all of us" (Trial Br. at 4), namely "why, for more than a decade, the proportion of

its mail processing time devoted to not handling and other nonproductive activities in manual operations has been increasing uncontrollably and the productivities in those operations have been deteriorating" (*id.* at 8).

In its Docket No. R97-1 decision, the Commission responded:

> These issues are important. The analysis presented thus far by the Service is incomplete, not well developed or examined, and may be selective. For this reason, the Commission welcomes the cooperative inquiry into the costs of Periodicals mail that is planned by the Postal Service and the industry.

PRC Op. R97-1, at 147, ¶ 3194.

In recognition of these and other problems, the Commission lowered the Periodicals Class markup to 101%, the minimum level allowable under the Act.

Immediately after the Docket No. R97-1 decision was issued, the "cooperative inquiry" to which the Commission referred was initiated. A joint industry/USPS Periodicals Mail Processing Review Team ("Periodicals Task Force") was formed to investigate why Periodicals mail processing costs were rising and to seek mutually agreed upon solutions. The Task Force included representatives from American Business Media, the Magazine Publishers of America, the Operations and Finance divisions of the Postal Service, and a consultant from Christiansen and Associates. It made extensive visits to Postal Service facilities, including BMC's (Bulk Mail Centers), P&DC's (Processing and Distribution Centers), Annexes, and Associate Offices, that collectively handled 14% of all flat mail processed in the United States. The Task Force's Report, issued in March 1999, and produced a total of fifteen recommendations containing short- and long-term action items for local postal operations, national postal operations, and/or mailers.[11]

Among these recommendations were the following:

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[11] *See* Docket No. R2000-1, LR-I-193, Report of the Periodicals Operations Review Team; and Direct Testimony of James O'Brien (TW-T-2), at 2-3: Tr. 24/11170-71.

- Preparation standards for Periodicals should more closely match postal processing configurations.

- Optimization of containerization can help reduce costs.

- Further develop and communicate the flats operation plan.

- Separation of mail classes is of questionable value and may add to costs without necessarily improving service.

- Improved bundle preparation by mailers and improved materials handling by the Postal Service will reduce bundle breakage--which appears to increase Periodicals Costs significantly.

- Focus operations management on the importance of efficiently managing processes and equipment.

- There is opportunity for cost reduction by more effective utilization of automated flat sorting equipment.

- Cost attribution methodologies should be reviewed in light of operational observations.

- The Periodicals rate structure should be reviewed to ensure that it is consistent with the overall Periodicals processing strategy and induces appropriate mailer behavior.

The response to the recommendations of the Task Force from Postal Service management was promising.[12] A number of actions were taken in furtherance of the recommendations of the Task Force.[13] However, these initial measures have clearly not solved all the problems.

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[12] *See* Docket No. R2000-1, TW-T-2 (O'Brien), at 20-21, 25-26: Tr. 24/11194-95; TW-T-1 (Stralberg), at 4-5, 9: Tr. 24/11351-52, 11356.

[13] For example, the Postal Service has created new labeling lists to allow greater presorting efficiency. The L001 list, for example, takes advantage of the fact that some DDU's serve more than one 5-digit ZIP code, allowing "5-digit" pallets to the combined ZIP codes. The L007 list takes advantage of the fact that AFSM-100 machines often perform simultaneous incoming secondary sorting to more than one 5-digit zone. The Postal Service implemented a recommendation to allow the multiple stacking of small pallets up to four tiers high. Periodicals Standard Operation Procedures were revised to permit postal managers to commingle Periodicals and Standard(A) flats when doing
[footnote continues on next page]

The effectiveness of the AFSM-100 in reducing Periodicals mail processing costs remains to be seen. In FY2001, when most of the AFSM-100 deployment occurred, Periodicals mail processing unit costs increased by 7.62%, versus a 3.18% increase in clerk and mailhandler wage rates. Things went a little better in FY2002, when the Postal Service, faced with unprecedented financial challenges, was able to achieve substantial reductions in staffing levels. Periodicals mail processing unit costs that year declined by 2.8%, leaving a net increase from FY2000 to FY2002 of 4.61%.

However, after all the efforts at technological solutions, including the AFSM-100, the efforts by Periodicals mailers to reduce costs through increased worksharing, and all of the attention given to Periodicals costs by Postal Service management and by the Commission, Periodicals per-piece processing costs (adjusted for inflation) remain far higher today than when all processing was being done manually.

In Docket No. R2000-1, witness Stralberg testified that he was:

> more convinced than ever that the only reliable way to reduce postal costs is for mailers to prepare their mail in ways that bypass as much of the postal system as possible, i.e., by increased worksharing. In addition to regulations requiring more efficient mail preparation, which the Postal Service apparently plans to introduce more of, it is my view that there must be strong rate incentives to encourage worksharing.

TW-T-1 at 7-8: Tr. 24/11354-55.

What may not have been apparent in 1990 but became so over the ensuing decade is that the Periodicals rate structure does not send proper, cost-based rate signals to mailers. Rates that would induce them to prepare their mail in a more

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so is consistent with maintaining Periodicals service standards. *See* Docket No. R2000-1, TW-T-2 (O'Brien), at 5, 6, 11: Tr. 24/11173, 11174, 11179. More recently, it allows barcoded and non-barcoded flats to be in the same presorted package, in recognition of the fact that they are likely to be sorted on the same machine anyway.

efficient manner and would reduce total Periodicals costs would better conform to the policies and ratemaking criteria of the Act.

IV.   JURISDICTION

The Commission's jurisdiction is founded on 39 U.S.C. §§ 3662, 101(a), (d), 403(a), (c), 3622(b)(1)-(8), and 3623(c)(1). The relevant policy provisions are:

§ 101(a). . . . The 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. . . . The costs of establishing and maintaining the Postal Service shall not be apportioned to impair the overall value of such service to the people.

§ 101(d). Postal rates shall be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis.

§ 403(a). The Postal Service shall plan, develop, promote, and provide adequate and efficient postal services at fair and reasonable rates and fees. . . .

§ 403(c). In providing services and in establishing classifications, rates, and fees under this title, the Postal Service shall not, except as specifically authorized in this title, make any undue or unreasonable discrimination among users of the mails, nor shall it grant any undue or unreasonable preferences to any such user.

§ 3621. Except as otherwise provided, the Governors are authorized to establish reasonable and equitable classes of mail and reasonable and equitable rates of postage and fees for postal services in accordance with the provisions of this chapter. Postal rates and fees shall be reasonable and equitable and sufficient to enable the Postal Service under honest, efficient, and economical management to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States. . . .

§ 3622(b). Upon receiving a request, the Commission shall make a recommended decision on the request for changes in rates or fees in each class of mail or type of service in accordance with the policies of this title and the following factors:

(1) the establishment and maintenance of a fair and equitable schedule;

(2) the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery;

(3) the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type;

(4) the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;

(5) the available alternative means of sending and receiving letters and other mail matter at reasonable costs;

(6) the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;

(7) simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services;

(8) the educational, cultural, scientific, and informational value to the recipient of mail matter; and

§ 3623(c). The Commission shall make a recommended decision on establishing or changing the schedule in accordance with the policies of this title and the following factors:

(1) the establishment and maintenance of a fair and equitable classification system for all mail.

V. PROFFER OF EVIDENCE

Pursuant to the Commission's rules of practice and the requirements of sections 3622, 3623, and 3624 of the Act, Complainants are prepared to carry the burden of presenting substantial record evidence in support of the legality of the proposed alternative rates and the conclusion that a more cost-based rate structure using the proposed rates would be substantially more consistent with the policies of

the Act than are existing Periodicals rates. Complainants proffer the following expert testimony in support of their direct case:[14]

TW et al.-T-1: Proffered Testimony of Robert W. Mitchell Concerning Periodicals Rate Design

TW et al.-T-2: Proffered Testimony of Halstein Stralberg Concerning Periodicals Costs

TW et al.-T-3: Proffered Testimony of John Steele Gordon Concerning the Impact of Technological Progress on the Widespread Dissemination of Information in the United States: 1879 to the Present

TW et al.-T-4: Proffered Testimony of Joe Schick Concerning the Impact of Eliminating the Unzoned Editorial Pound Rates on Smaller Publications and their Printers

VI. RELIEF REQUESTED

Complainants respectfully request that the Commission promptly hold hearings on this Complaint under § 3624 of the Act and then issue a recommended decision under §§ 3622, 3623, and 3625 of the Act, recommending the adoption of cost-based Periodicals Outside County rates that more fully reflect differences in operational and cost-causing characteristics within the Periodicals Outside County subclass, that discontinue the policy of maintaining an unzoned editorial pound rate, and that promote more efficient methods of mail preparation and entry by sending mailers better price signals.

---

[14] The proffered testimony of Robert W. Mitchell and of Halstein Stralberg is appended to this Complaint as Attachments A and B. The proffered testimony of John Steele Gordon and Joe Schick can be produced reasonably quickly following a determination by the Commission to conduct a hearing on this Complaint.

Respectfully submitted,

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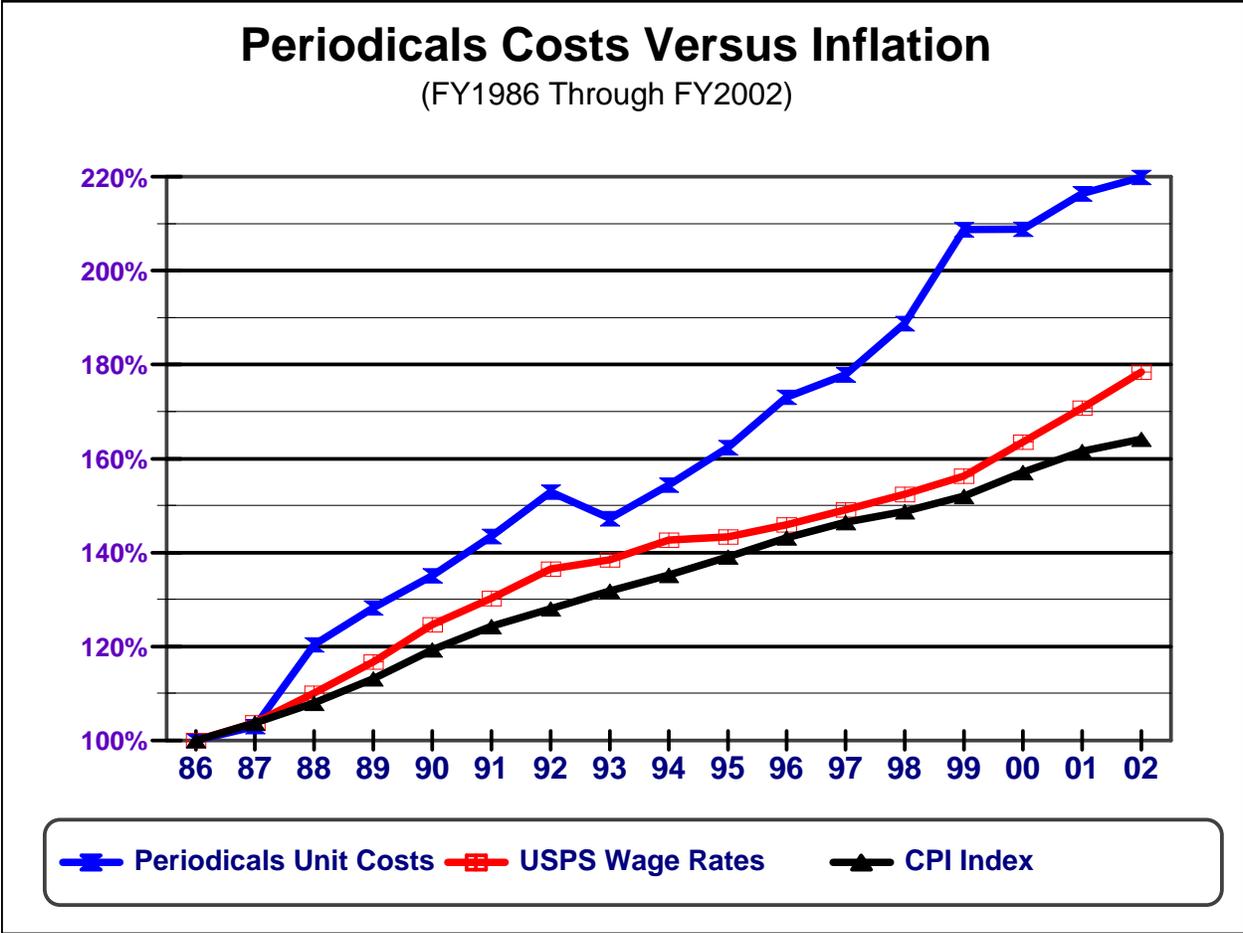
ON BEHALF OF
TV GUIDE MAGAZINE GROUP, INC.

EXHIBIT A

Periodicals Costs Versus Inflation
(FY1986 Through FY2002)

Legend: Periodicals Unit Costs — USPS Wage Rates — CPI Index

EXHIBIT B

PERIODICALS RATES									
Per Piece		Per Bundle		Per Sack		Per Pallet		Per Pound	
Bundle Level		Container Level		Sack Level		Pallet Level		Distance (Zone)	
Piece Description		Bundle Level		Entry Point		Entry Point		From Entry Point	
Bundle/ Piece	$/Pc	Container/ Bundle	$/Bundle	Sack/ Entry Pt.	$/Sack	Pallet/ Entry Pt.	$/Pallet	Entry Zone	$/Pound
Mx. ADC		**Mx. ADC**				**ADC**			
Non	0.439	MADC	0.260	**Mx ADC**		Origin	40.78	DDU	0.144
Mach	0.306	ADC	0.320	Origin	1.54	DBMC	27.13	DSCF	0.165
Bar-Non	0.383	3-D/SCF	0.350			DADC	13.79	DADC	0.173
Bar-Mach	0.261	5-D	0.380	**ADC**				Z 1&2	0.189
ADC				Origin	3.28			Zone 3	0.204
Non	0.312			DBMC	2.39	**3-D/SCF**		Zone-4	0.242
Mach	0.282	**ADC**		DADC	1.30	Origin	40.36	Zone-5	0.300
Bar-Non	0.279	ADC	0.100			DBMC	27.13	Zone-6	0.361
Bar-Mach	0.245	3D/SCF	0.170	**3-D/SCF**		DADC	25.94	Zone-7	0.434
SCF/3-D		5-D	0.200	Origin	3.25	DSCF	13.79	Zone-8	0.497
Non	0.312	CR	0.210	DBMC	2.39				
Mach	0.276			DADC	2.04				
Bar-Non	0.280			DSCF	1.30	**5-D**			
Bar-Mach	0.241	**3-D/SCF**				Origin	42.75		
5-D		3-D/SCF	0.110	**5-D/CR**		DBMC	30.72		
Non	0.219	5-D	0.180	Origin	3.33	DADC	24.79		
Mach	0.213	CR	0.190	DBMC	2.80	DSCF	17.20		
Bar-Non	0.211			DADC	2.12	DDU	1.58		
Bar-Mach	0.195			DSCF	1.75				
CR Basic	0.122	**5-D/CR**		DDU	0.93				
CR HD	0.090	5-D	0.000						
SAT	0.082	CR	0.080						
Piece Sorting Delivery		Bundle Sorting		Sack Handling/Sorting Sack Opening Sack Return		Pallet Handling Pallet Opening Pallet return		Transportation Bulk Handling Some Piece Sorting Delivery	

Per-pound Editorial Discount, cents per editorial pound	10.1
Per piece editorial discount, cents times editorial percent	7.4
Per-piece charge for qualified Ride-Along pieces, cents	12.4

Proposed Rate Schedule - Outside County Periodicals - Non-Letters

**[Complaint of Time Warner Inc. et al.
Attachment A]**

TW et al.-T-1

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

———————————————————————

COMPLAINT OF TIME WARNER INC. ET AL.
CONCERNING PERIODICALS RATES   Docket No. C2004-1

———————————————————————

PROFFERED DIRECT TESTIMONY OF
ROBERT W. MITCHELL
ON BEHALF OF
TIME WARNER INC.,
CONDÉ NAST PUBLICATIONS, A DIVISION
OF ADVANCE MAGAZINE PUBLISHERS INC.,
NEWSWEEK, INC.,
THE READER'S DIGEST ASSOCIATION, INC.
AND
TV GUIDE MAGAZINE GROUP, INC.
CONCERNING PERIODICALS
RATE DESIGN

January 12, 2004

TABLE OF CONTENTS

1   **Direct Testimony**
2
3   **Of**
4
5   **Robert W. Mitchell**
6
7
8   **AUTOBIOGRAPHICAL SKETCH**
9
10
11   My name is Robert W. Mitchell. I am a consultant on issues relating to postal

12 rates. From 1992 until my retirement in 2002, I worked as Special Assistant to the Postal

13 Rate Commission and, before that, as Special Assistant to the Chairman. From 1975 to

14 1992, I was a Cost Systems Analyst, a Planning Officer, an Assistant to the Assistant

15 Postmaster General of Rates and Classifications, Manager of the Primary Rates Branch in

16 the Office of Rates, and a Principal Economist at the United States Postal Service. I have

17 worked on a wide range of rate issues, from costing to rate administration to rate design

18 to regulatory policy. I have represented the Rate Commission and the Postal Service to

19 mailers and postal groups. I was the Postal Service's witness on Periodicals and Standard

20 Mail rates (then second and third class) in Dockets No. R87-1 and R90-1, and testified

21 for the Postal Service in four other dockets. I have also been a consultant on rates to the

22 nations of Dominica and The Gambia.

23   Prior to joining the Postal Service, I was an Assistant Professor of Business at the

24 University of Wisconsin-Milwaukee, teaching Economic Theory and Managerial

25 Economics. I have a Bachelor of Science in Mechanical Engineering from the University

1   of Cincinnati and an M. A. in Economics from Case Western Reserve University. While

2   at Case, I passed my written and oral comprehensive examinations for the Ph.D. in

3   Economics, with major areas in Economic Theory, Econometrics, and Industrial

4   Economics.

5   I have written a number of articles and published papers, primarily on economic

6   issues relating to postal rates, including: "Postal Worksharing: Welfare, Technical

7   Efficiency, and Pareto Optimality," in *Emerging Competition In Postal and Delivery*

8   *Services* (1999), and "Preparing the Postal Service's Rate Structures for Competition: A

9   Study of How the United States Postal Service Might Adjust to Increased Competitive

10   Pressure," in *Future Directions in Postal Reform* (2001).

1 **I. PURPOSE OF TESTIMONY**

2   The purpose of my testimony is to describe the deficiencies in Periodicals rates

3 and to propose alternative rates, more consistent with the guidance in the Postal

4 Reorganization Act, that recognize costs efficiently and give appropriate signals to

5 mailers.

6   I contend that our current understanding of postal costs and mailer capabilities

7 makes it clear that Periodicals rates are at variance with the Act's guiding background

8 presumption in favor of efficient rates. I also contend that when a full record is

9 developed, it will show that the unzoned editorial pound rate is not serving its intended

10 purpose and is adverse to accepted principles of efficient rate setting.

11   My testimony has three main sections: (1) an analysis of the deficiencies of the

12 current Periodicals rates (Section III); (2) a proposed alternative rate design for

13 Periodicals that would take a long stride toward remedying those deficiencies, including a

14 specific rate schedule and a detailed account of the development of the rates therein

15 (Section IV); and (3) an explanation of the desirability of the proposed alternative rates,

16 and their superiority to the current rates, in relation to the statutory ratemaking factors

17 and other policy provisions of the Act (Section V).

18   In Appendix A, I develop a model of publisher decisions on whether a zoned

19 editorial pound rate would provide reason to reduce or eliminate subscribers in the higher

20 zones.

21   My workpapers consist of three spreadsheets and are contained in library

22 reference TW et al. 2. WP-Mitchell-1.xls is equivalent to the Commission's Library

23 Reference No. 9 in Docket No. R2001-1, except that the billing determinants are for full-

1   weight zoning and three errors are corrected. WP-Mitchell-2.xls contains the formulas to

2   separate the letter-size pieces from the non-letter-size pieces; see sheet 'Ltr BD' in it.

3   WP-Mitchell-3.xls shows the development of the proposed rates.

4

1   **II. SUMMARY OF TESTIMONY**

2   Following is a summary of the three principal sections of this testimony.

3

4   Section III

5   Section III poses what seems, in the context of a complaint proceeding, the

6   obvious threshold question: what is so wrong with current Periodicals rates as to

7   justify a complaint proceeding seeking to effect their reform?

8

9   My answer to that question is essentially as follows:

10   1. Over a period that extends back into the 1980s, the increases in Periodicals

11   rates have been greater than the increases in the Consumer Price Index,

12   even after the reduced markups recommended by the Commission. The

13   fact that this has been occurring makes it all the more important to search

14   for other avenues of progress, on which this Complaint focuses.

15

16   2. Improvement in our understanding of costs in recent years has brought the

17   existing deficiencies into clearer focus and has suggested new paths that

18   cost recognition should follow. For example, the makeup of bundles,

19   sacks, and pallets, including their entry points and associated interactions,

20   are now understood to be important cost drivers, but these factors are all

21   but neglected in rates. As a consequence, mailers often have no way of

22   knowing or reason for caring that their decisions about mail preparation

1   and transportation are needlessly wasteful. If the factors that drive costs

2   were reflected in rates, mailers would respond accordingly.

3

4   3. Despite statutory language and legislative history that emphasize costs and

5   require recognition of the preparation of the mail, the Periodicals rate

6   structure still includes the highly inefficient unzoned editorial pound rate,

7   an outdated policy preference that thwarts adequate recognition of cost

8   incurrence. Maintaining this structure has interfered with the natural

9   forces that promote more efficient rates in every part of the Periodicals

10   rate design. For example, a variety of pound-oriented savings have been

11   converted into per-piece discounts in order to avoid undermining the

12   insensitivity of the editorial pound charge to actual cost incurrence.

13

14   4. If the pound rates for editorial matter were to vary with distance, the

15   marginal costs of printing and distributing would remain low relative to

16   revenues from advertising and subscriptions, even for the higher zones.

17   Therefore, publishers faced with zoned editorial pound rates would

18   continue to find it profitable to add higher-zone subscribers and would not

19   find reason to drop such subscribers or otherwise to limit the availability

20   of their publications based on the geographical proximity of the recipients.

21   An unzoned editorial pound rate is not required to make periodical

22   publications equally accessible in all areas or to promote the widespread

23   dissemination of editorial matter.

1

2   5. Because of the unzoned editorial pound rate, many local and regional

3   publications that choose to print near their home base are unfairly charged

4   elevated rates in order to support reduced rates for publications going

5   greater distances.

6

7   Section IV

8   1. Section IV develops a schedule of rates designed to recognize costs

9   efficiently and to give appropriate signals to mailers. The proposed rates

10   are tied to the rates recommended by the Commission in Docket No.

11   R2001-1; they preserve all discounts and rate structures to the maximum

12   extent possible; they are revenue neutral; and they are based on the same

13   volumes and billing determinants.

14

15   Section V

16   1. The proposed rates achieve improved consistency with the ratemaking

17   factors set out in §§ 3622(b) and 3623(c) of the Act. They are more fair

18   and equitable. Implicit cost coverages are more in line with principles of

19   worksharing, efficient component pricing, and lowest combined cost.

20

21   2. Costs are recognized in the proposed rates in ways that are consistent with

22   widely accepted rate-setting principles. The rates present mailers with the

23   cost implications of their decisions and give them tools for dealing with

1   those implications in the form of incentives for more economical mailing

2   practices.

3

4   3.   The proposed rates substantially improve the recognition of the effects of

5   the preparation of the mail on the Postal Service's costs. Specific

6   attention is paid to the handling and the makeup of bundles, sacks, and

7   pallets, and their associated entry points. Weight-related costs, however,

8   continue to be recovered in the pound charges, even when they are

9   incurred handling bundles.

10

11   4.   The effects on mailers of any rate increases have been carefully

12   considered. The proposed rates move closer to rates that would be

13   generated by a competitive market at a measured pace that leaves room for

14   further improvement in the future. They would reduce cost averaging

15   across the subclass and increase the alignment of the rates of individual

16   mailers with the underlying Postal Service costs, but these steps are

17   tempered by consideration of potential impacts on individual mailers and

18   the desire to avoid undue burdens or extreme dislocations in intra-subclass

19   rate relationships. For example, no markups are proposed for the new rate

20   elements and higher-zone mailers would be faced with only the *additional*

21   costs associated with their mail. Also, many small publications will be

22   helped by the ADC presort level, the DBMC dropship rate, the recognition

1 of machinability, improvements in the pallet/sack differential, and

2 improved dropship discounts for sacks.

3

4   5. The proposed rates are not unduly complex. They align with the

5 operations that mailers perform in preparing mail and should be easy to

6 understand. They avoid certain complexities in the current rates and

7 diminish or eliminate a number of anomalies caused by the divergence of

8 current rates from costs.

9

10   6. The proposed rates do not diminish the current recognition of the

11 educational, cultural, scientific, and informational value of matter in

12 Periodicals. The implicit cost coverages on editorial and advertising

13 matter are not altered.

14

1   **III. WHAT IS WRONG WITH PERIODICALS RATES?**

2   Essentially, Periodicals (then denominated "second class") came into existence in

3   1879. In 1885, the rate was set at 1 cent per pound, independent of the distance

4   transported or the proportion of advertising. If a publisher failed to qualify for this rate,

5   he paid the third-class rate of 1 cent for each 2 ounces, fully 8 times higher. Clearly,

6   Congress intended not only to separate Periodicals for rate purposes but also to make the

7   rates extremely attractive.

8   Many adjustments in rates have occurred since that time, but Periodicals has

9   remained a separate class of mail throughout. Since the Postal Reorganization Act of

10   1970 (hereinafter Act), the rate level for Periodicals has been determined, except for

11   phasing provisions, by the application of a Commission-determined markup to

12   Periodicals costs. In a 1976 Amendment to the Act, Congress required that in selecting

13   markups, consideration is to be given to the "educational, cultural, scientific, and

14   informational [ECSI] value" of the mail matter conveyed. This consideration is

15   understood to apply in its strongest form to Periodicals.[1]

16   With this kind of history, one might expect Periodicals rates to be low and

17   attractive. But Periodicals rates are not low. They have been rising inordinately, and

18   their attractiveness is dwindling. One would be hard pressed to argue that this outcome is

19   consistent with what Congress expected. Something went wrong.

20   I do not contend that a few adjustments in the rates for Periodicals will solve all of

21   the problems. I do contend, however, that the current rates are inefficient to such a

---

[1] "Eligibility for the Periodicals class is conditioned, among other things, on a minimum amount of nonadvertising—or editorial—content. The presence of this type of content entitles all Periodicals mail to special consideration, given explicit statutory recognition of educational, cultural, scientific and informational value as a ratemaking criterion." PRC Op. R2000-1, p. 406, ¶ 5573 (footnote omitted).

1   degree that they do not conform to the policies of the Act and that improved rates that

2   enhance efficiency will improve the lot of publishers. The purpose of this section is to

3   explain some of the problems and to point to improvements. Then the next section

4   discusses more specifically the improvements being proposed.

5

6   **A. Periodicals Rates Have Been Increasing Too Rapidly**

7   Particularly since the late 1980s, there has been concern that, due to rising costs,

8   the rates for Periodicals have been rising inordinately rapidly. After years of efforts by

9   mailers and the Postal Service to stem the rising costs, or even to agree about the reasons

10   for the rise, the Commission said in Docket No. R2000-1:

11   The only conclusion is not comfortable: there are many
12   reasons for believing that costs should have decreased; only a few
13   factors that could be associated with increases; and a persistent net
14   upward trend. It is clear that mailers and the Service must
15   aggressively pursue the cost reduction opportunities identified on
16   this record, and explore other aspects of the "operational realities"
17   they face.
18
19   PRC Op. R2000-1, p. 412, ¶ 5593.
20
21   The extent of the problem is easy to illustrate. Graph 1 shows an index of

22   Periodicals rates, at a constant markup index,[2] along with the Consumer Price Index,

23   Urban (CPIU). The picture is disturbing. If no technological changes occurred and no

24   scale economies were realized, and if factor prices increased in accord with inflation,

25   then the index would be expected to increase with the CPIU.[3] As shown, however, the

---

[2] The notion of a markup index was introduced by the Commission in Docket No. R90-1 to help compare markups over time for specific subclasses when the average markup for all subclasses varies. The index is equal to the markup for a subclass divided by the average markup, both in percentage terms. If a rate were 6 cents and the cost were 4 cents, the markup would be 50 percent. If the average markup were 75 percent, the markup index would be 0.667 (50/75).

[3] Strictly speaking, this expectation requires an assumption that there have been no qualitative changes of significance in the product supplied by the Postal Service. If mailers switched to the use of pallets, for

– 9 –
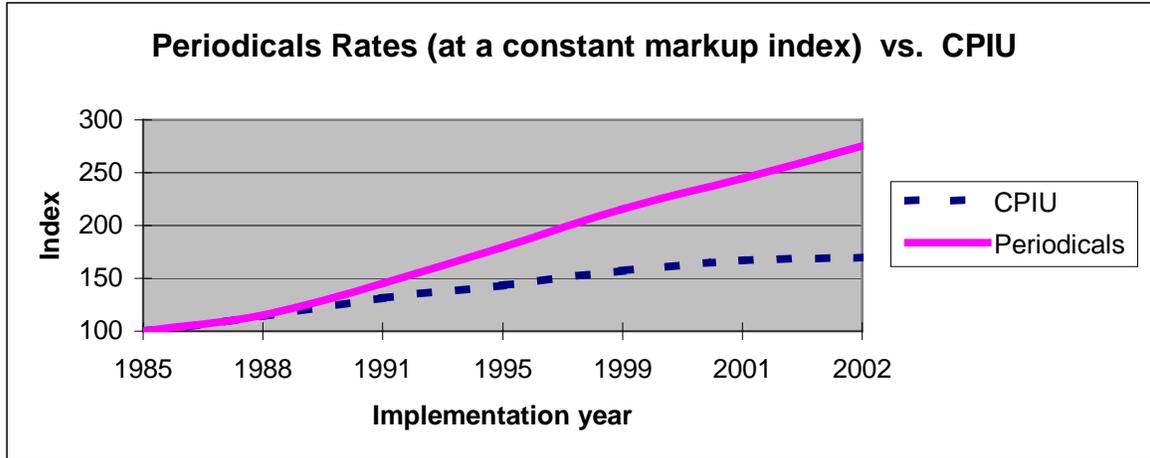
Graph 1

3   Periodicals index has outstripped the CPIU, by a wide margin. Using the outcome of the

4   1984 rate case as a base, meaning that the indexes have a value of 100 in 1985, the

5   Periodicals index increased to 275 while the CPIU increased to 170. The difference is

6   substantial.

7   But the actual situation is worse than the picture. The Postal Service claims that

8   important technological advances *did* occur during the period and that its total factor

9   productivity (TFP) index increased 9.8 percent. It claims as well that it is realizing

10   increasing returns to scale. In addition, some shifting to the use of pallets occurred, but a

11   separate pallet rate did not exist.[4] This means that the most supportable expectation

12   would actually be for the price index to be *below* the CPIU. Alternatively, if increases in

13   real wages absorbed the gains from mechanization, palletization, scale, and other

14   improvements, the rate index still should not exceed the CPIU. It is clear no such

15   expectations have been borne out.

---

example, but no separate cost-based pallet rate were reflected in the index (as was in fact the case during the period shown), one would expect the price index to *decrease*. Excepting pallets, it is not apparent that meaningful changes in the product have occurred. But if they have, possibly through the efforts of MTAC workgroups, the effect on the index would probably be to reduce rates, not to increase them.

1   This outcome is consistent with a phenomenon I have elsewhere referred to as

2   *negative technological change*. That is, mailers make cost-reducing adjustments (such as

3   the use of pallets), the Postal Service invests in advanced technology (such as flat sorting

4   machines and barcode readers), economies of scale are realized (consistent with the

5   Service's analysis of mail processing costs), and costs, corrected for inflation, do not

6   decline but *increase*.

7   By any measure, the situation is troubling. More effective measures to restrain

8   cost growth and to improve subclass efficiency are plainly needed. The most promising

9   measure—one that requires approval by the Commission—is to provide improved signals

10   in the rates for efficient conduct by aligning them more closely with Postal Service costs.

11

12   **B. Periodicals Rates Are Not Cost Based**

13   Under the Postal Reorganization Act of 1970, which supports recognition of costs

14   and of the preparation of the mail, a number of improvements have been made to the

15   Periodicals rate structure, all based on a record developed before the Postal Rate

16   Commission. In the first rate case, Docket No. R71-1, piece rates were introduced to

17   recognize that not all costs are pound related. The piece rates grew on a case-by-case

18   basis and now account for approximately 60 percent of Periodicals revenue; beyond this,

19   some evidence has been presented that the proportion should be even higher. It is clear,

20   then, that pound rates play a substantially lesser role than they did prior to reorganization;

21   indeed, the revenues obtained from the pound rates have gone from 100 percent down to

22   40 percent.

---

[4] Note that since the Periodicals rate index is a constant-mix index, it is unaffected by volume shifts over
the period among established worksharing categories. Changes in worksharing would, however, affect

1   In 1978, presort discounts were introduced, providing three separate presort tiers.

2   In 1985, dropship discounts (on a per-piece basis) were introduced for destination-SCF

3   entry. These discounts were subsequently expanded and refined to include both per-piece

4   and per-pound elements and to apply to destination area distribution centers and

5   destination delivery units. Saturation and high-density discounts were introduced in

6   1991, as were barcode discounts. In 2001 the number of presort tiers was expanded to

7   four. A pallet discount was introduced in 2002.

8   All of these changes improved the signals given to mailers, and they were all cost

9   based. As explained here and in other sections of my testimony, however, both the

10   quality of the signals and the extent to which costs are recognized are at this point

11   deficient. Our understanding of cost incurrence has improved substantially, especially in

12   recent years, as has the ability of mailers to respond to such incurrence. It is therefore

13   time to improve the signals and to take further steps in the direction of recognizing costs

14   in rates. Periodicals appears to be lagging other subclasses in this respect. There is little

15   question, for example, that some of the recent growth in the volume of parcel post has

16   been due to cost-based rate innovations, and Standard mail rates have been moving in the

17   direction of closer alignment with costs.

18   In times past, particularly when mailings were smaller and computers were rarer,

19   rate differences on the order of a cent per piece might not have been large enough to

20   evoke meaningful responses. But one of the realities of today's mailing environment is

21   that most mailers are reasonably sophisticated and have both the capability and the

22   willingness to analyze their operations and to respond to signals in rates. Today,

23   fractions of a cent can bring about meaningful alterations in the way mail is prepared,

---

revenue-per-piece figures.

1   entered, and delivered. Even small changes in the parameters and constraints in mailing

2   software can change the output in important ways, just by pressing the calculate button

3   on a computer. When such capabilities on the part of mailers are neglected, and cost-

4   based signals are not provided, the entire subclass suffers. It important that we not let

5   this continue to occur.

6   Disparities between costs and rates are in need of attention, despite the progress to

7   date in the recognition of worksharing: (1) the *differences* among zones in the advertising

8   pound rates are based on transportation costs only, and do not recognize that non-

9   transportation costs also vary with distance; (2) the non-transportation portion of the

10   dropship discounts (relative to zones 1&2), which is largely pound oriented, is given 50

11   percent on a per-piece basis; (3) many of the costs depend on the quantities and sizes of

12   the bundles, sacks, and pallets in a mailing, but this fact goes largely unrecognized in

13   rates; (4) the costs of handling bundles depend on the makeup (*e.g*., ADC, SCF, 3-digit,

14   or 5-digit) of their containers and where they are entered, but neither are these factors

15   recognized in rates; (5) the one-half-cent per-piece pallet discount is based on a pound-

16   oriented savings; and (6) the one-cent per-piece pallet discount is also based on pound-

17   oriented savings and applies only to dropshipped pallets, although the savings exist for *all*

18   pallets.

19   Many of these factors can be recognized in rates, and doing so would be in line

20   with Commission emphasis in recent years on cost recognition, efficient component

21   pricing, worksharing, and notions of lowest combined cost. Recognizing them would

22   help the Postal Service to be a more effective delivery organization, and would improve

23   the lot of mailers.

1 **C. Periodicals Rates Provide Poor Signals to Mailers**

2   Signals in prices are important throughout the economy. In fact, buyers (whether

3 firms or individuals) respond more strongly to price signals than to any other force I can

4 think of. Both firms and individuals watch out for their bottom line. The following story

5 may seem mundane and far removed from the economics of big business, but it is quite

6 relevant. I have a niece who lived in an apartment in Indianapolis for some years, and

7 had a cat. She told me that she left her kitchen faucet running slowly night and day, so

8 that her cat could get a drink. I asked her about her water bill. She said: "What

9 difference does it make? My water is included in my rent." Without appropriate signals,

10 people make inefficient decisions.

11   The current rates send underdeveloped signals to mailers, thus failing to provide

12 them with a reasonable and valuable avenue for responding to the high costs. It is

13 difficult to accept that putting mailers in this position is consistent with the ratesetting

14 guidance contained in the Act.

15   The following observations indicate the importance of signals generally and the

16 inadequacy of the signals given by the current rates.

17   Our understanding of cost incurrence and how it should be reflected in rates

18 progresses as we make advances in cost analysis. For many years, attention centered on

19 whether costs were piece-oriented or pound-oriented, with some recognition of cubic

20 measures in parcel post.[5] If only reality were so simple. More recently, attention has

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[5] The reasoning has been that a marginal cost can be partitioned into a piece-related cost and a pound-
related cost. If the number of pieces increases, say, 10 percent and the number of pounds remains the same
(which requires a decrease in the per-piece weight), the piece-cost will increase 10 percent and the pound-
cost will remain unchanged. Alternatively, if the number of pounds increases 10 percent and the number of
pieces remains the same (which requires an increase in the per-piece weight), the pound-cost will increase
10 percent and the piece-cost will remain unchanged. It is not necessarily the case, however, that such a

1   focused increasingly on cost drivers and on linkages among cost drivers and volume.[6]

2   Part of the interest in cost drivers derives from the increased use of mechanization and

3   automation by the Postal Service. For example, with bundles now being sorted on small

4   parcel and bundle sorters (SPBSs), the cost of sorting bundles is virtually independent of

5   the weight of the bundles and the number of pieces in them. Similarly, with the use of

6   sack sorters and lift trucks, the costs of sorting sacks and pallets are virtually independent

7   of the nature of their contents.[7] Moreover, the processing these receive depends on their

8   makeup and their entry point. When these factors are not recognized in rates, mailers

9   cannot be expected to understand or respond to the costs of handling their mail. The rates

10   being proposed, by taking significant steps toward recognizing these factors, would

11   increase the efficiency with which mail is prepared and handled.

12   The current relationship between rates and actual processing is disjointed and

13   sometimes perverse, as James O'Brien explained in his testimony in Docket No. R2000-

14   1. (Tr. 24/11166). For example, the same carrier-route bundles receive different

15   processing and incur different costs depending on whether they are on 5-digit pallets or 3-

16   digit pallets. Yet, these pieces pay the same rates. Faced with such signals, mailers

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partitioning is always possible. That is, it is not always the case that the cost function, even for marginal cost in a relevant range, can be described well by an equation of the form $MC = a * pieces + b * pounds$.
[6] For example, see Michael D. Bradley, Jeff Colvin, and John. C. Panzar, "Issues in Measuring Incremental Cost in a Multi-function Enterprise," pp. 3-21, in *Managing Change in the Postal and Delivery Industries*, ed. Michael A. Crew and Paul R. Kleindorfer, 1997, Kluwer, Boston. Also see "Technical Report #1: Economic Analysis of Data Quality Issues," especially Chapter 2, *Data Quality Study*, prepared for the United States Postal Service, Contract No. 102590-97-B-1972, April 16, 1999. The Commission has emphasized reliance on cost drivers as well. In a discussion of transportation costs, for example, it said: "This step is viewed as relating to the behavior of pricing in the transportation markets in the sense that the cost at which transportation can be procured is related to the cubic-foot-miles of capacity involved; in the parlance used in recent years in such analyses, cubic-foot-miles of capacity is called a 'cost driver' of transportation costs." PRC Op. R2000-1, p. 169, para. 3250.
[7] One dimension of scale economies is that a larger-scale operation might have heavier bundles, sacks, and pallets. These economies cannot be realized if inappropriate signals are given to mailers.

1   cannot be expected to consider the cost implications of the preparation decisions they

2   make.

3   As another example, consider the tradeoff between bundles and sacks. In some

4   cases, mailers have a choice between preparing one 24-piece bundle and 24 sacks

5   containing one piece each, which would be sorted individually and taken intact to the

6   carrier. Processing the sacks is vastly more expensive than processing the bundle, but the

7   rates are the same. If the mailer, given appropriate signals, values the sacks and is

8   willing to pay for their handling, the outcome is not inconsistent with efficiency.

9   Alternatively, the mailer could decide that the return from using the sacks is not worth the

10   cost. But neither of these is happening, as the result of improper pricing signals.

11   Before Docket No. R90-1, the rates for Standard mail were uniform nationwide.

12   In that case, consistent with principles of efficient component pricing, lower rates were

13   allowed for mail entered at destination BMCs, SCFs, and delivery units. Going into the

14   case, the Postal Service estimated that 14.6 percent of Standard mail was dropshipped.

15   Today, 73.3 percent of it is dropshipped, and the efficiency of the class has increased

16   dramatically. Changes of this magnitude point to the efficacy of signals in rates in

17   promoting more efficient mailer behavior.

18   The difference between 14.6 percent and 73.3 percent represents an enormous

19   waste of resources, at the expense not of the Postal Service, since it is entitled by law to

20   charge rates that achieve breakeven, but of Standard mailers themselves. Until the advent

21   of correct price signals, however, they were helpless to do anything about it. Periodicals

22   mailers are currently in much the same situation.

1   It is not reasonable to expect publishers, or printers, or anyone else to consider

2   costs that do not affect their bank accounts. So, if the Postal Service charges no more to

3   deliver to more distant locations, it is unreasonable to expect printing bids to reflect the

4   additional transportation costs that the Postal Service incurs, or to expect the publisher to

5   recognize those costs.[8] In the extreme, if service were not an issue and rates were not

6   dependent on distance, all printing could be done in Guam and the publisher could not be

7   faulted for making a bad decision. But publishers collectively would nonetheless suffer

8   from such decisions, because *all* of the handling and transportation costs for Periodicals

9   *are* attributed to Periodicals, even if they are not transcribed into rates that recognize

10   actual handling and distance. If all publications were printed in Guam, handling and

11   transportation costs for Periodicals, and, accordingly, all Periodicals rates, would be

12   exceedingly high, although no publisher or printer would be right to regard his own

13   choices as the reason for those high rates.

14   The implications are clear. In order for publishers and/or printers to make

15   efficient decisions about distribution methods and/or printing locations, and thereby to

16   bring about efficient, low-cost postal services, postal rates must reflect the Postal

17   Service's costs. The extent to which they do so currently is limited. Insofar as

18   unnecessary or inefficient transportation over long distances is concerned, the problem is

19   two-fold. First, due to the unzoned editorial pound rate, the postage paid does not reflect

20   the higher *transportation* costs associated with the higher zones. Second, as Periodicals

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[8] I am assuming that postage costs are included in printer's bids. Another possibility is for the printer to bid without postage and then somehow pass the postage through to the publisher. Either way, the publisher should be considering the postage.

– 17 –

1   rates have been developed thus far, neither does the postage paid reflect the higher *non-*

2   transportation costs associated with the higher zones.

3   Recognition of the importance of rates as signals for efficient behavior is not new.

4   In Docket No. MC95-1, where automation and bulk bypass were issues, the Commission

5   said that "[r]ates send economic signals to mailers," that it "remains committed to

6   adapting mail classifications and . . . rates to the demonstrated cost savings resulting from

7   automated processing," and that its decision would "encourage mailers to provide mail

8   that is compatible with automated processing and the bulk bypass of processing." PRC

9   Op. MC95-1, pp. I-9-10, ¶¶ 1023-24. Rates that are better aligned with preparation

10   options and their associated costs, as proposed in this Complaint, would undoubtedly

11   have an effect on mailer decisions, whether it be on the sizes of the bundles, the

12   containers selected, the makeup and contents of the containers, or the entry points.

13   Mailer responses to these signals would make Periodicals more efficient as a subclass.

14   One of the purposes of this case is to help make that happen.

15

16   **D. Zoning the Editorial Pound Rate Will Not Reduce the Widespread Availability**
17   **of Periodicals and Will Treat Local and Regional Publications More Fairly**
18
19   1. History and purpose of the unzoned editorial rate

20   In the decades before the 1917 legislation on rates (40 Stat. 327, 328), several

21   postmasters general expressed concern that the extraordinarily low rate at which second-

22   class material was being carried (one cent per pound irrespective of distance) was a

23   serious drain on public revenues.[9] "In 1901, Postmaster General Smith reported that the

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[9] In 1901 President Roosevelt noted that second class "composed three-fifths of the weight but paid only about $4 million of the more than $111 million it cost to operate the postal service." *A Study of the Intent of Legislation on Second-Class Mail*, Rita L. Moroney, Research Administrator/Historian, United States

1   Government paid not less than 5 cents a pound for transportation of second-class matter

2   and at least 2 cents a pound for handling."[10] Transportation costs at that time, at least

3   relative to other postal costs, were obviously very large.

4   Following a detailed and exacting study of all 1908 postal costs, the Hughes

5   Commission found that 42.4 percent of second-class costs were for transportation (a

6   proportion that increased to 66.5 percent if costs characterized as "other transportation"

7   were added).[11] In contrast, transportation costs are now approximately 14.3 percent of

8   Periodicals costs, and only about two-thirds of these are distance-related.[12] If these

9   proportions are indicative, the importance of transportation costs then was at least three

10 times what it is now, and maybe higher than that.[13]

11   Despite the desire of the Post Office Department and two successive presidents

12 (Roosevelt and Taft) to do something about the situation, opposition from the

13 beneficiaries of the existing rate prevented anything from being accomplished until 1917,

14 when a Congress in urgent need of revenues to fund America's participation in World

15 War One acted to improve the alignment of second-class rates with costs.[14] After

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Postal Service, July 1977, p. 39. The magnitude of the sums involved can be inferred from the fact that total federal outlays in that year were $525 million. *Political Facts of the United States: 1789*, ed. Erik W. Austin (Columbia U. Press, 1986), p. 450.

[10] *Quoted in* The Report of the Commission on Second-Class Matter, Appointed Pursuant to the Joint Resolution of Congress, Approved March 4, 1911), *contained in* Message of the President transmitting The Annual Report of the Postmaster General for the Fiscal Year ending June 30, 1911 and The Hughes Commission Report, February 22, 1912, p. 65 (hereinafter Hughes Commission Report).

[11] Hughes Commission Report, at 127.

[12] Calculated from PRC Library Reference 9, Docket No. R2001-1. Only the distance-related transportation costs affect the relative levels of the zoned pound charges.

[13] Operations then and now may be comparable in terms of average haul. The Hughes Commission Report shows an average haul for subscriber second class of 602 miles, *id*. at 84, and the Postal Service's CRA for Fiscal Year 1989, the last year average haul figures were developed, shows an average haul for Regular second class of 724 miles. Similar figures can be developed, however, from the Periodicals billing determinants and the average hauls by zone. Doing this for the test year in Docket No. R2001-1 yields 464.8 miles for all of Outside County.

[14] The magnitude of the unexpected financial burden imposed on the federal government by World War One is indicated by the growth in total federal outlays from $713 million in 1916, to $1.95 billion in 1917,

1   extensive negotiation and compromise, a zoned rate structure was adopted for advertising

2   matter carried in second-class publications, with a lower, unzoned rate for editorial

3   matter.

4   The decision not to apply the zone rates but to arrange a low, clearly subsidized

5   rate for editorial matter was a compromise reached after publishers argued that applying

6   the zone rates uniformly would have deleterious effects on the distribution of

7   publications.   The extremely low, unzoned rates for publications that had existed since

8   1885 had generated a powerful political constituency fiercely devoted to their

9   preservation, particularly the many highly successful nationally circulated publications

10   that tended to be edited and produced in the nation's great cities and to be transported

11   throughout the country virtually free of charge, courtesy of the Post Office. *The Saturday*

12   *Evening Post* and *The Ladies Home Journal* are familiar examples. It is therefore not

13   surprising that the arguments against zoning focused on the high costs of transportation

14   and raised the specter of a nation divided into separate regional publishing zones because

15   of cost prohibitive rates for mailing to subscribers in remote parts of the country.

16   When it last reviewed the question of zoning the full weight of publications, the

17   Postal Rate Commission emphasized similar concerns: "Witness Kielbowicz concludes:

18   Public information found on the pages of periodicals should be just as accessible to the

19   residents of Washington State as to the residents of Washington, D.C.'" PRC Op. R90-1,

20   p. V-120, ¶ 5277. The *MOAA* court recognized that a concern of this kind, rooted in the

21   "rather broad anti-Balkanization principle" (2 F.3d 408, 436 (D.C. Cir. 1993)) expressed

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$12.7 billion in 1818, and $18.4 billion in 1919. After 1919, federal outlays would not top the $10 billion mark again until 1941. *Political Facts of the United States: 1789*, p. 451.

1   in the Act's definition of the Postal Service's purpose as "bind[ing] the Nation," prompted

2   the Commission's decision to maintain the unzoned editorial pound rate.

3   I do not see that a risk of publishing zones exists today. For one thing,

4   transportation costs are much lower than they were in 1917, making it highly unlikely

5   that publishers would find it profitable to drop subscribers in the higher zones.[15] And

6   even in the unlikely event that zoning of the editorial pound rates were to cause some

7   zones to be disfavored or dropped by some publications,[16] it is hard to see how, given all

8   of the other sources of information and avenues of communication now available, the

9   effect on the unity or cohesion of the nation could be significant.

10   Another factor that needs to be considered is the *funding* of the unzoned editorial

11   rate. Since the advertising rate appears to have been set at a level approximate to its

12   costs, any remaining shortfall in revenue had to be covered as part of the federal budget.

13   For all practical purposes, this continued until Reorganization in 1970. The situation

14   now, however, is that any relief in rates provided to one group of mailers is made up by

15   higher rates for other groups. Therefore, any evaluation of the effects of the unzoned

16   editorial rate on "bind[ing] the Nation" must include its effects on publications that are

17   disadvantaged by it, which would include all lower-zone publications. One well defined

18   group having this characteristic, as discussed further below, is local and regional

19   publications. The expectation would certainly be for them to print near their areas of

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[15] For a detailed analysis of why zoning the editorial rate would be unlikely, in current circumstances, to alter the overall geographical pattern of publication distribution, or to diminish the "widespread dissemination of information," *see* Appendix A.

[16] It should not go unnoted that providing a subsidy to a wide group of publications in order to achieve certain behavior on the part of a small portion of that group is an extremely inefficient way to bring about a desired end, and should be avoided.

1   delivery, which leads currently to rates elevated by the benefit given to higher-zone

2   publications.

3

4   2. Impact of the unzoned editorial rate on local and regional publications

5   According to *The Magazine Handbook*, published by the Magazine Publishers of

6   America,[17] there were 17,321 different magazine titles published in the year 2002.

7   *Handbook*, p. 4. In Docket No. R2000-1, the Postal Service indicated that there were

8   9,679 Nonprofit permits and 22,798 Regular permits, with an overlap of 1,218.[18] These

9   numbers are large enough to contain subgroups of considerable size, an important one

10   being local and regional publications. Some of these publications are represented on the

11   Mailers Technical Advisory Committee by the City and Regional Magazine Association,

12   which has existed for 25 years and whose 87 member magazines have circulations

13   averaging in the range of 25,000 to 50,000. Most of the copies are delivered within a

14   given metropolitan area, and very few use In-County rates.[19]

15   The local and regional category includes publications devoted to particular

16   industries or professions, such as the eleven different construction magazines published

17   by McGraw-Hill, including *California Construction News*, *Colorado Construction*,

18   *Louisiana Contractor*, and *New York Construction News,*[20] publications centered on

19   individual cities, such as *Chicago*, *Cincinnati*, *Indianapolis Monthly*, and *Kansas City*

20   *Home Design*, state travel magazines, such as *Ohio* and *Wisconsin Trails*,[21] college

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[17] *The Magazine Handbook* is available on MPA's website:
http://www.magazine.org/Government_Action/2408.cfm
[18] *See* Docket No. R2000-1, interrogatory response CRPA/USPS-T38-3, Tr. 17/6959.
[19] *See* http://www.citymag.org.
[20] *See* the McGraw-Hill web site http://regionalpublications.construction.com/.
[21] *See* http://www.magazinetime.com/categories-regional---local-mid-west.html.

1   alumni magazines,[22] regionally and locally oriented religious publications, and various

2   publications that cater to geographically concentrated ethnic communities or interest

3   groups, such as *The Baltimore Afro-American*.

4   Around the subclass average, a publication's implicit cost coverage is a function

5   of its proportion of advertising content, among other things. This reflects the recognition

6   of ECSI value. In order to abstract from this effect, and to allow balanced comparisons, I

7   assume that all local and regional publications have an average proportion of advertising

8   content. It follows that if they were average in other respects as well, their cost coverages

9   would all be equal to the average for the subclass. But these publications are not average

10   in other respects. Importantly, their final delivery occurs primarily in limited

11   geographical areas, regardless of where they are printed. I know of one city magazine

12   that is entered in zones 1 and 2. Ninety-four percent of its copies stay within those two

13   zones.

14   Another factor affecting publications' implicit cost coverages is their postal zone,

15   with respect to which local and regional publications may be viewed as falling into one of

16   two camps. Camp 1 is composed of publications printed in close proximity to their final

17   delivery area. These publications have short hauls and relatively high cost coverages.

18   They represent what would seem the natural and expected model for publications with

19   geographically concentrated subscriberships. Camp 2 is composed of publications

20   printed some distance from their delivery area and then carried to the delivery area by the

21   Postal Service. These publications have a substantial haul and relatively low cost

22   coverages.

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[22] The graduates of larger, more prominent schools that draw students from across the nation may be distributed widely, but there are thousands of smaller schools that draw largely from their own states and

1   Camp-2 publishers have made decisions to print some distance from their home

2   base. There is no reason to believe that these decisions were not rational, given the rates

3   they see. But these rates do not show them the full costs of their decisions and thus they

4   cannot be expected to make efficient decisions. Because the increase in postal rates

5   attendant to a decision to print at a distant location is less than the associated increase in

6   postal costs, Camp 2 publishers have unknowingly made decisions that imposed extra

7   costs on someone else. Camp-1 publishers, who are printing in close proximity to their

8   delivery area, are paying these extra costs, and thus are helping to finance longer-distance

9   mail.

10   Camp 1 publishers should not be discriminated against, and Camp 2 publishers

11   should not be blinded to the resource implications of their decisions. Both should be

12   given cost-based signals and then allowed to choose where to print. Those who decide to

13   print locally should not be required to pay elevated postal rates to help support publishers

14   who make different decisions or who mail more broadly.

15   The discussion thus far has assumed that local and regional publications have an

16   average degree of advertising content. This assumption is important to thinking clearly

17   about implicit coverages, cost-based rates, and the signals sent to mailers. But when one

18   begins to look at real situations and actual decisions, it is evident that the proportion of

19   advertising content is actually quite important. Consider, for example, a local publication

20   with little or no advertising, whose increase in postage with distance is therefore

21   negligible. The current rate structure puts the Postal Service in the position of saying:

22   "You can print your publications 3,000 miles from where your subscribers live if you

23   wish. We will carry it back at no additional charge. All of your freight will be paid by

communities, and whose graduates tend to remain much closer to home.

1   other mailers." This is an extreme example of inappropriate signals in rates. In the case

2   of a *nationwide* publication distributed from one location, *some* of the copies will be

3   carried a considerable distance at no additional charge; in the case of a *local* publication

4   printed far from home, *all* of the copies will be carried a considerable distance at no

5   additional charge.

6   Publications whose subscribers are concentrated in limited geographic areas exist

7   naturally, because of who they are, and are not the result of plucking unusual

8   observations from the tail of a distribution. There is nothing random about them, and

9   they are not part of some kind of continuum that warrants averaging for rate purposes.

10   The local and regional grouping represents a legitimate focus and warrants attention. I do

11   not contend that this group should be singled out for any kind of preferred treatment, but

12   it certainly deserves to be treated fairly.

13

1   **IV. RATE DESIGN**

2   The rates developed in this section are for the Outside County subclass and are

3   aimed specifically at the weaknesses discussed in earlier parts of my testimony. In a

4   general sense, the costs of the mail are recognized in the rates, consistent with accepted

5   rate-design principles, in such a way that mailers are able to decide whether the value

6   they receive from higher-cost services is greater than the value they receive from lower-

7   cost services, after considering any costs they might incur to prepare their mail in one

8   way or another. Unless mailers are presented with the cost consequences of the decisions

9   they make, and unless they are given choices concerning preparation alternatives, it is not

10   possible for them to make decisions that result in the efficient use of the nation's

11   resources.[23] It is certainly the case that neither the Postal Service nor the Rate

12   Commission knows either the value that individual mailers receive from their use of the

13   mail or these mailers' costs of various preparation alternatives. But even if these values

14   and costs were known and understood, it would still not be possible to use them

15   effectively, on a mailer-by-mailer basis. Mailers, however, can do just that, given cost-

16   based rates.

17   More specifically, the rates developed here zone publications' full weight,

18   recognizing transportation costs according to the way they are incurred, and at the same

19   time recognizing alternatives associated with the preparation and usage of bundles, sacks,

20   and pallets. Mailers have alternatives in all of these areas, and it is accordingly important

21   that the cost-consequences of these alternatives be reflected in the rates. The non-

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[23] Note that the postal costs associated with mailer decisions are costs not to the Postal Service only, but to the nation as well. It is not possible for the Postal Service to use resources to process and deliver the mail without the remainder of the nation giving up the use of those resources and the output associated with that

1 transportation portion of distance-related costs is reflected by allowing the charges for

2 containers to vary with the point of entry. As explained further below, for example, a 5-

3 digit sack entered at an origin facility receives more handling than the same sack entered

4 at a destination facility, such as an SCF.[24] Similarly, a 5-digit bundle in an ADC sack

5 receives more handling that the same bundle in a 5-digit sack.

6   In line with precedent, but with one modification, the degree of presortation is

7 recognized. The flow models developed by the Postal Service, which underlie the current

8 rates, give separate recognition to, among others, pieces sorted into mixed ADC bundles,

9 ADC bundles, and 3-digit/SCF bundles. Therefore, in order to follow costs, these three

10 presort levels are proposed. There is no change in recognition of sortation to the 5-digit

11 and the carrier-route levels, the latter including high density and saturation. For all

12 sortation levels except the carrier-route level, machinability is recognized, in addition to

13 the current recognition of prebarcoding. Note that the inclusion of SCF bundles in the

14 existing 3-digit category is consistent with the cost analysis on which the current rates are

15 based. For this reason, the costs behind the current rates are not well aligned with the

16 definition of the categories.[25]

17   While recognizing the distinctions necessary to allow mailers to make efficient

18 decisions, the rates developed preserve to the maximum extent possible the

19 recommendations of the Commission in Docket No. R2001-1. Specifically, the rates

20 preserve all applicable discounts, are based on the same costs and the same cost studies,

use. When viewed in terms of other output forgone, the cost of inefficiently using resources for postal
output becomes real indeed.
[24] Throughout my testimony, and in the proposed rate schedules, "origin" entry refers to entry at an office
or other facility that is upstream of the destination BMC.
[25] There was no record evidence concerning this issue in R2001-1 and no indication that anyone focused on
the problem. Now that it is clear, however, there is no reason not to recognize the issue in the rates.
Indeed, costs are not available to properly support the former presort structure.

1   are revenue neutral, are based on the same volumes and billing determinants, and result in

2   the same cost coverage. Neither the In-County nor the Ride-Along rates are affected.

3   Existing palletization discounts are eliminated as separate rate categories, but the costs

4   avoided due to palletization are recognized more thoroughly and more uniformly via the

5   per-sack and per-pallet charges that vary by container type and entry point. As explained

6   below, three rate-design errors are corrected, one of which the Settlement Agreement

7   could have recognized.

8   An overview of the rates developed here should note that no argument is being

9   made, and no position taken, that any mailers *should* change the way they are preparing

10   their mail or that *all* mailers find themselves in situations where changes are feasible or

11   costless. Similarly, no position is taken that any mailers, given the rate signals and the

12   alternatives they currently face, are making poor preparation decisions. However, a

13   position *is* taken that mailers should be given cost-based signals in rates, and it *is*

14   believed that many mailers will then find it in their best interests to make changes.

15   Furthermore, the position *is* taken that these changes will improve the general situation of

16   Periodicals mailers as a class and the efficiency of Periodicals mail as a subclass.

17   The remainder of this section deals with specific topics important to the design of

18   the rates being proposed.

19   **Per-Piece Charges.** The per-piece costs, along with the associated volumes, are

20   provided by witness Stralberg, TW et al.-T-2. The volumes reconcile with those of the

21   Commission, as contained in PRC LR-9, Docket No. R2001-1. The top presort tier is for

22   pieces sorted into mixed ADC (MxADC or MADC) bundles. Within this tier, barcoding

23   is recognized, as in the current rates. Also, recognition is given to the machinability of

1   the pieces. Machinable pieces can be processed on the AFSM-100 and non-machinable

2   pieces (usually processed on the FSM-1000) cannot. The breakout, then, is non-

3   machinable (Non), machinable (Mach), barcoded non-machinable (Bar-Non), and

4   barcoded machinable (Bar-Mach).

5   Beyond this first tier, the tiers are ADC, 3-d/SCF, 5-d, and carrier route. Within

6   carrier route, high density and saturation are recognized, with discounts equal to those in

7   the current rates. The 3-d/SCF tier is slightly different from the current 3-digit tier, in

8   that it includes pieces sorted into SCF bundles.[26] This is done because the flow models

9   on which the current 3-digit discount is based include the costs for SCF pieces in the

10   costs for the 3-digit tier. One could argue, then, that the existing tiers are not defined

11   according to the costs behind them.

12   In Docket No. R2001-1, the rates recommended for barcoded pieces and carrier-

13   route presorted pieces recognized the associated *carrier* savings. Those savings were

14   derived from the carrier costing system and are not included in the costs developed by

15   witness Stralberg. In order to be consistent with the Commission's recommendations,

16   those savings are added to the differences derived from witness Stralberg's figures. The

17   savings for barcoded pieces are found in PRC LR-9, Discounts! cells D32-D53 (0.633

18   cents) and for carrier route in Discounts! cells D32-D59 (2.983 cents). Because the high

19   density and saturation rates are found by applying Commission discounts to the carrier-

20   route rate, no adjustments in them are required.

21   **Per-Bundle Charges.** The handling received by bundles depends on the makeup

22   of the bundles (whether they are mixed ADC bundles, ADC bundles, 3-d/SCF bundles, 5-

1   digit bundles, or carrier-route bundles) and the level of the container on (or in) which the

2   bundles reside. For example, a 5-digit bundle on an ADC pallet receives bundle sorts

3   before it is broken, while a 5-digit bundle on a 5-digit pallet does not. Within limits

4   allowed by Postal Service regulations, mailers have options concerning the sizes and the

5   makeup of bundles. Since the cost of bundle handling is relatively independent of both

6   the weight of the bundles and the number of pieces in the bundles, it is clear that makeup

7   can affect Postal Service costs. The charges shown are per bundle, depending on the

8   level of the bundle and its container.

9   **Per-Sack and Per-Pallet Charges.** Sacks are the traditional container for mail

10   and are handled in various ways. Pallets are more recent and are handled with lift trucks,

11   although pallet jacks are sometimes used. Intuitively, a cost is incurred each time a sack

12   or a pallet is handled, and this cost is relatively independent of both the weight of the

13   container and the number of pieces on (or in) it. Since mailers have options concerning

14   not only what kind of container to use but also container makeup, these costs should be

15   recognized in rates.

16   Sacks and pallets incur costs up to the point where their contents are removed and

17   processed further. Clearly, a container entered far from its destination receives more

18   handling than a container entered at its destination. Also, a container should not be

19   entered further downstream than its makeup. For example, an ADC container should not

20   be entered at a destination SCF, as it would then have to be hauled upstream to the ADC

21   for processing. The costs developed by witness Stralberg recognize the containers' levels

22   and entry points.

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[26]The Postal Service is expected to clarify preparation guidelines concerning 3-digit and SCF bundles. At
the present time, there are relatively few SCF bundles. It may be that mailers will be required to exhaust

1   Because of their role in dropshipping activities, specific recognition in the

2   proposed rates is given to the destination BMC, the destination ADC, the destination

3   SCF, and the destination delivery unit (commonly DBMC, DADC, DSCF, and DDU,

4   respectively). Facilities not qualifying as one of these are categorized as "origin"

5   facilities. These include stations, branches, post offices, annexes, SCFs, P&DCs, ADCs,

6   and OBMCs.[27] Costs do vary according to which of these facilities are used, but they are

7   averaged, as in the current rates. Most mail is entered at larger facilities, and mailers

8   often respect Postal Service preferences on entry arrangements. The respective entry

9   points are recognized in the proposed rates for mixed ADC, ADC, 3-d/SCF, and 5-d/CR

10   containers.

11   **Zoned Pound Rates.** The zoned pound rates are developed according to

12   Commission procedures of long standing, with the modification that they apply to the

13   publications' full weight. As usual, only the transportation costs are used in this

14   development, separated, as typically done, according to whether they are distance-related,

15   with the result that the *differences* in the zone rates reflect 100 percent of the variable

16   transportation costs between any two zones for which the difference is calculated.

17   Importantly, the higher zones do not pay any additional institutional costs relative to the

18   lower zones. The scheme is as follows: DDU entry pays no transportation costs; DSCF

19   entry and above pay non-distance-related transportation costs; and DADC and above pay

20   distance-related transportation costs.

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the preparation of 3-digit bundles before preparing SCF bundles.
[27] In Docket No. R97-1, DBMC and OBMC facilities for Periodicals were referred to as Transfer Hubs.
See Response of USPS to ABM interrogatory No. 6, Tr. 19A/8430. For dropship and other entry purposes,
it is assumed that the Postal Service will specify the appropriate facilities for Periodicals, along with any
submission requirements.

1   The first step in distributing the transportation costs is to develop a set of billing

2   determinants appropriate to zoning the full weight. This provides, for each entry point,

3   the weight in pounds of both the advertising and the editorial matter. Much of the

4   development needed was done by the Postal Service in Docket No. R2001-1 and is

5   contained in PRC LR-9. The calculations were done by recognizing that, even though the

6   *pounds* of editorial for DDU and DSCF entry are not reported separately, there has been a

7   *per-piece* discount for these entry points. Therefore, the number of pounds can be

8   estimated by multiplying the number of pieces by the per-piece weight. The Postal

9   Service also estimated the number of pieces entered in the DADC, so that the weight at

10   this entry point can also be calculated. For zones 1&2 through 8, the number of pounds

11   is estimated in my workpapers by assuming that pieces entered in these zones have an

12   average proportion of editorial content. The average proportion on a pound basis is used

13   for this calculation, not the piece-weighted average.

14   Normally, 100 percent of the distance-related transportation cost is distributed to

15   the zones, according to the proportion in each zone of total pound miles.[28] That is, 100

16   percent of the distance-related transportation cost is distributed on 100 percent of the

17   weight. Per-pound transportation costs by zone are then obtained by dividing the cost for

18   each zone by the total pounds in each zone. The *differences* among the zones in these

19   per-pound costs are preserved for advertising matter while, in order to cover other pound-

20   related costs and the benefit given to editorial matter, the absolute levels are increased.

21   Equivalently, 44 percent (approximating the proportion of the total weight that is

22   advertising) of the distance-related transportation costs could be distributed on 44 percent

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[28] The average haul in miles for each zone is contained in PRC LR-9, which includes an average haul for
DADC entry.

1 of the weight, and the *differences* would not affected. In Docket No. R2001-1, however,

2 the Postal Service distributed 50 percent of the distance-related transportation cost on 44

3 percent of the weight, thus obtaining inflated differences among the zones and inflated

4 pound rates for higher-zone mail. When asked about this procedure in a Presiding

5 Officer's Information Request (POIR), witness Taufique responded that "[d]istributing

6 approximately 44 percent of the transportation cost to the calculation of advertising

7 pound rates is more appropriate than the 50 percent allocation in the context of the Postal

8 Service proposal." Response of witness Taufique to Question 3, POIR No. 5, Tr.

9 11C/4512. Strangely, this error was not corrected in the Settlement Agreement. The

10 problem, however, goes somewhat beyond the Commission's question and Taufique's

11 response. According to Taufique's workpapers, only 40.47 percent of weight entered at

12 the DADC and above is advertising. Thus, 40.47 percent of the transportation cost

13 should be distributed to the advertising weight. In order to reduce the burden on higher-

14 zone mailers, indeed to reduce their rates so that they are aligned more fairly with costs,

15 this error is corrected in the rates being proposed.[29]

16   Two other errors of the Postal Service in Docket No. R2001-1 are corrected. As

17 shown in PRC LR-9, Pound Data_Adv!, cell E57, the Postal Service withheld a portion

18 (0.4 cents per piece) of the DSCF pound-rate discount from DSCF-entered mail.[30]

19 Correcting this error improves the alignment of rates and costs and is consistent with past

20 Commission recommendations. Also, on the same spreadsheet (see cells D58 and D59),

21 the Postal Service divided the transportation costs by only 75 percent of the weight of

---

[29] As developed in my workpaper WP-Mitchell-1.xls, correcting this error would have resulted in a zone-8 pound rate for advertising of 56.6 cents per pound instead of the current 63.8 cents.
[30] Specifically, the reference to cell E49 should be removed from cell E57.

1   Science-of-Agriculture publications. Since the transportation costs are caused by the full

2   weight carried, the 75-percent restriction should be removed.

3   **Dropship Discounts.** In the current rates, dropshipping is recognized in several

4   ways. First, the pound rates for advertising are reduced according to the zone of entry,

5   including separate pound rates for DADC, DSCF, and DDU entry. Second, per-piece

6   discounts are offered for pieces entered at DADC, DSCF, and DDU locations. Third, an

7   increased pallet discount of one cent per piece is provided to dropshipped pallets. And

8   fourth, a special discount is added for a limited class of co-palletized pieces that are

9   dropshipped. All of these are based, in one way or another, on Postal Service savings.

10   However, not all of the savings for dropshipping are recognized. Specifically, no pound-

11   rate discount is provided for editorial, and no discount is provided to account for non-

12   transportation cost differences between the zone of otherwise entry and zones 1&2, the

13   latter being different for sacks and pallets. In addition, some of the discounts that *are*

14   given are not well aligned with costs.

15   The rates being proposed recognize dropship savings in both transportation and

16   non-transportation costs, in fairer, more balanced, and more appropriate ways. First, the

17   transportation savings are recognized in the zoned pound rates, which are proposed to

18   apply to the full weight of the mailing. Second, both the per-sack and the per-pallet

19   charges vary with the makeup of the container and, more importantly, with the entry

20   point of the container. Third, the per-bundle charges vary with the makeup of both the

21   bundle and the associated container. The rate schedule recognizes that a mixed ADC

22   container would not normally be dropshipped, and that an ADC container may or may

23   not be dropshipped. When the options are offered in this way, the question of

1   dropshipping is integrated with other alternatives mailers have, all of which have cost

2   consequences.

3   **Pallet Discounts.** As reviewed partially above, the current rates contain an

4   overlay of three pallet discounts. First, a one-half-cent per-piece discount is provided to

5   all pieces on approved pallets. Second, an additional one-cent per-piece discount is

6   provided to all pieces on dropshipped pallets. Third, effective April 20, 2003, as a result

7   of Docket No. MC2002-3, an even further discount of either one cent per piece or 0.7

8   cents per piece is provided, in order, for DSCF and DADC entry of qualifying *co-*

9   *palletized* pieces.

10   Generally, these discounts reflect costs in an uneven way and do not present

11   mailers with a true reflection of the cost consequences of their decisions. For example,

12   the savings on which the one-cent-per-piece discount (No. 2 in the previous paragraph) is

13   based exist whether or not the pallet is dropshipped, yet the discount is given only if the

14   pallet is dropshipped. This presents an unnatural incentive to remove potentially

15   attractive pallets from the Service's transportation system. Similarly, the savings on

16   which the co-palletization discount (No. 3 in the previous paragraph) is based exist for

17   both sacks and pallets, whether co-palletized or not, but the discount is given only for co-

18   pallets. In addition, on a per-piece basis, the cost of handling pallets as they move across

19   the country is less than the corresponding cost of handling sacks, but these differences are

20   not recognized at all. Finally, many, perhaps most, of the pallet savings are pound-

21   oriented; yet the discounts are given on a per-piece basis.

22   The recognition of pallets in the rates being proposed is uniform and cost-based,

23   as well as much simpler. It occurs implicitly through the per-sack and the per-pallet

1 charges that vary by container makeup and entry point. Mailers can make choices based

2 on container preferences, in view of the cost consequences of those decisions. At the

3 same time, the Postal Service will receive suitable compensation for handling containers,

4 including on its transportation equipment. No perverse incentives are provided.

5   **Recognition of Editorial Content.** In the past, editorial content[31] has been

6 recognized in rates in two ways. First, editorial matter in all zones and at all entry points

7 has paid a pound rate that has generally been set at 75 percent of the pound rate for

8 advertising going to zones 1&2. Second, since Docket No. R84-1, a per-piece editorial

9 discount has been provided, which now equals 7.4 cents times the proportion of editorial

10 content. If a piece has 70 percent editorial content, a per-piece discount of 5.18 cents (7.4

11 * 0.70) is allowed.

12   The funding for these lower rates has been provided by increasing *all* Periodicals

13 rates, both pound and piece rates, both advertising and editorial. In support of the

14 unzoned editorial pound rate, all of the pound rates for advertising have been increased.

15 When the editorial rate was then set at 75 percent of the increased zones 1&2 rate, the

16 editorial rate became higher as well. In support of the per-piece editorial discount, the

17 piece rates have been increased. If an average piece had 50 percent editorial, for

18 example, all piece rates would be increased by 3.7 cents (0.5 * 7.4), and then the piece

19 with 70 percent editorial would receive the 5.18-cent discount. The net reduction in the

20 piece rate would be 1.48 cents (5.18 – 3.70). This reduction becomes an add-on for

21 pieces with a lower-than-average proportion of editorial content. Although the form of

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[31] A definition of advertising is contained in the DMCS, which refers to content that does not qualify as advertising as non-advertising. Informally, non-advertising is often referred to as editorial. My testimony refers frequently to editorial content.

1   the per-pound editorial benefit is different in the rates being proposed, the funding

2   mechanism is the same.

3   Because of the lower rates provided to editorial matter, the cost coverage on

4   editorial matter has been considerably lower than the cost coverage on advertising matter.

5   As reference points, these "implicit" coverages can be calculated easily from the current

6   rates and the billing determinants behind them. Two packages of mail can be considered,

7   each identical in every way to the nation's total Periodicals mailings for one year, except

8   that one is all editorial and the other is all advertising. The revenue for these two

9   packages can be calculated at current rates. The two revenues can be compared to the

10   costs for the year, it being the case that the costs of handling editorial and advertising are

11   the same. When this is done, it turns out that the current cost coverage on editorial is

12   84.7 percent and the corresponding coverage on advertising is 129.5 percent.[32] On

13   average, the coverage is 101.3 percent. PRC Op. R2001-1, Appendix G, Schedule 1.

14   In the rates being proposed, these coverages on advertising and editorial matter

15   are maintained. Substantial deference is therefore provided to the educational, cultural,

16   scientific, and informational value of Periodicals, as required by § 3622(b)(8) of the Act

17   and as reflected in current rates. The current per-piece editorial benefit is maintained.

18   The per-pound benefit, currently skewed by distance, is provided in the form of a new

19   discount equal to 10.1 cents per pound of editorial matter. Arranging the editorial benefit

20   in this way does not favor some (longer-distance) editorial matter over other (shorter-

21   distance) editorial matter.

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[32] These cost coverages are calculated before accounting for the benefit for the preferred categories, which generally lowers the coverage by about one-half percentage point.

1   It is reasonable to ask why it would not be better to arrange a per-pound editorial

2   benefit by allowing a suitable percentage reduction to the total pound charges. This

3   would provide a discount proportionate to postage and, therefore, generally,

4   proportionate to costs incurred.[33] Such a proposal, however, fails on two counts. First,

5   the higher-zone publications, which would have the higher pound charges and therefore

6   the higher discounts, have not been charged any additional institutional costs. Therefore,

7   even at subclass coverages some distance above those that currently exist, these

8   publications, after the percentage discount, would be paying below-cost rates. Second,

9   and perhaps more importantly, the zone charges are recognized in the dropship discounts,

10   and giving a percentage postage reduction would effectively reduce those discounts to

11   levels below avoided costs. The end result, then, would violate the principles of cost-

12   based rates, lowest combined cost, and efficient component pricing, which are critical to

13   bringing about efficient mailer decisions.

14   The damage that would be done to discounts by a uniform percentage reduction

15   for editorial can be illustrated easily. Assume the base rate is 20 cents and the

16   worksharing activity saves 4 cents. The rate for workshared pieces should then be set at

17   16 cents. If both workshare and non-workshare mailers were given a discount of 10

18   percent, the non-workshare mailers would be paying 18 cents (20 cents less 10 percent of

19   20 cents) and the workshare mailers would, similarly, be paying 14.4 cents. The

20   difference between 18 and 14.4 is 3.6 cents, less than the savings of 4 cents (20 cents less

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[33] The argument in favor of a percentage discount would be that it is somehow unfair for highly workshared publications to be given a percentage reduction for editorial content that is larger than the percentage reduction given to less workshared publications. But, as explained in the text, this argument runs up against difficulties.

1   4 cents = 16 cents; 16 cents less 10 % of 16 cents = 14.4 cents). The signal, then, would

2   be inappropriate.

3   **Deference to Higher-Zone Material.** The unzoned editorial pound rate has

4   clearly provided considerable deference to higher-zone publications, depending, of

5   course, on their proportions of editorial content. Indeed, they are generally carried below

6   cost. It is reasonable to ask how these higher-zone publications would be treated under

7   the rates being proposed. The answer is that they would be treated quite favorably. By

8   design, the higher-zone publications would pay only the *additional* costs associated with

9   distant entry, and no additional fixed costs. Relatively speaking, then, their rates would

10   tend to exceed their marginal costs by less than the rates of other mailers, and rates equal

11   to marginal costs are generally understood to be ideal. The result is a high form of

12   consideration.

13   **Proportion of Revenue from the Pound Rates.** The proportion of Periodicals

14   revenue obtained from the pound rates has declined over time to a current level about 40

15   percent. To some extent, this proportion has been as much an input to rate design as an

16   endogenous figure based on costs and billing determinants. The procedure has been to

17   begin with a revenue requirement for the subclass (equal to total cost multiplied by the

18   cost coverage), and to obtain 40 percent of that requirement from the pound rates.

19   Conversely, 60 percent of the requirement is obtained from the piece rates.[34]

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[34] When the procedure is mapped out in detail, account is taken of Ride-Along revenue and fees, plus the contingency and a small adjustment factor. Note that the proportion of revenue from the pound rates should be expected to change with the average weight per piece and therefore or should have been affected by the merger into Outside County of Nonprofit and Classroom. The result should also be affected by the discount received by Nonprofit and Classroom.

1   Of the revenue obtained from the pound rates, about 36 percent is accounted for

2   currently by transportation costs.[35] The remainder, to the extent that the rates are cost-

3   based, is accounted for by non-transportation costs that are pound-oriented.[36] To build

4   these non-transportation costs into the pound rates, as well as to recover the revenue loss

5   associated with the unzoned editorial pound rate, the usual procedure has been to develop

6   first-cut pound rates based on transportation costs alone, and then to add an additional

7   amount (23.8 cents per pound in PRC LR-8, R2001-1) onto each zoned rate. Doing this

8   does not affect the zone differences of the first-cut rates.

9   In the rates being proposed, some of these non-transportation costs (currently

10   viewed as pound oriented) are covered by the per-bundle, per-sack, and per-pallet

11   charges, as the associated costs are affected in some degree by weight. Therefore, in

12   order to maintain an appropriate level for the pound rates, I adopted a reduced proportion

13   for the pound rates, consistent with witness Stralberg's conclusion that about 30 percent

14   of the costs are pound-oriented, and obtained 70 percent of the revenue from the per-

15   piece, per-sack, and per-bundle charges. In effect, this assumes that 10 percentage points

16   of the revenues formerly obtained from the per-pound rates should be obtained from the

17   per-piece, per-bundle, per-sack, and per-pallet rates. This tie to the current rates seems

18   reasonable.

19   **Letter-Size Pieces.** The Outside County subclass contains a number of letter-size

20   pieces (hereinafter letters). Most of them, if not all, are prepared in trays, and any

21   associated use of bundles, sacks, and pallets is undoubtedly quite different from the use

22   of same by flats. Because of the differences in the way letters are handled and the

---

[35] Transportation costs are 14.3 % of total costs; 14.3% divided by 40% = 35.75%.
[36] One could argue that about 1.3 % of the pound revenue is a contribution to institutional costs.

1   associated inapplicability of the proposed charges for bundles, sacks, and pallets, it is

2   proposed that letters continue to pay the current rates.

3   Making this provision for letters requires an estimate of the amount of revenue

4   they generate, so that the remainder of the revenue requirement can be obtained from

5   non-letters. Postal Service Library Reference J-53 (R2000-1) shows that 4.3793 percent

6   of the total volume is letters. (See cell Class! G74 in spreadsheet SHP03U_1.xls.) A

7   partial breakdown of this proportion is contained in the billing determinants, which

8   provide the number of barcoded letters at each of the non-carrier-route presort levels.

9   The following assumptions were then made: (1) that there are no high density or

10   saturation letters; 2) that no pallet discounts are given for letters; (3) that no letters have

11   Ride-Along attachments; (4) that the ratio of letters to flats in the carrier-route category is

12   the same as the corresponding ratio for *all other* letters; (5) for the per-piece editorial

13   benefit and the per-piece discounts for DDU, DSCF, and DADC, that the number of

14   letters is equal to the billing determinant figure for these categories multiplied by the

15   proportion of letters in the subclass; (6) that letters are distributed among the zones in the

16   same proportions as the flats; (7) that letters in the Regular and the Classroom categories

17   weigh 2.5 ounces each; and (8) that letters in the Nonprofit category weigh 2.0 ounces

18   each.

19   Next, in order to complete the estimate, the ratio of barcoded letters to total

20   barcoded pieces was calculated for each of the non-carrier-route presort tiers, a factor was

21   applied to each of these ratios (the same factor for each ratio), and the result was applied

22   to the number of *non-barcoded* pieces in each tier. This factor, which was selected so

23   that the total number of letters came out at the correct level, turned out to be 48.13

1   percent. Thus, if 6 percent of the barcoded pieces in the basic presort tier are letters, then

2   the estimate is that 2.88 percent (6% * 0.4813) of its non-barcoded pieces are letters. It

3   makes sense that the proportion of letters in the non-barcoded categories is lower than in

4   the barcoded categories, because: a) the incentive for letters to barcode is larger than the

5   incentive for flats, and b) the equipment necessary to barcode letters is cheaper and more

6   readily available. The calculations leading to the estimate of letter revenue are shown on

7   sheet Ltr BD! of file WP-Mitchell-2.xls, in my workpapers.

8   **Nonprofit and Classroom Publications.** In P.L. 106-384, Congress amended

9   the Revenue Forgone Reform Act (RFRA) (P.L. 103-123) to require that Nonprofit and

10   Classroom Periodicals be given a 5 percent discount on their total postage bill, excepting

11   postage due to the advertising pound rates or for commingled pieces. This provision is

12   accommodated in the rates being proposed.

13   **Science-of-Agriculture Publications.** As provided in RFRA, Science-of-

14   Agriculture (SoA) publications pay pound rates on their within-zones-1&2 advertising

15   equal to 75 percent of the corresponding rate for Outside County publications. Under the

16   proposed rates, this provision is satisfied. In general, SoA publications will benefit from

17   the proposed rates, since they have a short average haul. The proportion of SoA

18   publications going to zones 1&2 (and closer) is 73 percent, compared to only 59 percent

19   for all Outside County publications. The corresponding proportions for zone 3 and closer

20   are 90 percent and 68 percent. Also, SoA publications are highly presorted, 59.4 percent

21   to carrier route, compared to a subclass average of 42.1 percent. In effect, under the

22   unzoned editorial rate, SoA rates have been increased to help pay the costs of higher-zone

23   publications, even though SoA publications are predominately lower-zone.

– 42 –

1   **Schedule of Rates.** The complete schedule of rates, consistent with the

2   development described above, is shown below.

3

4   **Proposed Rate Schedule – Outside County Periodicals – Non-Letters**

PERIODICALS RATES									
Per Piece		Per Bundle		Per Sack		Per Pallet		Per Pound	
Bundle Level		Container Level		Sack Level		Pallet Level		Distance (Zone)	
Piece Description		Bundle Level		Entry Point		Entry Point		From Entry Point	
Bundle/ Piece	$/Pc	Container/ Bundle	$/Bundle	Sack/ Entry Pt.	$/Sack	Pallet/ Entry Pt.	$/Pallet	Entry Zone	$/Pound
Mx. ADC		**Mx. ADC**		**Mx ADC**		**ADC**			
Non	0.439	MADC	0.260	Origin	1.54	Origin	40.78	DDU	0.144
Mach	0.306	ADC	0.320			DBMC	27.13	DSCF	0.165
Bar-Non	0.383	3-D/SCF	0.350	**ADC**		DADC	13.79	DADC	0.173
Bar-Mach	0.261	5-D	0.380	Origin	3.28			Z 1&2	0.189
ADC				DBMC	2.39			Zone 3	0.204
Non	0.312			DADC	1.30	**3-D/SCF**		Zone-4	0.242
Mach	0.282	**ADC**				Origin	40.36	Zone-5	0.300
Bar-Non	0.279	ADC	0.100			DBMC	27.13	Zone-6	0.361
Bar-Mach	0.245	3D/SCF	0.170	**3-D/SCF**		DADC	25.94	Zone-7	0.434
SCF/3-D		5-D	0.200	Origin	3.25	DSCF	13.79	Zone-8	0.497
Non	0.312	CR	0.210	DBMC	2.39				
Mach	0.276			DADC	2.04				
Bar-Non	0.280			DSCF	1.30	**5-D**			
Bar-Mach	0.241	**3-D/SCF**				Origin	42.75		
5-D		3-D/SCF	0.110	**5-D/CR**		DBMC	30.72		
Non	0.219	5-D	0.180	Origin	3.33	DADC	24.79		
Mach	0.213	CR	0.190	DBMC	2.80	DSCF	17.20		
Bar-Non	0.211			DADC	2.12	DDU	1.58		
Bar-Mach	0.195			DSCF	1.75				
CR Basic	0.122	**5-D/CR**		DDU	0.93				
CR HD	0.090	5-D	0.000						
SAT	0.082	CR	0.080						
Piece Sorting Delivery		Bundle Sorting		Sack Handling/Sorting Sack Opening Sack Return		Pallet Handling Pallet Opening Pallet return		Transportation Bulk Handling Some Piece Sorting Delivery	

Per-pound Editorial Discount, cents per editorial pound	10.1
Per piece editorial discount, cents times editorial percent	7.4
Per-piece charge for qualified Ride-Along pieces, cents	12.4

5

1 **V. COMPLIANCE WITH REORGANIZATION ACT**

2   In addition to certain general policies, the Act identifies two specific sets of

3 factors that should be included in considerations leading to rates. One set is found in §

4 3622(b) and the other in § 3623(c). Although there is overlap, the former set is specified

5 as applicable to changes in rates and fees, and the latter set as applicable to "changes in

6 the mail classification schedule." § 3623(b). In practice, the former set has received its

7 greatest scrutiny in regard to selecting markups for the various subclasses and services,

8 consistent with breakeven, as is typically done in omnibus rate cases. They are

9 important, then, as much or more in a relative sense as in an absolute sense.

10   The rates being proposed are guided by an interest in giving mailers more

11 appropriate signals. The belief is that such signals will bring about more efficient

12 decisions, which will improve the efficiency of the class, the lot of the mailers, and the

13 contribution that periodicals make to the nation. Practically speaking, the rates being

14 proposed recognize more effectively the costs of bundles, sacks, and pallets, and

15 associated interdependencies, including entry points, in a way that aligns operationally

16 with decisions mailers make. To an extent, then, the changes focus on the implicit

17 markups of mail categories (some of which may be viewed as new), a process the

18 Commission has indicated is at the heart of rate design.[37] [38] No changes in subclass

19 markups are proposed.

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[37] The phrase "implicit coverage" (or "implicit cost coverage") is used in rate proceedings to refer to cost coverages calculated for categories or other groupings of mail that fall *within* subclasses. Such coverages are usually expressed in percentage terms. The numerical value of an implicit coverage is not necessarily *implied* by anything other than that the numerator is the revenue of the category and the denominator is the corresponding cost. In percentage terms, the implicit *markup* equals the implicit coverage minus one hundred percentage points.

[38] See PRC Op. R2000-1, p. 390, ¶ 5533, where the Commission said: "Rate design for a subclass can be thought of as setting the implicit percentage markups for each rate category."

1   Periodicals has long been regarded as the class with the most complex rate

2   structure. To the extent that this is true, it has been because of: a) the way in which rates

3   differ for editorial and advertising content and b) an interest in being at the forefront of

4   recognizing costs in rates.[39] At any particular time, however, cost recognition is limited

5   by the data that are available, the analysis that has been done, and our understanding of

6   the mail and its markets. Especially with the improved flow models now being used, our

7   perspective is much better than it was even a few years ago. Accordingly, this case can

8   be viewed as a significant step in the appropriate recognition of costs and in bringing

9   Periodicals into suitable alignment with the criteria in the Act.

10   It is not necessary to decide which set of criteria is most applicable to the changes

11   being proposed. Both sets are important in their own right and should be included, as

12   applicable, in all rate considerations. They are considered here. My discussion of these

13   criteria should not be viewed as legal opinion, as I do not claim expertise in that area. It

14   *is* my opinion, however, that the criteria primarily employ practical language and

15   economic terms of art, and that most, if not all, refer to concepts that are susceptible to

16   being understood by economists and rate practitioners. It is from this perspective that I

17   testify.

18   Section 3622(b) identifies nine specific criteria, listed below:

19   1.   the establishment and maintenance of a fair and equitable
20   schedule;
21
22   2.   the value of the mail service actually provided each class or type of
23   mail service to both the sender and the recipient, including but not
24   limited to the collection, mode of transportation, and priority of
25   delivery;

---

[39] Another point worth noting is that since all periodicals are required to have a frequency of publication and a list of subscribers or requesters, Periodicals mailing are to a considerable extent repetitive. Thus, once mailing arrangements are made, any associated efficiencies can be realized over and over.

1
2   3. the requirement that each class of mail or type of mail service bear
3   the direct and indirect postal costs attributed to that class or type
4   plus that portion of all other costs of the Postal Service reasonably
5   assignable to such class or type;
6
7   4. the effect of rate increases upon the general public, business mail
8   users, and enterprises in the private sector of the economy engaged
9   in the delivery of mail matter other than letters;
10
11 5. the available alternative means of sending and receiving letters and
12   other mail matter at reasonable costs;
13
14 6. the degree of preparation of mail for delivery into the postal
15   system performed by the mailer and its effect upon reducing costs
16   to the Postal Service;
17
18 7. simplicity of structure for the entire schedule and simple,
19   identifiable relationships between the rates or fees charged the
20   various classes of mail for postal services;
21
22 8. the educational, cultural, scientific and informational value to the
23   recipient of mail matter; and
24
25 9. such other factors as the Commission deems appropriate.

26
27   Section 3623(c) identifies six specific criteria that are to be included in the

28 consideration of classification changes. They are:

29   1. the establishment and maintenance of a fair and equitable
30   classification system for all mail;
31
32   2. the relative value to the people of the kinds of mail matter entered
33   into the postal system and the desirability and justification for
34   special classifications and services of mail;
35
36   3. the importance of providing classifications with extremely high
37   degrees of reliability and speed of delivery;
38
39   4. the importance of providing classifications which do not require an
40   extremely high degree of reliability and speed of delivery;
41
42   5. the desirability of special classifications from the point of view of
43   both the user and of the Postal Service; and

1

2   6.   such other factors as the Commission may deem appropriate.

3

4 Sections 3623(c)(3) through (c)(4) do not apply to this proposal. Also, §

5 3622(b)(5), focusing on alternatives, does not apply. The remainder of the criteria are

6 considered.

7 **Sections 3622(b)(1) and 3623(c)(1), Fairness and Equity**

8   In both sections, criterion number one indicates that consideration should be given

9 to the fairness and equity of the rates. Although fairness and equity are sometimes

10 viewed as existing in the eye of the beholder, and therefore as matters of opinion, there

11 are several generally accepted notions that are usually thought of as being indicated.

12 First, fairness and equity require that similarly situated mailers be treated similarly. I

13 believe the rates being proposed move strongly in the direction of meeting this

14 requirement. In accordance with widely accepted rate-design principles, they recognize

15 similarities and differences in bundle preparation, sack usage, and pallet usage. They

16 also recognize similarities and differences in entry patterns, entry points, and distance

17 transported. In addition, they reduce the extent to which mailers will find their rates

18 influenced in undesirable ways by the practices of dissimilarly situated mailers whose

19 rates do not reflect cost incurrence.

20   Another reflection of fairness and equity involves the extent to which the rates

21 reflect costs. On this point, the Commission has explained:

22   The Commission begins the rate design process assuming
23   equal implicit markups. This is a neutral starting position which
24   seems to be implied by § 3622(b)(1), a fair and equitable schedule.
25   It is consistent with the Commission's general policies that the
26   rates for each rate category be above cost; that rates reflect the
27   costs developed in the record; and that rate design results in
28   identifiable relationships between rate categories. Equal implicit

1   markups, however, are only a starting place, and often may not be
2   practical or appropriate.
3
4   The Commission bases worksharing discounts on avoided
5   costs. Basing discounts on avoided costs does not result in equal
6   implicit markups, rather it results in equal per-piece markups. It
7   also results in worksharing mail having higher implicit markups
8   than mail which is not workshared and the most heavily
9   workshared pieces *(i.e.* those with the largest discount) having the
10   highest implicit markups.
11
12   This approach to worksharing discounts is called "efficient
13   component pricing" (ECP) in the economic literature. The theory
14   requires the discount to be 100 percent of the cost savings. The
15   Commission tries to achieve 100 percent passthrough of the
16   worksharing savings, but again it frequently may depart from this
17   standard for a variety of reasons. An important virtue of ECP is
18   that the mailer will perform the workshared activity *(e.g.* presort)
19   when he can do so at a lower cost than the Postal Service. This
20   leads to productive efficiency *(i.e.* the most efficient provider does
21   the work resulting in the lowest cost to society). Because ECP also
22   lowers the real cost of mailing, volume should increase in response
23   to lower effective prices.
24
25   PRC Op, R2000-1, p. 390, ¶¶ 5533-35.
26
27   The rates being proposed reflect costs fairly and lead to implicit markups that are

28   consistent with notions of efficient component pricing and the appropriate recognition of

29   worksharing activities. The costs of bundles are recognized in the rates for bundles,

30   according to their makeup and the processing they receive. And the costs of sacks and

31   pallets are recognized in their rates, according to the way incurred. In all cases, the

32   makeup of the containers is recognized, consistent with their entry point. The converse

33   of developing implicit markups in this way is that it is fair for mailers to face in rates the

34   costs of their own mail and their own preparation decisions, and that it is fair for mailers

35   to see in rates a reflection of the resources absorbed by their mail.

36   There are three more notions of fairness that warrant note. First, it is fair to give

37   mailers tools for responding to the situations they face, and for influencing the market

1   into which they are essentially locked.[40] As explained earlier in my testimony,

2   Periodicals mailers have faced substantial rate increases for nearly two decades. They

3   have sought options for cooperating with the Postal Service in ways that would help both

4   sides. They have been willing to invest of themselves and make changes, if only given

5   the options and the appropriate signals. They have found themselves *with* the motivation,

6   but *without* the tools. The proposed rates provide mailers with a broader range of signals

7   relating to costs and resource usage. The rates place a little more of the outcome in the

8   hands of the mailers themselves, so they can do more than stand and watch. I believe this

9   is an inherently fair thing to do.

10   Second, to mailers that dropship, it is fair to provide a rate reduction equal to the

11   Postal Service's associated cost reduction. The existing rates are deficient in this regard;

12   the proposed rates are not. Costs mailers incur preparing and submitting their mail may

13   be irrelevant to determining economically efficient rate levels, but they are not irrelevant

14   to fairness. They point as well to the importance of assuring that accepted rate-design

15   principles are honored, such as those associated with efficient component pricing.

16   Besides, it seems unfair on its face for the Postal Service to find itself in the position of

17   saying: "We understand that you may dropship in order to meet subscriber needs and to

18   achieve a viable product, and we are giving you that option. But when you do it, your

19   reduction in rates will be considerably smaller than our reduction in costs, so that we will

20   be extracting a higher per-piece contribution than before, and your implicit markup will

21   be elevated far more than might be expected under accepted worksharing principles.

---

[40] The Private Express Statutes, as I understand they are interpreted, do not prevent rivals from competing
with the Postal Service for the delivery of periodicals. However, the mailbox rule places a severe
constraint on potential (and actual) private operators. If it were not for that rule, I am confident that private
operators would be delivering a substantial portion of periodicals today.

1   Furthermore, we are going to use that extra contribution to help provide lower rates (in

2   many cases below-cost rates) to mailers who do not dropship."

3   Third, it is an axiom of regulatory theory that the rates that would be generated by

4   the forces of a competitive market, were such a market possible, are fair and equitable

5   rates, and that regulation should tend to replicate such rates, where feasible. It seems

6   clear that competitive rates would be based on the costs of providing the service and that

7   the rates for mail entered at the destination would be based on the costs to accomplish

8   delivery from that point. Periodicals rates at the present do not meet this test, while the

9   proposed rates do.

10   **Sections 3622(b)(2) and 3623(c)(2), Value**

11   These sections refer in one way or another to the value of the mail matter and the

12   mail service to the sender and the recipient. The rates being proposed, along with the

13   associated rate structure, are designed specifically to allow mailers to focus on the value

14   they place on various kinds of service, and at the same time, on the costs to the Postal

15   Service and to the nation of providing those services. Consider sacks, for example. The

16   cost of handling a sack is relatively independent of the amount of mail in the sack. This

17   means that a sack could have one 5-pound bundle or several bundles totaling 30 pounds.

18   Under the proposed rates, the mailer using sacks can focus on the value of using the sack,

19   with various contents. If the sack is the preferred alternative and is worth the cost, the

20   mailer will use it, and will pay for the resources required. Importantly, and fairly, no

21   other mailer will be required to help finance that decision. On the other hand, if the

22   mailer decides on a different alternative, he will be able to evaluate that alternative in

23   view of its costs and the value placed on it.

1   Considerations of value are unique to each mailer. Neither the Postal Service nor

2   the Rate Commission can presume the value that various mailers place on various

3   alternatives. But when the cost of each service is reflected in the rates, each mailer can

4   make his own assessment, given his own value determinations. Nothing is wrong with a

5   mailer using a higher-cost service, as long as he is charged for that service. The Postal

6   Service, under these conditions, incurs the costs and passes them on to the mailer.

7   Neither the Postal Service nor the mailer would be better off if the mailer chose a

8   different service and the Postal Service's costs were lower.

9   **Section 3622(b)(3), Costs**

10   This section has been interpreted, for the most part, to require that *subclasses* of

11   mail recover their costs, with appropriate cost coverages. But, as the Commission noted

12   in Docket No. R2000-1, quoted also above "[r]ate design for a subclass can be thought of

13   as setting the implicit percentage markups for each rate category." Op. p. 390, ¶ 5533.

14   Clearly, the interest in tracing costs goes well below the subclass level as, I believe, it

15   should. Indeed the contribution that the classification approach makes to the setting of

16   appropriate rates is that it helps provide a fair path to establishing rates for particular

17   mailpieces that recognize their costs and other appropriate factors. If the cost coverages

18   on particular mailpieces were found to be substantially higher than the coverage for the

19   subclass as a whole, or even if substantially lower, including the possibility of coverages

20   below 100 percent (indicating below-cost rates), a case could be made for inquiry into

21   whether the pieces are appropriately classified and rated. Much of the history of

22   ratemaking under the Reorganization Act has involved questions of whether new rate

1   categories (within subclasses) should be established and of how these categories should

2   be priced.

3   The Commission has often shown an interest in the cost coverages on particular

4   groups of mail within subclasses. For example, after considering the coverage on

5   Standard mail above and below the break point, it concluded:

6   The Commission hopes that reliable information on
7   implicit markups may make it possible to calculate the total
8   amount of revenue that should be obtained from pieces above and
9   from pieces below the break point. This would be an important
10   contribution to ensuring that intra subclass rate relationships for
11   Standard Mail are fair and equitable. The separate issue of the best
12   way to design rates for the pieces above and below the break point
13   might also be addressed by studying implicit markups.
14
15   PRC Op. R2000-1, p. 392, ¶ 5540.
16
17   Similarly, in regard to the Residual Shape Surcharge in Standard, on the same

18   record, the Commission said:

19   Several objections raised on this record were also presented
20   and resolved in Docket No. R97-1. In essence, these include
21   arguments that there is no cost coverage requirement below the
22   subclass level; that costs should not be "blended"; and that other
23   mailers have not objected to "averaged" costs. The Commission
24   has once again considered the validity of these arguments, but
25   finds no sound reasons to depart from its previous conclusions. In
26   general, the Commission continues to believe that overall
27   considerations of fairness and equity and an interest in cost-based
28   rates overcome opponents' objections.
29
30   PRC Op. R2000-1, p.357, ¶ 5436.
31
32   The rates being proposed are designed to track costs within the subclass, and to do

33   so in a way that aligns with decisions mailers must make about their mail. They are in

34   line with interests the Commission has expressed in cost-based rates and in implicit

35   markups.

1   In addition to a general interest in tracking costs and in giving mailers appropriate

2   signals concerning the resource requirements of *their* subclass, improvements are made in

3   three specific categories within Periodicals that now have what may be called *deviant*

4   cost coverages. First, as discussed in the Rate Design section above, Science-of-

5   Agriculture publications have a much lower average haul than the Periodicals subclass.

6   They are, therefore, paying rates that are elevated in order to help finance discounts for

7   higher-zone mail. It would seem more reasonable for them to receive their

8   congressionally provided discount from a cost-based rate than from one that is elevated.

9   This end is achieved in the proposed rates.

10   Second, a more general perspective on the extent to which the Periodicals rates

11   track (or do not track) costs is provided by a comparison with In-County rates. Under

12   RFRA, the markup on In-County is one-half the markup on Outside County. The latter

13   being 1.3 percent, it follows that the former is 0.65 percent. Therefore, for all practical

14   purposes, both sets of rates are at cost. All In-County publications are entered at what is

15   essentially their destination. Therefore, the rate for DSCF-entered In-County

16   publications is an at-cost rate. We know, then, that if Outside County rates were cost

17   based, the rate for DSCF entered Outside County pieces would be near the corresponding

18   In-County rate, for there is little reason to believe that the costs of handling the pieces

19   would be different. It turns out, however, that the Outside County rate is in the

20   neighborhood of twice the In-County rate. This suggests that the low-zone rates for

21   Outside County Periodicals are elevated above costs to a degree that cannot be called

22   anything but excessive, and therefore that higher-zone periodicals have rates that are

23   substantially below costs.

1   Third, as discussed in Section III-D, local and regional publications as a group,

2   entered in their associated areas, are paying rates that are elevated to help provide lower

3   rates for higher-zone mail. And if these publications are printed and entered at distant

4   locations, they pay rates that do not recognize the Postal Service's additional costs, and

5   they thereby impose additional costs on other mailers. Nothing in this pattern of charges

6   relates the rates to the costs incurred. In fact, these publishers are part of the group

7   discussed in the previous paragraph, which is paying excessive rates, a situation

8   addressed by the proposed rates.

9   **Section 3622(b)(4), Effects of Rate Increases**

10   It has been common in rate proceedings to set rates in such a way as to temper the

11   effects on mailers that receive substantial increases. On the other hand, it is important to

12   take meaningful steps toward improved and meritorious rate positions.

13   The proposed rates will have effects on mailers and some of them may be viewed

14   as substantial, meaning, of course, that the mail involved has been the beneficiary for

15   some time of rate preferences. But the impact is limited. For one thing, the amount of

16   revenue obtained from the bundle, sack, and pallet charges, is only about 21 percent of

17   the total revenue requirement, and no markup is proposed on these charges. For another,

18   some of the effects are due to improvements in the piece charges, in that ADC

19   preparation is no longer averaged with mixed ADC and non-machinability is recognized.

20   Many small mailers will benefit from these changes. In addition, it may be important to

21   mailers of smaller quantities that a new DBMC dropship discount is proposed, that the

22   pallet discounts are not restricted to dropshipped mailings, and that improved dropship

23   discounts are proposed for pieces in sacks.

1   More importantly, however, the proposed rates focus on a range of cost-driving

2   factors over which mailers have control and to which mailers would be expected to

3   respond. In general, Periodicals mail is prepared using computers and commercially

4   available software. In using such, inputs and constraints must be selected, like sack

5   weight, pallet weight, bundle weights, and preferences relating to sack and bundle

6   makeup. In addition, mailers will face improved signals relating to machinability and

7   barcoding. If the reality of the costs behind these signals is hidden by excessive

8   tempering, mailers will not understand the cost consequences of their decisions and

9   efficient changes will not be made.

10   **Section 3622(b)(6), Preparation**

11   This criterion requires that consideration be given to the "degree of preparation of

12   [the] mail . . . by the mailer and its effect upon reducing costs to the Postal Service ."

13   The importance of this criterion, and the role it has played, is great. It has been the basis

14   and justification for a wide and still evolving range of worksharing discounts, which have

15   set the United States apart from most countries of the world.[41] In addressing, as it does,

16   the general issue of "preparation," its importance goes beyond issues of worksharing *per*

17   *se* and to issues of the nature of the mail itself, for the preparation of mail involves

18   decisions on bundles, containers, and entry points. These issues are addressed

19   specifically by the rates being proposed.

20   One of the great failures of the current rates is the extent to which they do not

21   allow mailers to see the cost effects or the efficiency implications of the decisions they

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[41] See: Elcano, Mary S., German, R. Andrew, and Pickett, John T., "Hiding in Plain Sight: The Quiet
Liberalization of the United States Postal System," in Michael Crew and Paul Kleindorfer, *Current
Directions in Postal Reform*, pp. 337-52, 2000, Kluwer, Boston. Also, the Commission said: "The concept

1   make. Mailers cannot be expected to do what is best when they are given financial

2   incentives to do something different. Yet these same mailers are forced to live with the

3   cost implications of their decisions, because the rates they pay are ultimately based on

4   costs.

5   One could argue that mailers are hamstrung; they want to do something to help,

6   but are given no guidance. The proposed rates break through this blindness and allow

7   them to consider the efficiency improvements that are possible by aligning preparation

8   decisions with the value of the service and its associated costs. Mailers will be expected

9   to do nothing more than watch out for their own best interests, and at the same time reap

10   the efficiency benefits of being able to balance the benefits and the costs. The overall

11   efficiency of the Periodicals subclass should increase.

12   **Section 3622(b)(7), Simplicity**

13   This section is referred to, in shorthand, as focusing on simplicity and complexity.

14   But it goes on to highlight the importance of "identifiable relationships between the rates

15   . . . charged." It is true that one could argue for simplicity at any cost. In fact, a postal

16   official, not especially knowledgeable in rates, once asked me: "Why don't we just

17   charge them all a quarter and get it over with?"

18   As rates become simpler, however, fairness declines, the efficiency of the

19   subclass declines, costs get ignored and become inflated, mailers are given poor signals

20   concerning what is best to do, and rates increase. To their credit, Periodicals mailers

21   have not generally argued for simplicity. They use computers to prepare their mail and

22   are able to respond to the signals in rates.

---

of worksharing has been widely applied and is credited with helping the Service to attract expanding
volumes of mail and to improve its productivity." PRC Op. MC95-1, p. III-26, ¶ 3068.

1   The rates being proposed may appear complex, but they are orderly and

2   identifiable. Also, they are not adorned with special discounts, restrictions, or

3   surcharges. There are per-piece charges, per-bundle charges, per-sack charges, and per-

4   pallet charges. The charges depend in clear ways on the makeup and entry point of the

5   containers. The purpose of the charges is clear. The options of the mailers are also clear.

6   And, the charges are for things that mailers know and understand: mailers understand

7   presorting, barcoding, and machinability; mailers know how many bundles they have and

8   their makeup; mailers understand their usage of sacks and pallets; and mailers are keenly

9   aware of their entry points. Indeed, one of the great advances of recent years has been

10   the development of dropship software and the integration of such programs into trucking

11   operations.

12   Part of the attractiveness of the proposed rates is their freedom from the

13   complexities caused by the split nature of the pound rates that now exist. Under the

14   unzoned editorial pound rate, the rates are skewed away from costs in a way that presents

15   an endless array of anomalies and administrative difficulties. Several examples will

16   illustrate this point. First, printers see dropship discounts that depend on the proportion

17   of editorial content. Accordingly, two publications, identical except that one has more

18   editorial than the other, might have to be scheduled and handled differently. This causes

19   disparity in printing practices, for no apparent reason.

20   Second, discounts are difficult to arrange. In connection with the non-

21   transportation savings for DSCF and DDU entry in Docket No. R2000-1, witness

22   Taufique said:

23   The allocation of these non-transportation cost savings to pounds
24   and pieces is one area where my proposal differs from the R97-1

– 57 –

1   Commission methodology. Instead of a 50/50 split, the Postal
2   Service is proposing a 75 percent allocation of these cost savings
3   to piece-related discounts and only 25 percent to pound-related rate
4   reduction for DDU and DSCF entry. . . . On the pound side the
5   value of this discount diminishes because less than half of all the
6   pounds actually pay the zoned advertising pound rates. The piece
7   discount provides a more efficient vehicle to provide dropship
8   incentives because the value of the discount applies to every piece
9   regardless of the proportions of editorial and advertising contents.
10
11   USPS-T-38, pp. 9-10.
12
13   In support of its decision to continue its R97-1 method, the Commission observed:
14
15   It would seem, however, that if the savings are the same for
16   a container with many light-weight pieces as for a container
17   holding fewer heavy-weight pieces, then the savings are, in fact,
18   pound oriented. If, under these conditions, the discount is given on
19   a per-piece basis, the container with many lightweight pieces will
20   receive a discount larger than the Postal Service's savings and the
21   container with fewer heavy-weight pieces will receive a discount
22   smaller than the savings. The incentive thus provided would be for
23   mailers of lightweight pieces to dropship and receive an excessive
24   discount.
25
26   PRC Op. R2000-1, p. 437, ¶ 5684.
27
28   Third, there are complexities in the current pallet discount. In its Opinion in

29   Docket No. R2001-1, the Commission observed that the "consideration of pallet

30   discounts in previous cases has raised the possibility that associated savings, in terms of

31   transportation, may have a pound orientation and may vary with distance." (p. 109, ¶

32   3177) But it proceeded to recommend the per-piece pallet discount contained in the

33   Settlement Agreement. Under that arrangement, the discount is the same for a) heavy-

34   weight and light-weight pieces and b) pieces transported a short distance and those

35   carried long distances, even though the cost savings vary with both weight and distance.

36   There is no way that mailers can rationalize discounts of this kind. The proposed rates

37   turn these anomalies into understandable relationships.

1   **Section 3622(b)(8), ECSI Value**

2   The educational, cultural, scientific, and informational value of the materials in

3   the Periodicals subclass is recognized in two ways. First, the overall subclass is given a

4   low cost coverage of 101.3 percent. Second, the implicit coverage on editorial matter is

5   84.7 percent and that on advertising matter is 129.5 percent. These are values that

6   characterize the current rates, per the Commission's recommendation in Docket No.

7   R2001-1, and it is not proposed that they be changed.

8

9   The proposed rates, if approved, will meet the statutory criteria, send effective

10   pricing signals to mailers, help to align mail preparation with mail processing, and

11   increase the efficiency with which mailer needs are met.

12

1   **Appendix A – A Model of Publishers' Decisions**

2   Paraphrasing Kielbowicz slightly, additional light can be shed on the possibility

3   that the information on the pages of periodicals might become less accessible to residents

4   of Washington State than to the residents of Washington, D.C. by considering the

5   conditions that might lead to reduced accessibility. Specifically, it seems to me that in

6   order for information to be less accessible in the further zones than in the closer zones,

7   one of two possibilities would most likely have to occur. The first possibility is that a

8   publication might zone its subscription rates. The second is that a publisher might decide

9   to offer the publication to the closer zones only, to which the postage is lower.[42]

10   The possibility that a publisher would, given a zoned editorial pound rate, decide

11   to adopt a subscription scheme under which the higher zones are charged more than the

12   lower zones is, I think, remote. The primary reasons for this remoteness are

13   administrative difficulties and customer confusion (and, maybe, customer anger). One

14   example would be that travelers purchasing a newsstand copy could not be told as easily

15   what the subscription rate might be in their hometown. Also, both gift subscriptions and

16   subscriber relocations would be more difficult. In addition, publishers view themselves

17   as having competitors in the further zones and tend to feel that an increase there would

18   impair their competitive position. Interestingly, support for my conclusion was provided

19   at a recent postal meeting wherein one publisher explained that he once tried such a

20   scheme and found it to be a disaster.

21   The second possibility, concerning a publisher disenfranchising further-zone

22   subscribers, is at the heart of questions the Commission raised about accessibility, and the

---

[42] Other possibilities might be concocted, such as a change in the publisher's basic business model. But most of these changes would be second-order in character and would most likely affect all zones.

1   court's notice of an anti-Balkanization principle. If a publisher were to decide to cancel

2   all subscriptions from the higher zones, and to refuse to accept new subscriptions from

3   those zones, then it might be the case that potential subscribers in those zones would be

4   cut off from the information in the publication. Of course, such a cut-off, shown below

5   to be unlikely, would be total only if the publication were unavailable in libraries, or on

6   newsstands, or on the Internet.

7   In order to investigate whether it would be likely that publications would drop

8   subscribers in the further zones, the following model focuses on the determinants of their

9   profitability. Once the model is developed, the effects on profits of dropping subscribers

10   in zone 8 can be examined.

11   The profit of a publication (Π) is equal to its total revenue (TR) minus its total

12   cost (TC):

13

14   (1) $\Pi = TR - TC$

15

16   The total annual *revenue* of a publication is equal to the subscription revenue plus

17   the advertising revenue, which can be expressed as follows:

18

19   (2) $TR = V * P_{SUB} + n * V * k * P_{ADV} * Q_{ADV}$

20

21   where: V = the volume of one issue = the number of subscribers

22   P_{SUB} = the average price of a one-year subscription

23   P_{ADV} = the posted rate for a one-page advertisement in one copy

1   Q_{ADV} = the number of pages of advertising in one copy

2   k = a reduction factor from the posted advertising rate to account for

3   discounts, commissions, and sales fees

4   n = the number of issues per year

5

6   The total annual *cost* of the publication is equal to the cost of creating the editorial

7   material (C_{ED}, for one issue) plus the cost of printing ($C_{PRT-AVG}$, the average per piece for

8   one issue) plus the cost of mailing ($C_{MAIL-AVG}$, the average per piece for one issue) plus

9   the average cost of account maintenance (C_{AM}, for one subscriber for one year, includes

10   solicitation and billing and renewal) plus the cost of administration (C_{ADM}, for the

11   publication for one year, assumed relatively fixed with respect to volume), as follows:

12

13   (3) $TC = n (C_{ED} + V * C_{PRT-AVG} + V * C_{MAIL-AVG}) + V * C_{AM} + C_{ADM}$

14

15   The average cost of printing one issue can be viewed as having a fixed component

16   (FC_{PRT}) and a marginal component (MC_{PRT}), so that $C_{PRT-AVG} = FC_{PRT}/V + MC_{PRT}$.

17   The total postage for one issue ($V * C_{MAIL-AVG}$) can be expressed in terms of zones as

18   follows: $V_{SCF} * C_{SCF} + V_{1-2} * C_{1-2} + V_3 * C_3 + \ldots + V_8 * C_8$. The subscripts indicate

19   DSCF or zone of entry, assuming no DDU or DADC entry. The total volume, V, shown

20   above, is simply the sum of the subscripted volumes. Substituting, a detailed expression

21   for the profit is obtained:

1   (4) $\Pi = (V_{SCF} + V_{1\text{-}2} + V_3 + \ldots + V_8) P_{SUB} + n\,(V_{SCF} + \ldots + V_8)\,k * P_{ADV} * Q_{ADV}$

2                   $-\,n\,C_{ED} - n\,FC_{PRT} - n\,(V_{SCF} + \ldots + V_8)\,MC_{PRT}$

3                   $-\,n\,(V_{SCF} * C_{SCF} + V_{1\text{-}2} * C_{1\text{-}2} + \ldots + V_8 * C_8)$

4                   $-\,(V_{SCF} + V_{1\text{-}2} + \ldots + V_8)\,C_{AM} - C_{ADM}$

5

6   The partial derivative of profit with respect to zone-8 indicates the increase in

7 profit from adding a subscriber in zone 8, or the decrease in profit from dropping such a

8 subscriber:

9

10   (5) $/\ V_8 = P_{SUB} + n * k * P_{ADV} * Q_{ADV} - n * MC_{PRT} - n * C_8 - C_{AM}$

11

12 This equation is perfectly general. It says that if a subscriber is added in zone 8, the

13 revenue for the year will increase by the subscription price plus the advertising revenue.

14 These are the first two terms. Then, with negative signs, it says the cost will increase by

15 the marginal cost of printing another copy, the cost of mailing a copy to zone 8, and the

16 average cost of maintaining a new account, multiplied by the number of issues where

17 needed. It can be seen that if the last three terms, which include the postage to zone 8 as

18 the second term, are high, possibly because of high postage to zone 8 when the full

19 weight of the publication is zoned, there is the possibility of the addition to profit being

20 negative.

21   Some idea of the orders of magnitude involved in equation (5) can be obtained by

22 thinking about a specific publication. Since it has been discussed in previous cases, I

23 selected *The New Republic* (*TNR*) magazine for this purpose. The subscription price for

1   *TNR*, according to its website (www.tnr.com) is $39.95 per year. The lowest rate I could

2   find on the Internet was $34.95 per year (at www.magazinecity.net). In order to be

3   conservative, I used $34.95 as an average. *TNR* is a weekly magazine, with 44 issues per

4   year. Thus, n = 44.

5   Mailing information, last provided in Docket No. R90-1 by witness Dearth, shows

6   the average weight of *TNR* to be 3.3 ounces and the average proportion of advertising to

7   be 23 percent.[43] A set of full-weight-zoned rates to go with this information is easy to

8   develop and, for the subclass, does not result in a rate increase. It results only in a set of

9   rates that is more cost based than the existing rates, with the same revenue. This is done

10   by applying the current advertising pound rates to the full weight, instead of to just the

11   advertising weight, and then returning any excess revenue through a per-pound discount

12   on editorial pounds.[44] In this way, the average benefit to editorial matter is not changed.

13   Based on the Commission's workpapers in Docket No. R2001-1, applying the advertising

14   pound rates in this way results in additional revenue of $243,753,950, which, after

15   rounding, is equivalent to 10.1 cents per editorial pound. Thus, after applying the

16   advertising pound rates to the full weight of publications, a new discount is applied, equal

17   to 10.1 cents per editorial pound. Under these rates, assuming the pieces are presorted to

18   the 3-digit level, barcoded, and not on pallets, the postage for sending a copy to zone 8 is

19   $0.3416.

---

[43] See answers of Jeffrey Dearth of interrogatories of ABP, 1-18, Docket No. R90-1, Tr. 27 part 2/13661-778. The zone distribution of pieces was provided as: SCF – 3677, z1-2 – 10,110, z3 – 20,221, z4 – 22,978, z5 – 10,110, z6 – 4,595, z7 – 1,838, z8 – 18,383.
[44] Developing full-weight-zoned rates in this way, instead of developing them from scratch, adds to the conservatism of the analysis of this appendix since, as explained in Section IV, there is an error in the development of the current rates that artificially elevates the zone-8 pound rate.

1   From the web site, I also calculated a price for advertising of 0.1291 $/page

2   (assuming the ad is in 2 colors and is run 6 times). To check this, I calculated a similar

3   figure for *Business Week* and obtained 0.1024 $/page. In order to be conservative, I used

4   the lower of these two figures, and neglected the fact that advertising sold in less than

5   full-page increments is sold at a higher price. To account for discounts, commissions,

6   and sales charges, I used a value for k of 0.5. There is no way of knowing what the

7   correct factor is.

8   To obtain the quantity of advertising, I applied the weight of 3.3 ounces and the

9   advertising proportion of 23 percent to a weight figure of 0.00288 pounds per page,

10   which recognizes that each sheet of paper has two sides.[45] To go with these figures, the

11   marginal cost of printing is estimated to be $0.17 per copy.

12   Putting these figures into equation (5) shows that the additional profit from a

13   subscriber in zone 8 is $49.55 – C_{AM}. This means that as long as the cost of account

14   maintenance is less than $49.55, it will be profitable to add a subscriber in zone 8 or,

15   alternatively, that it will not be profitable to drop a subscriber in zone 8. The cost of

16   account maintenance is an average annual figure that includes the cost of obtaining and

17   renewing subscribers, billing, keeping records, and maintaining address files. The

18   difference between the realized subscription price ($34.95) and the cost of account

19   maintenance is known in the publishing industry as circ net, short for circulation net, and

20   is frequently expressed as a proportion of the subscription price. As a proportion, circ net

21   might be in the neighborhood of 50 percent. Since a negative circ net ($34.95 – $49.55)

---

[45] This figure was obtained by weighing an issue of *Business Week* magazine (8.5 ounces) with 184 pages.

1   would be very unusual, it appears that adding a subscriber in zone 8 would be

2   profitable.[46]

3   This analysis does not depend on a publication having paid subscribers. To get a

4   ballpark result for a controlled circulation publication, I looked at *Pit & Quarry,* a

5   monthly magazine. According to ABP's initial brief in Docket No. R90-1, it weighs 6

6   ounces. (p. 18) Its web site (www.pitandquarry.com) shows a subscription rate of

7   $39.00 per year for unqualified subscribers, but I assumed an average of zero. A

8   circulation of approximately 24,000 is shown. The full-page advertising rate for a color

9   ad run 6 times is $6,740, which gives a P_{ADV} of 0.2808 $/page. I assumed 50 percent

10 advertising, a marginal printing cost of 31 cents per copy, and 0.00288 pounds per page

11 (as above). Assuming 3-digit presort and barcoding, the postage for a piece going to

12 zone 8 is 46.63 cents. The implied increase in profit for a subscription in zone 8

13 (equation 5) is $100.37 – C_{AM}. In other words, as long as the cost of account

14 maintenance for one subscriber is less than $100.37 per year, which is almost certainly

15 the case, it is profitable to add subscribers in zone 8.

16   It may be noted that *Pit & Quarry* has been publishing since 1916. Without

17 question, as far as I know, it makes a major contribution to its industry and is an

18 important publication. On the other hand, it views itself as existing in a competitive

19 marketplace. Its website shows a "competitive analysis" with comparisons to two other

20 magazines, *Rock Products* and *Aggregates Manager*. It emphasizes that *Rock Products*

21 has lost 3,245 qualified subscribers (15 percent of its circulation) in the last year.

---

[46] At a subscription rate of $19.98, exactly one-half the published rate, the cost of account maintenance
would have to be $34.57 for zone 8 subscribers to be unprofitable. The conclusion in the text is unaffected.

1   There is another way, perhaps even more revealing, of bounding these estimates.

2   If the profit level of a publication were extremely high, one would expect healthy

3   subscription and advertising rates relative to costs, and that subscribers in all zones would

4   be profitable. If there were a chance that a subscriber in zone 8 would be unprofitable, it

5   would seem most likely in a situation where the profit level of the publication is zero.

6   Therefore, it is illuminating to constrain the estimate of equation (5) such that the profit

7   shown in equation (4) is zero. If this is done, by substituting the required relationship

8   from equation (4) into equation (5), it turns out that the added profit for a subscriber in

9   zone 8 is:

10

11   (6) $/\ V_8 = n * C_{ED}/V + n * FC_{PRT}/V + C_{ADM}/V + n * C_{MAIL\text{-}AVG} - n * C_8$

12

13   For *TNR*, the cost of sending a copy to zone 8 has already been calculated as

14    $0.3416. The average cost of sending copies in the mail ($C_{MAIL\text{-}AVG}$) can be calculated

15   using the above assumptions and the zone distribution provided by witness Dearth. The

16   result is $0.2878. Thus, the last two terms in equation (6) are 44 * (0.2878–0.3416)

17   dollars, or $–2.37. Therefore, in order for the additional profit from adding a subscriber

18   in zone 8 to be negative, it must the case that the sum of: a) 44 times the per-copy

19   editorial cost, b) 44 times the average fixed cost of printing a copy, and c) the annual cost

20   of administration per subscriber, is in total less than $2.37. I indicated above that the

21   marginal cost of printing a copy is estimated to be about $0.17. The corresponding

22   average cost is about $0.33, which means that the average fixed cost of printing

23   (FC_{PRT}/V) is about $0.16. This means that the term $n * FC_{PRT}/V$ by itself is 44* 0.16 =

– 67 –

1     $7.04. Since the second term is $7.04, the sum of the first three terms on the right is

2   certainly more than $2.37. The conclusion is that it is profitable to add subscribers in

3   zone 8.

4   Just as was done for equation (5), this equation can be evaluated, at least roughly,

5   for *Pit & Quarry* magazine. Some of the required figures are given above. I assumed an

6   average postage equal to that for zone 4, which is 34.52 cents per piece, and an average

7   fixed cost for printing of 30 cents. The equation shows the addition to profit for an

8   additional subscriber in zone 8 to be $12 * C_{ED}/V + C_{ADM}/V + \$2.15$.

9   The explanation for these results is reasonably simple, perhaps intuitive. The first

10   term on the right of equation six ($n * C_{ED}/V$) exists because the revenues (from

11   subscriptions and advertising) must be large enough to cover, among other costs, the cost

12   of creating the editorial content, but this cost does not depend on volume, so, to be

13   profitable, additional subscriptions do not need to contribute to this cost. The second

14   term on the right ($n * FC_{PRT}/V$) exists because the revenues must also be large enough to

15   cover the fixed costs of printing, but neither does this cost vary with volume, so, to be

16   profitable, additional subscriptions do not need to contribute to it either. The third term

17   on the right (C_{ADM}/V) exists because the revenues must be large enough to cover the

18   administrative costs of publishing, but these costs too are fixed, so, to be profitable,

19   additional subscriptions do not need to contribute to them. In effect, the revenue from the

20   new subscriptions is the same as the revenue from the existing subscriptions, but it needs

21   to cover only the low marginal cost of printing, the additional postage (which is

22   somewhat higher than average, due to it being in zone 8), and the additional cost of

23   maintaining another account, which is the same as the cost of maintaining the existing

1   accounts. The new subscriptions, although they provide revenue just like the other

2   subscriptions, do not have to contribute to the cost of creating editorial, the fixed cost of

3   printing, or the administrative costs. Under these conditions, they are bound to be

4   profitable. Subscriptions will be accepted from zone 8 subscribers and there is no

5   incentive to disenfranchise persons living there. The higher postage costs in zone 8,

6   when the editorial matter is zoned, are not high enough to overcome the fact that so many

7   costs are fixed.

8   One of the factors contributing to this outcome is that transportation costs today

9   are a much smaller portion of total costs than they were in 1917. Due to piece rates, the

10   source of about 60 percent of Periodicals revenue, pound rates play a much smaller role

11   in determining postage charges than they did in 1917. The increase in postage, even for

12   zone 8, that would be occasioned by zoning publications' full weight is much smaller

13   than it would have been in 1917, and, since deferential rates are now financed by other

14   rates within the same subclass, would be partially offset by lower pound charges in the

15   lower zones.

16   This result is directly responsive to the Kielbowicz concern for the residents of

17   Washington State. The analysis shows that his standard is met just as well with zoned

18   editorial pound rates as with unzoned editorial pound rates. No subscriber will be

19   disenfranchised by zoning the full weight of publications.

TW et al**.-**T-2

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

_____

COMPLAINT OF TIME WARNER INC. ET AL.
CONCERNING PERIODICALS RATES   Docket No. C2004-1

_____

PROFFERED DIRECT TESTIMONY OF
HALSTEIN STRALBERG
ON BEHALF OF
TIME WARNER INC.,
CONDÉ NAST PUBLICATIONS, A DIVISION
OF ADVANCED MAGAZINE PUBLISHERS INC.,
NEWSWEEK, INC.,
THE READER'S DIGEST ASSOCIATION, INC.
AND
TV GUIDE MAGAZINE GROUP, INC.
CONCERNING PERIODICALS COSTS

January 12, 2004

TABLE OF CONTENTS

LIST OF EXHIBITS

LIST OF TABLES

1 **AUTOBIOGRAPHICAL SKETCH**

2 My name is Halstein Stralberg. I am a consultant to Time Warner on issues related to
3 distribution of magazines through the postal system. Until June 1999 I was a principal
4 at Universal Analytics, Inc. (UAI), a management consulting firm in Torrance, California.
5 and manager of its Operations Research Division.

6 My academic background is in mathematics, with a master's degree from the University
7 of Oslo, Norway in 1963. I received a bachelor's degree in mathematics, physics and
8 astronomy at the University of Oslo in 1961. Most of my professional experience is in
9 the area of management science and operations research. I have directed and
10 performed 30 years of postal related studies as well as management studies for other
11 clients in government and private industry, including production scheduling and control,
12 corporate planning and finance, investment analysis, design and optimization of
13 transportation systems, health care and computer system design.

14 I have previously presented 19 pieces of testimony before this Commission on a variety
15 of postal costing and rate design issues: two rebuttal testimonies on behalf of the Postal
16 Service in Docket R80-1; four testimonies on behalf of Time Inc. in R87-1; four on
17 behalf of Time Warner Inc. in R90-1; one in MC91-3; two in R94-1; two in MC95-1; two
18 in R97-1 and two in R2000-1.

19 Since 1987 most of my work has been in support of Time Warner's participation in
20 postal rate cases. Besides presentation of testimony, I have advised Time Warner on a
21 variety of postal issues and directed the development of computer models for analysis
22 of postal costs and rate design. I participated actively as a member of the joint
23 industry/USPS Periodicals Review Team whose report and recommendations are
24 included in LR-I-193 of Docket No. R2000-1, as an industry representative in an MTAC
25 data collection on bundle breakage (LR-I-297) and recently in a USPS/Time Warner
26 task force to evaluate the feasibility of tailoring the preparation of Periodicals mailings to
27 the processing methods and sort schemes used in each postal facility.

28 From 1973 until 1987, I directed UAI's efforts under several contracts with the U.S.
29 Postal Service. My activities under these contracts included:

30 • Design and development of the Mail Processing Cost Model (MPCM), a weekly
31 staffing and scheduling computer program for postal facilities, with an
32 annualized extension (AMPCM), using linear programming for long term staffing
33 planning in a postal facility.

1

1   • An extensive data collection in 18 postal facilities designed to (1) establish a
2   Postal Service data base on mail arrival rates and mail attributes affecting costs
3   (subclass, shape, indicia, presort, container method, etc.), and (2) develop the
4   model input data needed to apply MPCM for each facility.

5   • The "Study of Commercial Mailing Programs" under the Long Range
6   Classification Study Program. This study involved a detailed cost and market
7   evaluation of several rate and classification concepts, including various presort
8   concepts, destinating SCF discounts for second class, plant loading and
9   barcoding of preprinted envelopes.

10 • A BMC cost analysis which resulted in the establishment of the Inter/Intra-BMC
11   parcel post rate differential in R80-1.

12 • Numerous simulation studies requested by USPS management.

13 My two testimonies on behalf of the Postal Service in R80-1 addressed the Intra/Inter
14 BMC cost analysis and Dr. Merewitz's use of MPCM to analyze peak load costs.

15 I conducted a number of classes and seminars on the use of MPCM for Postal Service
16 employees and interested outside parties. I have made extensive visits, including many
17 multiple repeat visits, to over 40 USPS mail processing facilities and have observed all
18 aspects of mail processing operations on all tours, as well as methods of mail
19 collection, acceptance and transportation, and various ongoing postal data collection
20 systems. I estimate that in total I have spent more than 2000 hours on site in postal
21 facilities.

22 Besides my postal activities, I directed a study for the department of Health and Human
23 Services of the impact of alternative regulatory policies used by state Medicaid
24 agencies, which included an extensive data gathering effort and multiple regression
25 analysis to determine factors influencing utilization and cost in the Medicaid program.

26 Before joining UAI I was an Operations Research Analyst at the Service Bureau
27 Corporation (IBM), where I performed several large-scale simulation studies, including a
28 design analysis of the Dallas/Fort Worth Airport's people mover system and simulations
29 to improve design and response time in large interactive computer systems.

30 As Operations Research Analyst at Norsk Hydro, a Norwegian petrochemical company,
31 my work included design, development and implementation of factory production
32 scheduling systems, studies of transportation and distribution systems and risk analysis
33 of investment decisions.

34 For three years I was assistant Professor of Mathematics at the University of Oslo.

1 **I.   PURPOSE OF TESTIMONY**

2   My testimony develops a set of unit costs and corresponding volumes for Outside

3   County Periodicals flats, flats bundles and containers that will make possible a more

4   cost based rate design than the one in effect today. I believe rates developed on the

5   basis of this information, as described in the testimony of witness Mitchell, will give both

6   large and small mailers incentives to improve their mail preparation and entry practices,

7   thus reducing Periodicals postal costs.

8   The costs and volumes I develop are consistent with PRC costing methodology and

9   with the TY03 after rates assumptions used by the Commission in its R2001-1 Opinion

10   and Recommended Decision. This allows witness Mitchell to develop a revenue neutral

11   restructuring of Periodicals rates.

12   My analysis is based on R2001-1 costs because those are the latest costs of record.

13   Use of more recent cost and volume data, which the Postal Service may already

14   possess, may change my unit cost estimates somewhat, but I do not believe it would

15   substantially alter the major conclusion arrived at both by myself and by Mitchell,

16   namely that a cost based restructuring of Periodicals rates today is both feasible and

17   highly desirable.

18   **II.   SUMMARY**

19   To develop unit costs I use a methodology similar to that employed by the Postal

20   Service to develop the model described in USPS LR-I-332 from Docket No. R2000-1.

21   The mail flow spreadsheets included with this testimony look similar to those used in

22   LR-I-332. My estimates are updated, however, to reflect the wage rates, piggyback

23   factors, productivity rates, mail flow assumptions and PRC costing methodology used to

24   develop TY03 costs in R2001-1. And whereas LR-I-332 identified all normal flats

25   processing costs as being either per-pallet, per-sack, per-bundle or per-piece costs, I

26   show that some of these costs are actually related to the weight, or bulk, of the mail and

27   are more appropriately described as per-pound costs. Section V describes all

28   modifications I made to the original model assumptions.

1   My results are summarized in Exhibits A and B. Exhibit A contains an expanded set of

2   TY03 after rates billing determinants for Outside County Periodicals, corresponding to

3   the mail categories for which I have estimated unit costs. Table A1 shows the

4   estimated number of sacks and pallets per container presort level and entry point.

5   Table A2 shows the number of packages (bundles) by bundle presort level, container

6   type (sack or pallet) and container presort level, and Table A3 shows the number of

7   Outside County flats pieces by container and bundle presort level, container type,

8   machinability and whether or not the pieces are pre-barcoded.[1] Exhibit B contains the

9   corresponding mail processing unit costs. For example, Table B1 contains the

10 estimated TY03 unit costs for each category of sacks and pallets in Table A1, etc.

11 Section III below discusses the major cost causing characteristics of a Periodicals flats

12 mailing and explains why it is important that postal rates recognize these characteristics

13 and their impact on USPS costs. I also explain why the flawed assumption inherent in

14 today's rate design, namely that costs depend only on the number of pieces and the

15 number of pounds, combined with other constraints, sends many incorrect signals to

16 the mailers, resulting in Periodicals postal costs being much higher than they need to

17 be.

18 Section IV describes the development of an expanded set of Periodicals billing

19 determinants used by Mitchell. Section V describes the development of unit costs.

20 Library reference TW et al. 1 contains the various spreadsheets used in my analysis.

---

[1] I use the term "presort level" in this testimony to refer both to the arrangement of individual
pieces within a mailer prepared bundle (package) and the arrangement of bundles (packages)
in a mailer prepared sack or pallet. Generally, a finer presort reduces postal costs by allowing
the mail to bypass some sorting operations and in some cases to bypass intermediate facilities.
DMM section M011.1.2 defines all presort levels recognized by the Postal Service. The ones
relevant to my testimony are: carrier route, 5-digit, 3-digit/SCF, ADC and Mixed ADC (MADC). I
have combined the 3-digit and SCF presort levels into one category because the cost
differential between them is small and in many cases zero, and because the LR-I-332 model in
fact assigns exactly the same costs to the two.

1   **III.   COST CHARACTERISTICS OF PERIODICALS FLATS MAILINGS**

2   Traditional rate design implicitly assumes that Periodicals costs are incurred on either a

3   per-piece or a per-pound basis. Considerable arguments have been made before this

4   Commission regarding which costs are piece related and which are pound related.

5   However, as explained in the following, some costs are neither.

6   Periodicals flats are prepared by mailers in presorted bundles and usually placed either

7   in sacks or on pallets provided by the Postal Service. The Postal Service must perform

8   various handlings on these sacks/pallets, often including transfers through multiple

9   facilities, until they are emptied of their contents and can be recycled for further use.

10   The Postal Service then must handle the bundles that were emptied out of the sacks

11   and pallets, until the bundles have been opened – after which it must handle the

12   individual pieces that were inside the bundles through additional sorting and delivery

13   operations.

14   Costs incurred handling sacks and pallets are better thought of as per-sack and per-

15   pallet costs than as per-piece or per-pound costs. Similarly, costs incurred in sorting

16   bundles are best thought of as per-bundle costs. Recognizing the characteristics of

17   sacks, pallets and bundles that affect postal costs, as well as the characteristics of

18   individual pieces that affect costs, and pricing these items in accordance with costs will

19   remove anomalies in the current rate structure and provide mailers with much better

20   pricing signals.

21   This section discusses the Periodicals costs that are associated with sacks, pallets,

22   bundles and pieces, as well as costs that are mostly weight related.

23   1. Sacks

24   Sack related costs include the cost of sorting sacks, either on mechanized sack sorters

25   or manually, loading and unloading sacks from trucks, moving them across postal

26   platforms and workroom floors, opening sacks, shaking out their contents, putting aside

27   empty sacks and recycling them for further use by mailers. Generally, these costs

28   depend on the number of sacks being handled, each sack's presort level and where it is

1 entered into the system relative to its final destination. The number of pieces inside a

2 sack has little impact on the cost of handling it.

3 A cost based rate design should include per-sack charges that are consistent with the

4 actual costs of handling sacks, which generally vary from $1 to over $3 each. Such

5 charges would, in my opinion, quickly reduce the fairly widespread practice among

6 Periodicals mailers of sending sacks with only one or a few pieces in them through the

7 postal system. A cost based sack charge may not seem unreasonable if the sack

8 contains 40 pieces, but it would present a strong disincentive to mailing a sack with only

9 one piece.[2]

10 2. Pallets

11 Pallets incur costs as they are moved on or off trucks, across platforms and across the

12 workroom floor to the bundle sorting area where the pallet's contents are distributed. If

13 the bundle sorting operation is mechanized, the pallet is "dumped" by a mechanized

14 pallet dumper. Finally, empty pallets, like empty sacks, are recycled for additional use

15 by mailers.

16 Use of pallets generally causes fewer costs than if the flats are entered in sacks. And

17 pallets with finer presort (e.g., 5-digit pallets) cause fewer bundle handling costs than

18 less presorted pallets. But because mailers may have a limited quantity of mail to a

19 given 5-digit or 3-digit zone, pallets with finer presort may also end up having less

20 volume. To avoid having to handle too many small pallets, the Postal Service imposes

21 minimum weight requirements. For destination entered pallets, the current minimum is

22 250 pounds. But some facility managers have indicated that they would be happy to

---

[2] With appropriate pricing, there is no need to prohibit this practice. A mailer may have a good reason (e.g., service related) for mailing a single piece or a few pieces in a separate sack. If given correct price signals that require them to bear the costs of choosing such practices, however, chances are that mailers will avoid such practices in almost all cases. It is important to note that the practice of mailing sacks with only one or two pieces in them is not at all limited to small mailers. In fact, I have become aware that it occurs frequently among very large mailers, including Time Inc.

1   receive 5-digit pallets containing considerably fewer than 250 pounds, because such

2   pallets can be transferred directly to the DDU and require much less bundle sorting than

3   3-digit or ADC pallets.

4   In this case I present per-bundle costs that vary with the presort level of the pallet the

5   bundles come on, and witness Mitchell proposes that bundles be priced accordingly.

6   That by itself could lead to many more pallets than there are today, especially in the

7   absence of pallet minimums, as mailers would find it advantageous to split current 3-

8   digit pallets into smaller 5-digit pallets and current ADC pallets into smaller 3-digit or

9   SCF pallets.   But the proposal also includes pricing the pallets themselves in

10 accordance with actual costs, which again vary with the pallet's presort level and where

11 it is entered into the postal system. This way the mailers themselves will be able to

12 figure out how far to go in producing pallets with finer presort, by weighing the higher

13 price of using more smaller pallets against the lower bundle prices that result from finer

14 pallet presort levels.

15 3. Bundles

16 The Postal Service's current mail flow models, which are used to estimate cost savings

17 produced by presortation and pre-barcoding, do recognize certain costs associated with

18 bundle sorting. But they translate those costs into per-piece costs, dividing them by the

19 average number of pieces per bundle. As a result, even if these models are otherwise

20 accurate, the presort savings they calculate are accurate only for bundles with the

21 average number of pieces, and even then actual savings from putting pieces in a

22 presorted bundle depend on whether those pieces would have been sorted by an

23 AFSM-100 machine or manually had they not been in the bundle, on whether they are

24 pre-barcoded or not, etc.

25 To avoid receiving bundles with too few pieces, where the added costs of handling the

26 bundle might outweigh the piece sorting costs avoided by the bundling, the Postal

27 Service establishes minimum numbers of pieces that presorted bundles must contain.

1   The current bundle minimums are six pieces for Periodicals flats and ten for Standard

2   flats. Postal officials have been known to argue that both minimums should be raised.[3]

3   But whatever new bundle minimum is imposed, the one thing we can be sure of is that

4   it will not be optimal for all circumstances. The "optimal" bundle minimum may depend

5   on whether the pieces are machinable, whether they are pre-barcoded, presort level of

6   the bundle, whether it is entered on a pallet or in a sack, and other factors.[4]

7   I believe therefore that the Postal Service would be better off simplifying its ever more

8   complicated mail preparation regulations, abandoning current minimums and simply

9   letting mailers figure out how many bundles to make by pricing both bundles and pieces

10   in accordance with actual costs. To assist in the development of such a pricing

11   structure, I have estimated the per-bundle costs for each combination of bundle and

12   container presort level, as well as the piece handling costs for different presort levels

13   and piece characteristics.

14   In reviewing the bundle related costs indicated by the model, I noticed that many of

15   those costs in fact do not depend on the number of bundles but rather on the bulk of

16   the bundles. Since bulk is more closely correlated with weight, I believe such costs are

17   more appropriately called weight related. These "weight related" bundle costs occur

18   when a hamper or other USPS container, after being filled with bundles in a bundle

19   sorting operation, is moved either to another bundle sort or to a piece sorting operation,

20   in either the same facility or a different facility. As in LR-I-332, my model assumes that

21   such USPS containers hold an average of 52.45 bundles each, and uses this to

22   translate the costs of moving the containers into "per-bundle" costs. However, these

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[3] In a December 11, 2003 Federal Register notice, 68 Fed. Reg. 69066, the Postal Service proposes raising to 15 the minimum number of pieces for certain categories of 5-digit Standard flats bundles.

[4] By "optimal bundle minimum" I mean the minimum number of pieces at which making up an extra bundle would save postal costs. Assume, for example, that a 5-digit bundle containing 30 pieces is placed on a 3-digit pallet. Some of the 30 pieces are to the same carrier route. How many pieces must there be to the same carrier route before it is worthwhile making a separate carrier route bundle? The answer to this question depends on a number of factors, including sorting technology and whether the pieces have a barcode.

1   postal containers are generally moved when they are full. They will fill up faster if the

2   flats are thick or there are many flats per bundle. These costs are therefore primarily

3   determined by cube, which tends to vary in closer proportion with weight than with the

4   number of pieces or bundles, and so it is more appropriate to classify them as per-

5   pound costs.

6   In the AFSM-100 environment, non-carrier route flats bundles are taken to a "prepping"

7   operation where the bundles are broken and pieces placed on "ergo carts" in a manner

8   designed to facilitate subsequent loading into the AFSM-100. This operation is

9   currently referred to as MODS operation 035. It tends to be performed also for flats that

10   will not be sorted on the AFSM-100. In the pre-AFSM-100 environment, the process of

11   cutting flats bundles and preparing the pieces for sorting was often integrated into the

12   piece sorting operations and indistinguishable from piece sorting.

13   I unfortunately do not have access to any productivity estimates for the MODS 035

14   operation. Nor was this operation or any equivalent operation included in the LR-I-332

15   model from which I have developed my current model of flats mail flows. Nor is there

16   any reference to it in the flats mail flow model described in LR-J-61, which was used in

17   R2001-1 to set flats presort and automation discounts. The bundle unit costs shown in

18   Exhibit B therefore do not include the 035 costs. Had I been able to include those

19   costs, the costs of the non-carrier route flats categories in Exhibit B would have been

20   higher relative to the carrier route categories.

21   4. Flats Pieces

22   Current Periodicals rate design takes into account whether non-carrier route flats are

23   pre-barcoded. It also recognizes four presort levels (carrier route, 5-digit, 3-digit and

24   basic). Not recognized is machinability of the mail pieces, even though machinability

25   has become much more important with the advent of the AFSM-100. In this testimony,

26   "machinable" refers to machinability on an AFSM-100. Magazines thicker than 3/4 inch

27   would, for example, be considered non-machinable.

28   The presort rate levels currently recognized are a confusing mix, referring sometimes to

1   the presort level of a bundle and sometimes to the presort level of the container the

2   bundle is presented in. For palletized flats, the presort rate level is defined by the

3   bundle presort; the presort level of the pallet is ignored, even though it has a major

4   impact on postal costs. For sacked mail, the presort rate level is defined by the bundle

5   presort for barcoded flats and by the sack presort for non-barcoded flats.[5]

6   It leads to much more cost based rates, and is conceptually simpler, to recognize all

7   meaningful combinations of bundle and container presort level, container type,

8   machinability and pre-barcoding. Tables A3 and B3 illustrate all the categories of piece

9   characteristics for which I am presenting estimates of volumes and unit costs.[6]

10   The piece handling costs I estimate refer only to mail processing. Additional per-piece

11   costs are incurred in the delivery function. I also have not attempted to model costs of

12   forwarding or other handlings that do not occur in the normal flow of most flats through

13   the postal system. Note that costs related to bundle sorting are not included in my

14   piece related costs.

15   LR-I-332 also estimates the costs of bundle breakage and presents them as per-bundle

16   costs. I have defined them instead as per-piece costs. Most of the extra costs incurred

17   when a bundle breaks prematurely are due to the additional piece sorting required for

18   the previously bundled pieces. Since these costs are proportional to the number of

---

[5] The inconsistent definitions of presort rate categories have led to some striking rate anomalies. Here is, perhaps, one of the worst. Consider a 5-digit flats bundle in an ADC sack. If the flats are pre-barcoded, their presort level is determined by the bundle presort, i.e., it is 5-digit and they pay the 5-digit automation rate (22.6 cents/piece). If the flats are not barcoded, their presort level is determined by the sack presort, i.e., it is basic, and they pay the non-automation basic rate of 37.3 cents/piece. Their reward for barcoding is therefore 14.7 cents/piece, even though the Commission approved a barcode discount for basic flats of only 4.8 cents/piece. Moreover, the actual cost differential between barcoded and non-barcoded pieces in this example is 0.3 cents if the pieces are non-machinable, and about 1.3 cents if they are machinable. See Table B3a.

[6] These categories were present also in the Postal Service's R2000-1 and R2001-1 mail flow models. But in both cases the USPS witnesses combined the more detailed set of categories into the much more limited number representing current presort/automation rate levels.

1   pieces that were in the broken bundles, rather than the number of broken bundles, I

2   consider them to be per-piece costs.

3   Some of the per-piece costs calculated by my model, and in LR-I-332, are incurred

4   while moving pieces between piece sorting operations and to the DDU.   These

5   movements typically involve rolling containers that are filled up with flats trays and

6   moved when they are full. Since thick flats fill up trays and rolling containers faster than

7   thin flats, these costs are more appropriately viewed as weight related.   Exhibit B

8   identifies these weight related "per-piece" costs separately. Witness Mitchell does not

9   use them in his design of piece rates, since they are more appropriately covered by

10   pound rates.

11   <u>5. Weight Related Costs</u>

12   Which Periodicals costs are piece related and which are pound related has been

13   debated for a long time and never fully resolved. Since R87-1 the Commission has

14   required 60% of regular rate Periodicals revenue to come from the piece rates, based

15   on an assumption that approximately 60% of the costs are piece related.[7]

16   Having concluded that some costs are related neither to pieces nor pounds but rather

17   to the sacks, pallets and bundles into which a flats mailing is prepared, and that a

18   portion of the postal revenues should be derived from charges on these items, it is

19   necessary to determine how the remaining costs can most properly be divided between

20   pieces and pounds.

21   First, it should be noted that, for Periodicals, bulk (measured in cubic feet) is probably

22   much more of a cost driver than weight. It is the bulk that consumes space on trucks

23   and in trays, hampers and other containers used to transport these flats. The faster

24   that trays, hampers and other containers are filled up, the sooner they must be

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[7] Since the merger of the three Outside County subclasses in Docket No. R2000-1, the assumption that 60% of costs are piece related is applied to the combined subclass, whereas before it was applied to regular rate Periodicals.

1   removed and replaced. However, since density (weight/cube) is fairly uniform, at least

2   among magazines, it is reasonable to continue to treat pounds, rather than cubic feet,

3   as a major cost driver.

4   Transportation costs are generally considered pound related. Delivery costs clearly are

5   affected both by weight and by the number of pieces delivered. Regarding mail

6   processing costs, I pointed out in the two preceding sections that more than half of the

7   costs that the mail flow model identifies as per-bundle costs would more appropriately

8   be considered weight related, and that a portion of the per-piece costs identified by the

9   model are also, strictly speaking, more weight than piece related.

10   Section V.6 presents an analysis that indicates approximately 30% of the Outside

11   County revenues should come from pound rates when the rates include cost based per-

12   sack, per-pallet and per-bundle charges.

13   **IV   VOLUME ESTIMATES**

14   This section explains the development of estimates of TY03 after rates volumes of

15   Outside County sacks, pallets, bundles and pieces, as summarized in Exhibit A. The

16   main data source used to develop the piece volumes in Table A3, the bundle volumes

17   in Table A2 and the number of containers by container type and presort level, is the

18   mail characteristics study reported in USPS LR-I-87, which USPS witnesses also used

19   both in R2000-1 and R2001-1. To estimate numbers of sacks and pallets by entry point

20   as well as presort level, I relied on the entry point study described in LR-J-114 and used

21   by USPS witnesses in Docket No. R2001-1.

22   I normalized the LR-I-87 survey results to be consistent with the TY03 after rates billing

23   determinants used by the Commission in its R2001-1 rate design. After letter shaped

24   pieces are separated out, the process used is essentially the same as that applied by

25   witness Miller (USPS-T-24, LR-J-61) in Docket No. R2001-1. It can be described

26   (though Miller did not explicitly express it this way) as using a set of multipliers that

27   relate billing determinant volumes of existing presort/automation rate categories to the

28   corresponding volumes computed from unadjusted survey results. I was able to extend

1   the use of these multipliers to bundle and container counts from the mail characteristics

2   survey.

3   The process outlined above was performed separately for regular rate and nonprofit

4   Periodicals. The results were then extrapolated to also include Classroom publications.

5   Finally, to produce the container volumes in Table A1, my estimates of sacks and

6   pallets by presort level, obtained in this manner, were used to normalize the container

7   counts by entry point obtained from LR-J-114.

8   Spreadsheet 'VolumesTY03AR.xls' performs the volume estimates summarized above.

9   The following describes my methodology in more detail.

10   1. Billing Determinants For Non-Letters

11   Because witness Mitchell handles the small volume of Periodicals that are letter shaped

12   separately, the volumes in Exhibit A refer to non-letters only. According to the

13   Commission's R2001-1 Opinion, the total TY03 after rates volume for Outside County

14   Periodicals is about 9.1 billion,. According to the shape related proportions indicated in

15   LR-J-81, 4.38%, or approximately 399 million pieces, are letters. That leaves 8.7 billion

16   flats and parcels. The number of parcel shaped Periodicals pieces is very small, and

17   since no separate model exists for them, I treat my flats mail flow model as applicable

18   to all non letter shaped pieces.[8]

19   The number of letter shaped pieces receiving automation discounts for each subclass

20   and presort rate level is known from the billing determinants. Mitchell uses this

21   information to estimate a complete set of billing determinants for letter shaped pieces.

22   Subtracting the letter volumes from the corresponding totals gives non-letter billing

23   determinants, to which I normalized the survey results from LR-I-87.

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[8] LR-J-81 is the PRC costing version (according to the Postal Service's interpretation of PRC costing) of LR-J-53 in Docket No. R2001-1. Both library references develop test year per-shape mail processing unit costs in each MODS/PIRS based cost pool. I used the LR-J-81 costs for Outside County Periodicals to perform a "CRA adjustment" to my unit cost estimates, as described below in Section V.5.

1   2. Non-Letter Piece Volumes

2   My starting point for estimating non-letter piece volumes is Tables 6 (regular rate) and 7

3   (nonprofit) in LR-I-87. I extracted from the original survey tables a set of "scenario"

4   volumes, where each "scenario" represents a combination of container type, container

5   presort, bundle presort and piece characteristics (machinability and pre-barcoding).

6   From combinations of these "scenario" volumes I created sums that correspond to the

7   seven main current piece rate categories for which billing determinants are available.[9]

8   Dividing actual billing determinant volumes by these summed scenario volumes gives a

9   set of multiplying factors, shown for regular rate and nonprofit in the table below.

10   As the table shows, the mail characteristics survey appears to have underestimated

11   considerably the volume of non-automation basic in both regular rate and nonprofit,

12   requiring large corrective factors for this rate category, while it appears to have

13   overestimated the volume of carrier route presorted flats in both subclasses.

Table 1: Multiplying Factors That Adjust Survey Results To Billing Determinants		
Rate Category	Regular Rate	Nonprofit
Non-automation Basic	2.268833	2.169982
Non-automation 3-Digit	1.567001	0.447340
Non-automation 5-Digit	1.684180	0.686931
Carrier Route	0.908587	0.749931
Automation Basic	0.930705	1.688308
Automation 3-Digit	1.014220	1.055454
Automation 5-Digit	0.847260	1.056143

14   No survey data exist for classroom publications, but there are billing determinants. My

15   volume estimates are extended to this subclass by applying a third set of multiplying

16   factors to the combined regular rate and nonprofit survey volumes.

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[9] See spreadsheet pages 'Vols-Per Reg' and 'Vols-Per Non'. Use of the term "scenario" to describe this division of the Periodicals flats volume was introduced in the testimony of witness Yacobucci (USPS-T-25) in R2000-1.

1   3. Bundle Volumes

2   The LR-I-87 mail characteristics survey provided counts of bundles per bundle presort

3   level, container type and container presort level. It also classified bundles as auto or

4   non-auto. This allows each cell of bundle counts to be associated with one and only

5   one of the rate categories in Table 1. I could therefore use the same set of multiplying

6   factors used for piece counts to adjust bundle counts to the billing determinants.[10]

7   Bundle counts are contained in LR-I-87's tables 9 (regular rate) and 12 (nonprofit).

8   From these I extracted another tabulation, with organization similar to LR-I-87's tables 6

9   (regular) and 7 (nonprofit) for the piece counts, in order to apply the multiplying factors

10   to bundle counts.

11   4. Container Volumes By Entry Point

12   Tables 14 (regular rate) and 15 (nonprofit) in LR-I-87 list, for various categories of sacks

13   and pallets, the estimated number of containers of each type and corresponding

14   numbers of pieces. Assuming no change in the number of pieces per container and

15   using the TY03 after rates number of pieces in each category, I could then estimate the

16   TY03 number of containers of each type and presort level, for each subclass. The total

17   number of containers used to enter Periodicals flats was estimated to be 111.756

18   million, including 3.127 million pallets and 108.629 million sacks, as shown in Table 2.[11]

19   The next step was to break down the volumes of sacks and pallets at each presort level

20   by the eight entry point categories used in LR-J-114:

21   (1) DDU (destinating delivery unit);

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[10] More recently the Postal Service has begun to accept bundles that mix barcoded and non-barcoded flats together, but at the time the survey was performed bundles were required to be classified as either auto or non-auto.

[11] Both the mail characteristics survey (LR-I-87) and entry point survey (LR-J-114) showed more pallets and fewer sacks than Table 2 indicates. The reason appears to be that both surveys tended to under-sample the very small mailings that use mostly sacks, and to over-sample large mailings that are mostly palletized.

1   (2) DSCF (destinating sectional center facility);

2   (3) DADC (destinating area distribution center);

3   (4) DBMC (destinating BMC);

4   (5) OBMC (originating BMC – when different from the DBMC);

5   (6) OADC (originating ADC – when different from the DADC);

6   (7) OSCF (originating SCF - when different from the DSCF); and

7   (8) OAO (originating associate office or station – when different from the DDU).

Table 2: Estimated TY03 After Rates Outside County Container Counts					
Container	Presort	Regular Rate	Nonprofit	Classroom	Total
Pallets	5-D	343,262	52,098	1,719	397,079
	3-D/SCF	1,785,584	238,612	10,288	2,034,485
	ADC	605,092	85,925	4,696	695,714
Total Pallets		2,733,938	376,635	16,703	3,127,277
Sacks	CR	4,654,313	1,398,182	26,886	6,079,382
	CRS	10,461,858	962,654	48,222	11,472,734
	5-D	37,053,094	5,427,540	249,642	42,730,277
	3-D/SCF	27,097,352	3,296,416	297,762	30,691,530
	ADC	11,308,787	1,362,476	187,730	12,858,993
	MADC	4,185,519	530,665	80,036	4,796,220
Total Sacks		94,760,925	12,977,933	890,277	108,629,135
Total All Containers		97,494,863	13,354,569	906,981	111,756,412

8   The LR-J-114 entry point study also provides information on the locations of the

9   originating facilities relative to the destinating facilities. For example, if a pallet or sack

10   was entered at the OAO, the survey recorded whether the location of the OAO was: (1)

11   within the service area of the destinating SCF (DSCF); (2) within the service area of the

12   DADC, but outside that of the DSCF; (3) within the service area of the DBMC, but

13   outside that of the DADC; or (4) outside the DBMC service area. Similarly, when entry

14   occurred at the OSCF, one of the last three of these possibilities was recorded, and

15   when it occurred at the OADC, one of the last two was recorded. Exhibit C shows the

16   composition of the origin entries for each type of sack and pallet. I made use of this

17   information to modify some LR-I-332 mail flow assumptions, as described in Section V.

18   A few comments may be useful at this point on current dropship patterns revealed by

19   the entry point study.

20   It is probably not surprising that pallets are generally dropshipped to a far larger extent

1   than sacks. As can be deduced from the figures in Table A1, about 47.5% of all pallets

2   are entered at a destinating facility (DBMC, DADC, DSCF or DDU), versus only 24.1%

3   of sacks. On the other hand, when pallets are entered at origin, the originating facility is

4   usually (85%) outside the DBMC service area, i.e., the origin is far away from the

5   destinating facility. When sacks are entered at origin, however, about 26% are actually

6   entered within the DBMC service area and many are entered even closer, e.g., at a

7   nearby SCF or AO. These sacks, with relatively short transportation by the mailer,

8   could avoid substantial postal costs. For example, of the about six million carrier route

9   (CR) sacks that are entered at the originating facility, more than 60% originate within

10 the service area of the DADC. A significant proportion of the 5-digit sacks entered at

11 origin are also in fact entered close to their destinating facility. One hopes that stronger

12 dropship incentives would cause more of these sacks (if not to convert to pallets) at

13 least to be taken to some destinating facility, thereby reducing the traffic on postal

14 platforms.

15 **V   THE COST MODEL**

16 The mail flow model used to calculate the unit cost estimates in Exhibit B is similar to

17 the LR-I-332 model developed by the Postal Service and Christensen Associates during

18 Docket No. R2000-1. LR-I-332's purpose was to estimate the reduction in Periodicals

19 mail processing costs that could be expected from various changes in mail preparation

20 requirements. It was designed to follow the flow of Periodicals flats entered with all

21 relevant combinations of bundle and container presort, either in sacks or on pallets,

22 from the time the mail is entered at a postal facility until it has been handed to the

23 carriers who will deliver it. It identifies all processing costs incurred by these flats as

24 either per-pallet, per-sack, per-bundle or per-piece, and produces a comprehensive set

25 of unit cost estimates.

26 The development of LR-I-332 began during R2000-1 as a cooperative industry/USPS

27 effort to try to limit the Periodicals rate increase. Because of the rapid growth in

28 Periodicals processing costs since the previous rate case, on top of years of large,

29 unexplained increases before that, another large increase seemed inevitable. Industry

30 representatives agreed to certain changes in mail preparation that were expected to

1   reduce processing costs. There was a need for a new model to estimate what those

2   savings would be, in order to make it possible to project test year Periodicals costs.

3   I participated in the earlier stages of LR-I-332's development as an industry expert. I

4   discussed the project with the developers in face-to-face meetings and several phone

5   conferences and I provided several suggestions that were incorporated in the model. In

6   reviewing the final product while preparing this testimony, I concluded that the modeling

7   approach used in LR-I-332 is well suited for developing the types of cost based rates

8   that are being proposed in this case, but that a number of substantial changes to the

9   model were needed, including the following:

10   • wage rates and piggyback costs from TY01 of R2000-1 were changed to
11   TY03 of R2001-1;

12   • the model was changed to use PRC costing methodology;

13   • the R2000-1 modeling assumptions for flats piece sorting were changed to
14   the R2001-1 assumptions, which include a more dominant role for the AFSM-
15   100 machines;

16   • mail flow assumptions for containers entered at origin facilities were modified
17   in accordance with the LR-J-114 entry point data;

18   • some costs categorized in the original model as per-bundle were re-
19   categorized as per-piece, and other costs originally categorized as per-bundle
20   or per-piece were re-categorized as primarily weight related.

21   • a CRA adjustment was applied to the modeled costs to make them
22   correspond to TY03 after rates mail processing costs for non-letter
23   Periodicals.

24   All of these changes have been made in the model prepared for this testimony and are

25   described below in further detail, following an overview of the model's organization.

26   <u>1. Model Overview</u>

27   The model consists of a series of interlinked Excel spreadsheets, included in Library

28   Reference TW et al. 1.[12]

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[12] The original model included some spreadsheets used only to carry out four parametric

1   Most of the model mail flow analysis is contained in 16 spreadsheets, each of which

2   corresponds to a particular container type (sack or pallet) and a particular type of entry

3   point. The naming convention is 'pallet_bb_' or 'sack_bb_' followed by a three or four

4   letter abbreviation for the type of entry point, followed by '.xls'. For example,

5   'pallet_bb_dadc.xls' is the model for pallets entered at the destinating ADC. There are

6   eight such spreadsheets for sacks and eight for pallets.[13]

7   In LR-I-332, each of the 16 spreadsheets contained large amounts of data common to

8   all of them, including piggyback factors, wage rates, productivity rates, conversion

9   factors, etc. A consequence of hard-coding so many numbers in so many different

10   places is that it becomes very cumbersome to make model changes. To facilitate

11   changes I use a new spreadsheet, called 'cost_variables.xls', that contains various

12   types of data and calculations common to the 16 model spreadsheets. This makes it

13   possible to make changes in one place, rather than 16.

14   The original model also contained essentially duplicative calculations of per-piece and

15   per-bundle costs in all 16 spreadsheets. It turns out that all the necessary piece related

16   and bundle related unit costs can be computed using just one sack and one pallet

17   model spreadsheet. I therefore made all the changes I needed to make for piece and

18   bundle related costs in spreadsheets 'pallet_bb_oao.xls' and 'sack_bb_oao.xls.' The

19   piece and bundle related flows in the 14 other spreadsheets were removed. However,

20   all 16 spreadsheets are needed to analyze the costs of containers at different entry

21   points.

22   Other linked spreadsheets included in the library reference are:

Costs_Volumes.xls   Extracts and tabulates the volume data contained in
                           Exhibit A and the unit costs in Exhibit B. Also determines
                           total costs implied by the calculated unit costs

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"scenario" analyses relevant to the R2000-1 estimates of the Periodicals revenue requirement but of no relevance to my present analysis.

[13] LR-I-332 uses a similar naming convention except that each spreadsheet name is preceded by 'method_', e.g., 'method_ pallet_bb_dadc.xls'.

VolumesTY03ar.xls	Calculates the billing determinants contained in Exhibit A and the entry point statistics in Exhibit C
Cost_Variables.xls	Miscellaneous input data and calculations
FlatsR01Modified.xls	Estimates piece sorting costs under R2001-1 assumptions
Bundleprod.xls	Sorting productivity in manual bundle sorting operations
CRAAdjust.xls	Performs CRA adjustment
LbPercentage.xls	Identifies Weight Related Costs

1   2. Estimates Of Piece Sorting Costs

2   The estimated per-piece costs include two main components:

3   (1) the "pure" piece sorting costs incurred at various manual, mechanized and
4   automated piece sorting operations; and

5   (2) certain other costs incurred in transporting pieces that have already passed
6   through at least one piece sort to subsequent piece sorts (if necessary) and to
7   the DDU, until the pieces have been given to the carriers, who will then
8   sequence and deliver them.

9   The first category of per-piece costs is in turn composed of two parts: (a) the piece

10   sorting costs incurred in the absence of premature bundle breakage; and (b) the

11   additional costs incurred when certain bundles break prematurely, which typically leads

12   to additional piece sorting costs. For example, when a 5-digit bundle breaks in a 3-digit

13   (incoming primary) bundle sort, the individual pieces from that bundle must be sent to

14   an incoming primary sort, instead of being able to pass directly to the incoming

15   secondary (5-digit) sort. The piece sorting costs related to bundle breakage were

16   defined as "per-bundle" costs in LR-I-332. However, I define them as per-piece costs

17   since they are determined not by the number of bundles that are broken but by the

18   number of pieces in the bundles that are broken.

19   In Exhibit B, my estimates of "pure" piece sorting costs are shown in Table B3a.

20   Witness Mitchell uses these costs in his design of Outside County piece rates.

21   The second cost category can be viewed as more weight related than piece related,

22   since the costs are determined more by physical bulk than by the number of pieces.

23   They are tabulated in Table B3b. While I computed these costs on a per-piece basis,

1   witness Mitchell did not use them in his design of piece rates. Table B3c contains the

2   sum of the two piece related cost categories.

3   The LR-I-332 developers tried to be consistent with the piece and bundle related cost

4   data contained in the Periodicals mail flow model in LR-I-90, presented in R2000-1 by

5   witness Yacobucci (USPS-T-25). They used his model, assuming no bundle breakage,

6   to run 48 different "scenarios," pasting relevant cost and flow data for piece sorting

7   operations under each scenario into a new table and making the resulting modified

8   model, which is referred to by the 16 model spreadsheets, a part of LR-I-332. The

9   spreadsheet was called 'flats_costs_model_modify.xls.'   I have replaced it with

10   'FlatsR01Modified.xls', which reflects R2001-1 assumptions regarding flow and cost of

11   piece sorting, including the more prominent role of the AFSM-100.

12   I developed 'FlatsR01Modified.xls' by starting with the Periodicals flats model in USPS

13   LR-J-61, introduced in R2001-1 by witness Miller (USPS-T-24). I set the assumed

14   bundle breakage rate to zero. Unlike the R2000-1 model, the R2001-1 model is not

15   structured around the 48 "scenarios."   However, the cost of "pure" piece sorting

16   (assuming no bundle breakage) depends only on bundle presort level and the

17   characteristics of the individual pieces, not on the container the bundle came in. As a

18   consequence, it is really necessary to develop the cost and flow information only for 16

19   separate scenarios. I used Miller's flow model to create separate models for flats

20   arriving in, respectively, MADC, ADC, 3-digitd/SCF and 5-digit bundles. Each model is

21   on a spreadsheet page that calculates the cost and flow information for the four

22   combinations of machinability/non-machinability and barcoding/no barcoding.   The

23   results are linked to a spreadsheet page named 'piece facility downflows,' laid out

24   exactly as in LR-I-332.

25   The modeling of bundle breakage costs in the R2000-1 flats model was severely

26   flawed, as I pointed out in my direct testimony in that docket.[14]   The LR-I-332

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[14] The Commission agreed and used an alternative flats model that I had developed, with a different treatment of bundle breakage costs, as the basis for setting flats presort and automation discounts. PRC Op. R2000-1, ¶¶ 5648-5652.

1 developers appear to have recognized this and to have created a sharply different

2 model, including the use of the package integrity data obtained from an MTAC data

3 collection summarized in LR-I-297.   The R2001-1 flats model, however, while

4 incorporating some LR-I-297 data, is also severely flawed in its assumptions.[15]   I

5 therefore used the original LR-I-332 method to calculate bundle breakage costs.

6 3. Estimates Of Per-Bundle Costs

7 Bundle sorting is either mechanized or manual.   Mechanized bundle sorting is

8 performed mostly at the SPBS (small parcel and bundle sorter) machines that come in

9 a variety of configurations. Some facilities also use the older LIPS machines for that

10 purpose.   MODS productivity rates are measured at the SPBS/LIPS.   For manual

11 bundle sorting, the only available productivity data are from special surveys, such as

12 the one described in LR-I-88 and used by USPS witnesses in the last two rate cases.[16]

13 But having measured overall productivity rates at these operations is not sufficient for

14 our purposes, because those productivity rates represent other work besides the actual

15 bundle sorting, such as opening sacks and shaking out their contents onto a moving

16 belt, disposing of the sacks, dumping pallets, etc. Since shaking out sacks generally

17 takes much more time per bundle than dumping a pallet, the productivity rates at an

18 SPBS operation can be expected to vary considerably with the mixture of sacked and

19 palletized mail that it processes.   Since our objective is to separate sack, pallet and

20 bundle costs, it becomes necessary to identify "pure" mechanized and manual bundle

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[15] For example, the R2001-1 flats model (LR-J-61) fails to recognize the difference between mechanized and manual sorting of palletized bundles. In manual sorting from a pallet, the bundles are not dumped onto a belt but lifted from the pallet and thrown directly into the containers for which they are intended. Since these bundles face no risk of being broken until they land in the intended container, which represents a higher presort level than the pallet from which sortation is being made, any bundle breakage at that point will result in less and often no additional piece sorting. In the case of carrier route bundles being sorted manually from a 5-digit pallet, the bundles will get to the carriers, who have to break the bundles anyway, so that there are no bundle breakage costs. Docket No. R2001-1, Tr. 2179.

[16] Docket No. R2000-1, USPS-T-25, at 7 and Docket No. R2001-1, USPS-T-24, at 1.

1   sorting productivities, by excluding the component that consists of sack and pallet

2   handling. Additionally, employees at bundle sorting operations spend time replacing

3   containers that have been filled with sorted bundles with new, empty containers and

4   taking the full containers to the next operation. These costs, while clearly bundle

5   related, depend more on the bulk of the bundles than the number of bundles.

6   The task is therefore to isolate the "pure" bundle sorting productivity, i.e., the part of

7   bundle sorting that varies only with the number of bundles, not with the number of

8   sacks or pallets or with the bulk of the mail. For mechanized bundle sorting, the task

9   was addressed in the original LR-I-332 development, and I am using that result in the

10 present model. The task does not appear to have been addressed for manual bundle

11 sorting, and I have developed an analysis for that purpose, as described below.

12 a.   Mechanized Bundle Sorting.

13 The Postal Service's R2000-1 flats model indicated an overall productivity of 223

14 bundles per workhour, based on LR-I-88. That was reduced to 201 under Yacobucci's

15 bundle breakage assumption and raised to 313 under the Postal Service's SPBS

16 volume variability assumption.   The R2001-1 flats model uses a MODS based

17 productivity of 243.41 bundles per hour (or 367, assuming 66% volume variability). [17]

18 Analysis by the LR-I-332 team, based on LR-I-88, indicated that 43.41% of mechanized

19 bundle sorting hours are spent actually sorting bundles. I am using that estimate

20 together with the 243.41 overall productivity estimate from R2001-1, giving a "pure"

21 mechanized bundle sorting productivity of 560.75 bundles per workhour.

22 b.   Manual Bundle Sorting

23 The R2000-1 flats model indicates that, according to LR-I-88, the manual productivity,

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[17] Curiously, examination of the LR-I-88 spreadsheet 'mechprod.xls' shows that use of all observations from that survey would give an overall productivity of 246, very close to the R2001-1 result. The lower (223 bundles per hour) estimate was obtained by excluding all observations with productivity over 380 bundles per hour.

1   before applying volume variability, was 178 bundles per hour for MADC, ADC and 3-

2   D/SCF containers, 409 for 5-D containers and only 99 for "CR Containers." LR-I-332

3   used those estimates after applying USPS volume variability factors.

4   As confirmed in the answer to a Time Warner interrogatory, the estimate for "CR-

5   Containers" actually refers to handling of carrier route sacks, not to bundle sorting.

6   Docket No. R2000-1, Tr. 1461-62. It is inappropriate to use it to represent bundle costs

7   in a model that treats sack handling costs separately. While a CR sack is likely to

8   undergo sack sorting, which contributes to the per-sack costs, the bundles in it do not

9   need any sorting, because they are already at the carrier when the sack is opened. In

10   fact, 5-D, 3-D/SCF, ADC and MADC are the only types of bundle sort that need to be

11   addressed.

12   As confirmed in the answer to another R2000-1 Time Warner interrogatory (Tr. 1468-

13   69), LR-I-88 really shows that bundle sorting productivity varies a great deal between

14   MADC, ADC and 3-D/SCF containers. This correction was adopted in the R2001-1

15   USPS flats model.

16   In order to isolate the "pure" bundle sorting productivity at each container presort level, I

17   followed the principle that activities that are separately identified in the model should

18   not also be included in the bundle sorting productivity, since that would amount to

19   counting the same activity twice.

20   Let me illustrate this with the case of MADC bundle sorting, applied to the bundles that

21   come in MADC sacks. According to Table A2, there are 29,243,276 such Outside

22   County bundles per year. With an overall productivity of only 76 bundles per workhour,

23   this sortation would take a total of 383,494 hours. But the operation includes, for

24   example, shaking out 4,796,220 sacks and disposing of those sacks afterwards. Those

25   operations, applying the productivity rates assumed for them, would take respectively

26   48,252 and 29,075 workhours. After subtracting these hours as well as hours for

27   moving containers of sorted bundles to other operations, replacing those with empty

28   containers and removing the empty containers that the sacks came in, all of which are

29   separately identified in the model, the hours remaining for actual bundle sorting are

1   241,368, which indicates a "pure" bundle sorting productivity of 121.

2   Similarly derived estimates for ADC, 3-D/SCF and 5-D manual bundle sort are 369, 455

3   and 505 bundles per hour.   The estimates are developed in spreadsheet

4   'bundleprod.xls'.

5   c.   Impact of Bundle Breakage

6   Although, as stated earlier, I treat the costs associated with bundle breakage as per-

7   piece costs, breakage does have an impact on the estimated per-bundle costs. When

8   a bundle breaks prematurely, it spends less time in the system as a bundle, leading to

9   lower per-bundle costs, as well as higher per-piece costs. Because bundles that come

10   in sacks have a much higher probability of breaking, the result is that for corresponding

11   combinations of container and bundle presort, the per-bundle costs are slightly lower for

12   sacked bundles. For example, a 5-digit bundle in an ADC sack is estimated to cost

13   51.56 cents, whereas the same bundle on an ADC pallet costs 54.84 cents under this

14   methodology.[18]   This should not be interpreted as meaning that putting bundles in

15   sacks is less costly; the reverse is true when piece handling and container handling

16   costs are also taken into account.

17   Because witness Mitchell's "bundle tree" rate design assumes that piece sorting costs

18   depend only on the bundle presort level and not on the container the bundle came in,

19   and that bundle costs depend only on the container presort, not the type of container,

20   he does not capture the distinctions described above. Ideally, the fact that sacks cause

21   more breakage than pallets should be reflected in higher per-sack costs; however my

22   present model puts those added costs as per-piece costs.

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[18] See Table B2c. The comparison refers to total bundle costs, including weight related costs.
When container and bundle presort levels coincide, pieces in a bundle that breaks do not lose
any sortation and bundle costs are the same whether the bundle came from a sack or pallet.
For this reason, 3-digit bundles in 3-digit containers and ADC bundles in ADC containers cost
the same whether the container is a sack or a pallet. See Docket No. R2001-1, Tr. 2168.

1   d.   Weight Related Bundle Costs

2   A substantial portion of the costs identified by the model as "per-bundle" are related to

3   activities such as placing empty containers (e.g., hampers, APC's) at a bundle sorting

4   operation to receive sorted bundles, removing those containers when they are full and

5   taking them to a subsequent operation or to the platform and onto a truck to another

6   facility. These costs are converted to per-bundle costs by assuming that the containers

7   used (called OWC's in the model spreadsheets) contain an average of 52.45 bundles.

8   In reality, of course, the number of bundles in a full container depends on the number of

9   pieces per bundle and on the size of those pieces. I refer to those costs as weight

10   related bundle costs and identify them separately.   Witness Mitchell excludes the

11   weight related bundle costs in his rate design. In Exhibit B, Table B2a contains the per-

12   bundle costs that Mitchell uses to develop per-bundle rates. Table B2b contains the

13   weight related bundle costs and Table B2c the sum of the two sets of costs.

14   4. Estimates Of Per-Sack And Per-Pallet Costs

15   The cost of handling sacks and pallets depends on entry point and the container presort

16   level. The model determines sack/pallet unit costs by: (1) identifying the types of postal

17   facilities that handle Periodicals sacks and pallets; (2) identifying the various processing

18   operations performed on sacks and pallets in each type of facility and determining the

19   unit cost of each operation; and (3) determining the probability that a sack or pallet with

20   given presort level and entry point will pass through each type of facility and each type

21   of operation.

22   a.   Facility Types

23   Periodicals sacks and pallets may be handled in one or more of the eight types of entry

24   facility listed in Section IV.4. LR-I-332 represents the same categories of facilities, but

25   calls them transfer hubs (THs) rather than BMCs. Some USPS testimonies in previous

26   proceedings before this Commission have also referred to Periodicals transfer hubs.[19]

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[19] See testimonies of witness Acheson, Dockets No. R87-1 (USPS-T-12) and MC91-3 (USPS-

1   The reason for this inconsistent terminology appears to be that to avoid mixing

2   Periodicals and Standard mail, both of which arrive at BMCs, the Postal Service often

3   directs Periodicals to separate BMC annexes – facilities that mainly crossdock sacks

4   and pallets but do little or no further processing. I believe there are also cases where

5   Periodicals bypass the BMC altogether and are instead taken to a nearby general mail

6   facility (GMF). The term "transfer hub" appears to have been intended to show that

7   Periodicals arriving at a BMC are not always processed in the BMC main facility.

8   However, postal officials have stressed that a separate network of Periodicals transfer

9   hubs does not exist.

10   I have assumed that Periodicals handling at BMCs consists only of cross docking

11   pallets and sorting and dispatching of sacks. No Periodicals sacks or pallets are

12   assumed opened at BMCs. Except for mixed ADC (MADC) sacks, whose contents are

13   typically distributed at the OADC, I assume, as does LR-I-332, that all sorting of

14   Periodicals bundles and flats pieces occurs at the DADC, the DSCF or the DDU.

15   In this case witness Mitchell proposes separate rates for sacks and pallets entered at

16   the DBMC that are lower than the rates proposed for sacks and pallets entered at origin

17   facilities. The proposed rates are based on the unit cost estimates in Table B1. The

18   separate DBMC rates would apply to entry at facilities that the Postal Service

19   designates for DBMC entry of Periodicals. As discussed above, this might not always

20   be the main BMC facility.

21   b.   Container Operations Costs

22   In LR-I-332, each of the 8 sack and 8 pallet spreadsheets computes a set of container

23   operations costs. Since an operation costs the same regardless of how frequently it is

24   performed on a container with given entry point and presort level, the operations cost

25   calculations are exactly the same in all 8 sack related spreadsheets, and similarly in all

26   8 pallet related spreadsheets. To avoid having to repeat every change in operations

---

T-2). On the other hand, witness Crum, Docket No. R2001-1 (USPS-T-27) refers to Periodicals
sacks and pallets being handled at BMCs.

1   costs eight times, I moved the spreadsheet pages 'sack operations costs' and 'pallet

2   operations costs' into spreadsheet 'cost_variables.xls' and linked each sack/pallet

3   model to the calculations in that spreadsheet.

4   The operations cost spreadsheet pages list a series of operations that may be

5   performed on sacks or pallets in each type of facility. The per-sack or per-pallet unit

6   cost is computed for each operation using the estimated productivity rate

7   (units/workhour), conversion factor if the unit handled is something other than sacks

8   (pallets) and TY03 wage rates, piggyback factors and premium pay factors.

9   LR-I-332 uses productivity rates for container handling operations from several different

10   sources:

11   1. LR-H-132, describing a survey of 6 BMC's to update some of the productivity
12   rates from witness Byrne's R84-1 testimony.

13   2. Byrne's R84-1 testimony, USPS-T-14, describing a study at the Philadelphia
14   BMC, the San Francisco BMC and the Buffalo ASF/SCF.

15   3. PIRS – the BMC workhour and volumes recording system; and

16   4. the Planning Guidelines (PGL), developed using industrial engineering methods.

17   I use most of the productivity rates that LR-I-332 uses, except that they are modified by

18   PRC, rather than USPS, assumptions of volume variability. Described below are some

19   of the changes I made in assumptions about productivity rates and container operations

20   costs, other than changes related to wages, piggyback factors and volume variability.

21   • Unloading At Entry Facilities. LR-I-332 container flows start with the containers
22   already at the platform of the entry facility. But the containers did not get there
23   by themselves. Generally, mailings entered at SCF's or BMC's are unloaded
24   onto the platform by USPS employees, adding to their costs. At delivery units
25   (AO's, stations and branches) unloading is generally done by the mailers. I
26   added unloading at the entry point facility when that facility is an SCF, ADC or
27   BMC.

28

1   •   Pallet Cross Docking. LR-I-332 assumes that 6.7 pallets are cross docked per

2   workhour. But this is based on BMC data, BMC's being large facilities with large

3   distances between inbound and outbound docks. Cross docking at most SCF's

4   should be faster. LR-I-332 also estimates that 8.5 pallets/hour are transferred

5   from the platform to the bundle sorting operation. This figure comes from the

6   testimony of Byrne, who gave it as an average BMC/SCF cross docking

7   productivity. He measured 9.5 pallets per hour at Buffalo, a large SCF and the

8   only one he studied. I am using 9.5 pallets/workhour for cross docking at SCF's

9   and ADC's, as well as for bringing pallets to the bundle sorting area. For cross

10   docking at BMC's I use the 8.5 pallets/hour estimate. The BMC annexes where

11   Periodicals often are cross docked are smaller than the BMC main facilities, with

12   shorter distances between inbound and outbound platforms.

13   •   Pallets That Are Sorted Manually. LR-I-332 recognizes the cost of "dumping" a

14   pallet at a mechanized bundle sorting operation – a fairly time consuming affair

15   because the dumping must occur slowly enough not to overwhelm the belt with

16   bundles or cause unnecessary bundle breakage. However, there are also some

17   costs associated with making a pallet ready for manual bundle sorting, such as

18   removing the plastic wrapping material used to keep bundles in place during

19   transport. I introduced an operation for breaking a pallet for manual sorting,

20   based on an industrial engineering standard used by USPS witness Acheson in

21   his R87-1 and MC91-3 pallet testimonies.[20]

22   •   Operations at AO's, Stations and Branches. Applying productivity rate

23   assumptions developed at the much larger SCF's and BMC's to small delivery

24   units can give a distorted picture of the workhours needed at the smaller offices.

---

[20] Acheson's estimate assumed that to open a pallet one had to cut the metal bands holding in place the hard (usually wooden) top that used to be placed on pallets carrying Periodicals or Standard flats. Today, most pallets are secured by plastic wrapping instead of a hard top, and opening a pallet involves just cutting through the plastic wrapping and removing it, generally a faster operation than the one Acheson analyzed. However, Acheson's productivity rate is the only one I am aware of that represents getting a pallet ready for manual bundle sorting.

1   For example, moving a pallet from the platform to a bundle sort operation can be
2   time consuming and costly at a large facility. When a 5-digit pallet is unloaded at
3   a DDU, the distance it must be moved from the platform to the bundle sorting
4   operation is only a few feet, and I assume it to be part of the unloading
5   operation. The same applies to rolling containers of sacks that arrive at the
6   DDU.

7   • Containers Entered at AO's. When a pallet is entered at an originating associate
8   office (OAO), LR-I-332 assumes it is cross-docked before being loaded onto a
9   van to the next facility. But the cross-docking productivity used assumes that the
10   pallet will be moved across a large area from inbound to outbound platform. At
11   an AO the inbound and outbound platform is the same and the "cross-docking"
12   can be rolled into the operation of loading the pallet.

13   Similarly, when sacks are entered at the OAO, LR-I-332 assumes they are
14   sorted, then moved in an in-house container to the outbound dock, then loaded
15   onto a truck. My assumption is that the sacks are not sorted at the OAO, just
16   passed on to the upstream facility, and that they do not need to be moved to the
17   outbound dock since they already are there.

18   Even with the changes described above, it is possible that the productivity rates used
19   tend to underestimate the cost of some operations and overestimate the cost of others.
20   For example, productivity rates derived from industrial engineering, such as those in the
21   PGL, refer to ideal conditions and therefore may not be achieved in practice. For this
22   reason, I may have underestimated the cost of operations such as shaking out a sack.
23   See Docket No. R2000-1, Witness Eggleston's response to Time Warner Interrogatory
24   TW-T26-2b. On the other hand, I may have overestimated the costs of some pallet
25   operations at non-BMC facilities, particularly cross docking. [21]

---

[21] My estimate that 9.5 pallets are cross docked per workhour is based on Byrne's survey at the
Buffalo SCF, which is larger than most SCF's. I haven't been to that facility recently, but at the
time when Byrne's survey was done, the incoming and outgoing platforms were on opposite
sides of the building, requiring one to cross through the workroom floor in order to transfer

1   c.   Container Downflows

2   Container downflows define the flow of containers between the eight types of facilities,

3   or entry points, listed earlier. Determining the downflow is reasonably straightforward

4   once a container reaches a destinating facility. For example, from a destinating BMC a

5   container with ADC presort will flow to the DADC, while three-digit and SCF containers

6   flow to the DSCF. Five digit containers may flow to either the DADC or the DSCF,

7   although some of them may flow directly to the DDU. And whether they go to the

8   DADC or DSCF, they will go from there to the DDU.

9   From more remote entry points, there are more possible paths that a container can

10 follow. It appears that the LR-I-332 developers must have made some fairly arbitrary

11 assumptions about the flow of containers from entry points OAO, OSCF and OADC.

12 For example, if a 5-digit container is entered at the originating associate office (OAO),

13 its next facility could be either the OSCF, OADC, OBMC, DBMC, DADC, DSCF or DDU

14 – a total of seven possibilities. LR-I-332 assumes the probability of each to be exactly

15 one seventh, or 14.286 percent. For 3-digit containers, there are six possible flows

16 from the OAO, and the probability of each was assumed to be exactly one sixth, or

17 16.667%. These do not appear to be empirically based estimates.

18 With the entry point data described in LR-J-114, more information is available than

19 when LR-I-332 was developed. Take for example the case of OAO entry. Clearly, the

20 subsequent flow depends on the OAO's location relative to the destinating facility. It

21 might be in the service area of the same SCF as the DDU, i.e., close by, a definite

22 possibility in the case of local publications. Or, it might be in the service area of the

23 DADC but not the DSCF, or in the service area of the DBMC, but not the DADC, or it

24 may be in the service area of another BMC, i.e., OBMC. From LR-J-114 it is possible to

25 determine the probability of each alternative, for each sack or pallet presort level.

---

pallets from one side to the other. And the BMC based productivity rates for loading and unloading pallets (respectively 12.7 and 11.6 pallets per workhour) are much slower than the rates indicated by the PGL (40.5 and 42.6 pallets per workhour). These discrepancies may be one reason why the CRA adjustment described in Section V.5 required a downward adjustment in sack, pallet and bundle cost estimates.

1   Exhibit C shows the distributions of originating entry point types among types of service

2   area. For example, when a 5-digit pallet is entered at the OAO, the OAO is either in the

3   service area of the DSCF (26.36%) or at least the service area of the DADC (73.64%).

4   Roughly similar numbers apply for carrier route sacks entered at the OAO, although

5   some entries are in more remote AO's.

6   When the OAO is in the DSCF service area, I assume that the next facility is the DSCF

7   and that from there the container (if it is a 5-digit container) flows to the DDU.[22] If the

8   OAO is in the DADC area, I assume that 50% goes to the DADC and 50% to the DSCF.

9   The table labeled 'Container Flows Between Facility Types' in spreadsheet

10 'VolumesTY03AR.xls' contains my assumptions of downflows from the OAO, OSCF

11 and OADC, under each possible assumption regarding the service area in which these

12 facilities are located. Combined with the LR-J-114 data described above, this allows

13 computation of the combined downflow from OAO, OSCF and OADC entry facilities, for

14 each combination of container type and container presort level. I relied on LR-I-332

15 assumptions regarding the downflows from OBMC, DBMC, DADC and DSCF.

16 One would naturally think of the OAO as the facility most remote from the mail's final

17 destination, followed by the OSCF, etc. But because OAO entered mail contains a high

18 component that is entered close to the destination (e.g., in the DSCF or DADC service

19 area), the estimated costs of some container type/presort combinations are actually

20 lower for OAO entry than for OSCF, OADC and OBMC entry. For example, a 5-digit

21 pallet entered at the OAO is estimated at $26.55, versus $30.72 under DBMC entry and

22 $37.62 under OBMC entry, as can be seen from Table B1.

---

[22] I assume that the flow from an originating AO is always to its SCF. If the mail could be sent to other facilities from the AO, there would have to be multiple transportation links from the AO and, at least in the case of sacks, the AO would need to sort outgoing sacks, a function I believe is normally left to upstream facilities. The LR-I-332 assumption that 14% would flow from the OAO directly to the DDU therefore seems unlikely to be true. On the other hand, the SCF serving the AO may be an ADC, so the flow from OAO could be to OSCF or to OADC.

1   5. CRA Adjustment

2   Applying projected TY03 after rates non-letter Outside County mail volumes to the

3   pallet, sack, bundle and piece unit costs indicated by my model results in total costs

4   somewhat higher than indicated by corresponding CRA based projections. I therefore

5   performed a CRA adjustment, as described below. The calculations are performed in

6   spreadsheet 'CRAAdjust.xls'.

7   In USPS LR-J-81 (R2001-1), spreadsheet 'shp03prc.xls' contains the PRC version of

8   the projected test year mail processing unit costs per shape, subclass and MODS/PIRS

9   cost pool. For Outside County Periodicals, the unit costs over all cost pools, including

10   piggyback costs, are $0.06727 for letters, $0.13274 for flats and $3.2788 for parcels.

11   When test year volumes are applied, projected total mail processing costs are $1,232

12   million, of which $27 million are for letters and $1,205 million for non-letters.

13   My model is designed to represent the flow of presorted flats through the postal system.

14   There is no separate model for parcel shaped Periodicals. But whereas letters are

15   treated separately in Mitchell's rate design, the non-letter rates must cover the total

16   costs incurred by both flats and parcels. It is therefore appropriate to compare costs

17   indicated by the model with the CRA costs for flats and parcels combined.

18   However, not all of the $1,205 million CRA based non-letter costs are related to the

19   normal flow through the system of sacks, pallets, bundles and pieces that the model

20   represents. I therefore excluded from the comparison $90.2 million corresponding to

21   costs incurred at 18 MODS based cost pools. The $47 million in forwarding costs

22   (MODS operation LD49) represent the biggest portion of excluded costs.

23   Subtracting the $90 million from the $1,205 million total, I conclude that the model, with

24   TYAR volumes applied, should indicate costs equal to $1,115 million. The model

25   actually gives a total of $1,213 million, requiring an 8.1% downward adjustment.

26   However, I do not believe it would be appropriate to apply this adjustment uniformly to

27   all model costs, for reasons explained below.

28   The model generates $425 million in piece sorting costs, not including the costs of

1   moving sorted pieces between operations or between facilities that I have identified as

2   weight related piece costs. I estimated the CRA based piece sorting costs by adding up

3   the costs at MODS/PIRS operations that represent piece sorting. They came to $431

4   million, slightly more than the model generated piece sorting costs. This would seem to

5   indicate that the modeled piece sorting costs should be increased by about 1.4%, while

6   the remaining modeled costs should be reduced by a much larger percentage. Since

7   the modeled piece sorting costs in fact are very close to the CRA costs, and some

8   judgment is involved in determining precisely which CRA costs to compare them with, I

9   did not adjust them. The required adjustment factor for per-bundle, per-sack and per-

10   pallet unit costs then comes to 0.875, representing a 12.5% downward adjustment.

11   The unit costs shown in Exhibit B are the adjusted costs that form the basis for witness

12   Mitchell's rate design. Spreadsheet 'Costs_Volumes.xls' contains both the adjusted

13   and unadjusted costs.

14   <u>Modeled Cost Pools</u>

15   This section describes my reasoning in selecting the MODS/PIRS cost pools to include

16   in the comparison with (1) total modeled costs; and (2) modeled piece sorting costs.

17   Mail processing CRA costs are based on IOCS sampled observations of the activities of

18   clerks and mailhandlers. Since R97-1, these costs are estimated by cost pools defined

19   by the MODS and PIRS systems. There are many apparent contradictions in the

20   MODS/IOCS data. Clerks may be recorded as sorting flats at a letter or parcel sorting

21   operation, or sorting letters or parcels at a flats operation, etc. Or they may be recorded

22   as handling Periodicals flats at operations where Periodicals flats do not belong, e.g.,

23   operations dedicated to Express mail, or international mail.

24   One can form different theories about what these aberrations mean. For example, the

25   CRA data show $526,915 spent sorting Periodicals flats at OCR's, which are used only

26   for letter mail. The corresponding IOCS observations may reflect flats actually being

27   handled at an OCR, or an employee logged into an OCR operation temporarily handling

28   flats, or simply IOCS recording errors. Since there is no way to know for certain how

1 these questions should be resolved, some reasonable assumptions are needed in order

2 to perform the type of CRA adjustment discussed here.

3 I assumed, first of all, that employees were handling flats when IOCS recorded that

4 they were handling flats, even though they may have been recorded at the same time

5 as working at letter or parcel operations. Similarly, I assumed that employees were

6 handling letters or parcels when recorded as handling those shapes by IOCS. The

7 same assumption appears to underlie the shape based costs in LR-J-81.

8 Second, I assumed that observations taken at the following cost pools do not represent

9 modeled processing activities and should be excluded from our comparisons:

10   • Forwarding (LD49);
11   • Acceptance (LD79);
12   • Priority;
13   • Express Mail;
14   • Business Reply;
15   • Mailgrams;
16   • Registry;
17   • Rewrap;
18   • Intl;
19   • Misc.;
20   • Support; and
21   • LD48 administrative functions

22 There are cost pools corresponding to Express, Registry and Misc. both in MODS and

23 Non-MODS offices. The LD48 includes four different cost pools. Altogether, that brings

24 to 18 the number of excluded pools.

25 Third, I counted as piece sorting related all costs recorded as flats or parcels handled at

26 pools for flats piece sorting (FSM, FSM-1000, MANF) and letters piece sorting (BCS,

27 BCS/DBCS, OCR, LSM, MANL).[23]   A further assumption was needed regarding the

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[23] I did not count as piece sort related the costs at pools associated with parcel sorting (e.g., PSM, SSM, Mecparc, Manp). Most of the Outside County costs at these operations are shown

35

1 Function 4 (stations and branches) operations LD41, LD42, LD43 and LD44. These

2 pools include various allied operations, such as unloading of sacks and pallets and

3 bundle sorting, as well as piece sorting. Analysis of IOCS tallies at these pools in

4 R2000-1 and R2001-1 indicates that roughly half are piece sorting costs and I assumed

5 that to be the case also for Periodicals flats.

6 Excluding all of the 18 cost pools listed above from the comparison between CRA and

7 modeled costs may have led to estimates of bundle, sack and pallet costs that are

8 somewhat too conservative. For example, a total of $17.2 million in flats and parcel

9 costs are associated with cost pools "Misc" in MODS and Non-MODS offices. Misc

10 activities could include many of the operations on pieces, bundles, sacks and pallets

11 that I am modeling, as well as costs not modeled. And when employees were recorded

12 as handling Periodicals flats in operations where Periodicals do not belong at all (e.g.,

13 Express, mailgrams, etc.), it is possible that the employees were clocked into those

14 operations but in reality performing one of the modeled activities. Excluding fewer cost

15 pools from the comparison would increase the unit cost estimates in Tables B1 and B2.

16 6. Estimating The Proportion Of Periodicals Costs That Are Pound Related

17 The total TY03 after rates costs attributable to Outside County Periodicals are

18 $2,404.808 million. After the CRA adjustment described above, the total costs related

19 to user prepared sacks and pallets, together with non-weight related bundle costs, are

20 $500.44 million, or 20.81% of the total costs. Based on this information, witness

21 Mitchell develops sack, pallet and bundle charges that represent roughly the same

22 percentage of the total revenue requirement.[24]

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as occurring for flats rather than parcels, and I believe it is more likely that such operations would be used to sort bundles of flats than individual flats.

[24] All dollar amounts in this section refer to TY03 after rates costs based on PRC costing methodology and before adding contingency. Calculations are performed in spreadsheet 'LbPercentage.xls' in LR TW-et-al.xxx. PRC Op. R2001-1, Corrected Appendix F gives the costs per subclass and cost segment. Spreadsheet 'pigty03.xls', in R2001-1 PRC library reference 6, contains applicable piggyback factors per cost segment and subclass.

1   Under traditional rate design, 60% of the revenue requirement is derived from the piece

2   rates and 40% from the pound rates. But with the new cost based rate elements for

3   sacks, pallets and bundles, it is necessary to derive only slightly less than 80% of the

4   revenue requirement from piece and pound charges. Witness Mitchell was faced with

5   the question of exactly which percentage of the costs it would be reasonable to derive

6   from the pound rates.

7   Since many postal operations are affected to some degree both by the number of

8   pieces handled and the weight of those pieces, it may never be possible to determine

9   with absolute precision which portion of the overall costs are primarily weight related.

10 However, the analysis presented below leads me to conclude that it would be

11 reasonable and consistent with the concept of cost based rates to derive 30% of the

12 Outside County revenues from pound rates, when 20+ percent are derived from sack,

13 pallet and bundle charges. My analysis identifies about 25% of the costs that are

14 clearly weight related and shows that there must be additional weight related costs both

15 in delivery and in mail processing.

16 Transportation costs are generally incurred on a cube or weight related basis and are

17 pound rather than piece related. Outside County costs from Cost Segment 14

18 (purchased transportation) and Segment 8 (vehicle service drivers) are respectively

19 $342.758 million and $45.144 million. The Segment 8 costs must be increased by a

20 factor of 1.589 to include piggyback costs. This gives total transportation related costs

21 equal to $414.498 million.

22 In addition, as described earlier, my analysis identifies certain bundle and piece related

23 costs that in fact vary not with the number of bundles or pieces but with their

24 cube/weight. After the CRA adjustment, those costs are, respectively, $128.185 million

25 and $50.987 million. Adding them to the transportation costs gives identifiable weight

26 related costs equal to $593.830 million, or 24.69% of total Outside County costs.

27 But the total weight related costs must be higher, for the following reasons:

28   (1)   delivery costs clearly must have some weight related component; and

29   (2)   even piece sorting costs are to some extent affected by the weight of the

37

1   pieces sorted.

2   Total delivery costs attributed to Outside County Periodicals, with piggyback costs, are

3    $743.054 million. I don't know what percentage of these costs is weight/cube related,

4   but clearly the percentage is greater than zero. Costs related to loading delivery

5   vehicles, walking a park and loop route, etc. seem likely to depend on weight more than

6   on the number of pieces.[25] Let us assume, for example, that delivery costs overall are

7   17% weight related. That would add $126.32 million to the weight related costs and

8   make them almost exactly 30% of the total.

9   Furthermore, even the costs of piece sorting, which so far we have assumed to occur

10   strictly on a per-piece basis, do have a weight related component. Take for example

11   the sorting of flats on an AFSM-100. This machine is typically staffed by five clerks:

12   three that feed flats into the machines and two that sweep trays of sorted flats and

13   replace them. The thicker the flats are, the faster those trays fill up, so that the sweep

14   side costs of the AFSM-100 operation are affected by weight to a substantial extent.

15   Similarly, there is bound to be some component of manual flats sorting that is affected

16   by the thickness of the flats being sorted.

17   Based on these considerations, although I cannot determine precisely the proportion of

18   either delivery costs or piece sorting costs that are weight related, I believe it is

19   reasonable to consider at least 30% of Outside County Periodicals costs as weight

20   related, when 20.81% are considered to be per-sack, per-pallet and per-bundle costs.

21   **VI.   CONCLUSIONS**

22   I have presented a set of unit cost estimates that reflect, as accurately as possible with

23   available data, how Periodicals mail processing costs vary with the number of pieces,

24   bundles, sacks and pallets, as well as with the piece characteristics, bundle and

25   container presort levels and container entry points relative to the destinating facility. I

---

[25] Rural carrier contracts are determined by counts of letters and flats, which would indicate that rural delivery costs are piece related. However, it seems likely that the carriers would demand a re-negotiation if those flats were suddenly twice as heavy.

1   have also identified the piece and bundle related costs that are most appropriate to

2   consider as weight related.

3   This information provides a foundation for the development of Periodicals postal rates

4   that are truly cost based and therefore can give mailers the most accurate price signals.

5   Postal rates consistent with this information, such as the rates presented by witness

6   Mitchell, will give mailers strong incentives to prepare their mail in a manner that

7   reduces the Postal Service's costs of handling it. In particular, such rates will provide

8   strong disincentives to certain long established but costly practices, such as forcing the

9   Postal Service to handle sacks with only one or a few pieces in them.

10 Establishment of postal rates based on these unit costs will present significant

11 challenges and opportunities to large and small mailers, to their printers and to

12 developers of mail preparation software, to prepare and enter Periodicals in a way that

13 minimizes the combined total costs to mailers and the Postal Service.

14 Development of my cost model started with the model described in LR-I-332 that was

15 developed by the Postal Service, with some input from the Periodicals industry, during

16 the Docket No. R2000-1 proceedings. To my knowledge, that model represented the

17 first serious attempt to identify and measure all the major mail characteristics, except

18 address quality, that affect the cost of processing a Periodicals mailing. In addition to

19 updates in accordance with the cost, volume and mail flow assumptions adopted in

20 Docket No. R2001-1 that form the basis for the rates currently in effect, I have identified

21 and corrected various imperfections in the original model, as documented in the

22 preceding pages.

23 No model is better than the data it is based on, and I did not have perfect data.

24 Following the practice established by USPS witnesses in recent rate cases, I addressed

25 the problem of imperfect data, in the aggregate, by a "CRA adjustment" that assures

26 that the total Periodicals processing costs predicted by the model are consistent with

27 TY03 after rates CRA costs.

28 Processing methods and mailer practices are changing continually. The data I have

1   used are several years old, and I have no doubt that the model could be improved by

2   use of more recent data which the Postal Service may already possess. However, I

3   believe that with updates based on the newest available data this model can continue

4   to be a suitable and accurate tool for the determination of unit costs and the

5   development of truly cost based Periodicals rates.

[Complaint of Time Warner Inc. et al. Attachment B]

Exhibit A, P. 1 of 2

OUTSIDE COUNTY NON-LETTERS EXPANDED BILLING DETERMINANTS

FOR R2001-1 TEST YEAR (FY2003) AFTER RATES VOLUMES

Table A1: Outside County Sack & Pallet Counts By Entry Point & Container Presort									
Container		Entry Point							
Type	Presort	DDU	DSCF	DADC	DTH	OTH	OADC	OSCF	OAO
Sacks	MADC	0	0	0	0	224,884	2,200,448	1,708,869	662,019
	ADC	0	0	422,139	78,776	1,424,488	5,366,765	4,925,537	641,288
	3-D/SCF	0	2,226,350	988,599	231,660	2,787,181	11,203,943	11,600,477	1,653,319
	5-d	309,522	11,224,523	2,518,589	202,342	1,770,182	9,622,411	14,581,714	2,500,994
	5-d CR	282,439	2,960,878	936,374	53,947	186,875	1,954,406	4,591,924	505,890
	CR	507,057	2,784,291	404,755	8,960	50,796	305,983	618,825	1,398,715
Pallets	ADC	0	0	71,306	10,201	74,720	272,412	236,724	30,351
	3-D/SCF	0	827,316	207,650	56,942	135,881	467,350	314,639	24,706
	5-Digit	44,443	245,000	18,099	4,308	14,846	26,038	43,955	389

Table A2: Estimated Counts Of Bundles By Bundle & Container Presort Level									
Bundle	Sacks						Pallets		
Presort	MADC	ADC	SCF/3-D	5-Digit	5-D CR	CR	ADC	3D-SCF	5-Digit
MADC	9,639,244								
ADC	9,914,650	15,172,444					1,486,740		
3-D	5,814,701	17,787,700	50,694,240				13,520,311	11,666,063	
5-D	3,874,680	6,589,924	41,427,415	71,933,516			43,716,582	93,469,264	2,070,635
CR					38,115,686	8,243,936	13,055,749	179,625,021	21,465,550
Total	29,243,276	39,550,069	92,121,655	71,933,516	38,115,686	8,243,936	71,779,382	284,760,348	23,536,185

[Complaint of Time Warner Inc. et al. Attachment B]

Table A3: Piece Counts By Bundle & Container Presort Level And Piece Characteristics:									
Bundle	Piece	Sacks						Pallets		
Level	Type	MADC	ADC	3-D	5-D	5-D CR	CR	ADC	3-D	5-D
MADC	NBC/NM	52,102,794								
	NBC/M	33,504,438								
	BC/NM	9,761,968								
	BC/M	28,720,921								
ADC	NBC/NM	19,061,366	57,620,772					2,590,905		
	NBC/M	34,625,721	39,295,246					5,119,522		
	BC/NM	9,646,521	19,938,480					1,418,346		
	BC/M	28,338,964	41,608,848					4,123,317		
3d	NBC/NM	16,120,706	24,764,255	156,901,102				20,001,049	24,815,933	
	NBC/M	10,705,336	22,826,894	76,128,804				20,152,286	39,882,698	
	BC/NM	6,353,327	46,784,622	170,299,566				58,237,066	35,906,692	
	BC/M	13,345,362	70,021,502	455,003,855				147,832,565	100,780,613	
5d	NBC/NM	10,912,188	12,350,855	43,397,518	216,206,791			20,102,894	52,591,277	666,942
	NBC/M	7,842,429	25,890,816	64,435,146	59,589,693			47,099,126	124,254,921	11,565,506
	BC/NM	713,971	3,205,328	54,744,526	371,968,417			129,428,996	240,368,395	835,143
	BC/M	2,177,572	9,429,278	202,827,640	169,630,150			327,279,486	883,656,105	7,202,595
CR	NM					285,547,287	134,258,757	32,911,822	304,715,641	50,269,303
	M					78,097,471	0	99,283,008	2,270,153,403	450,741,732
Total Pieces:		283,933,583	373,736,896	1,223,738,157	817,395,051	363,644,758	134,258,757	915,580,388	4,077,125,678	521,281,221
					Sacked:		3,196,707,203	Palletized:		5,513,987,287
								Total TY03:		8,710,694,490

[Complaint Of Time Warner Inc. et al.
Attachment B]

Exhibit B, P. 1 of 5

OUTSIDE COUNTY NON-LETTERS - MAIL PROCESSING UNIT COSTS OF HANDLING PIECES, BUNDLES, SACKS AND PALLETS

ADJUSTED TO R2001-1 TEST YEAR (FY2003) CRA COSTS UNDER PRC COSTING METHODOLOGY

Table B1: Unit Costs Of Sack/Pallet Handling By Entry Point & Container Presort									
Container		Entry Point							
Type	Presort	DDU	DSCF	DADC	DTH	OTH	OADC	OSCF	OAO
Sacks	MADC						$1.21	$2.03	$1.90
	ADC			$1.30	$2.39	$2.94	$3.38	$3.27	$3.27
	3-d		$1.30	$2.04	$2.39	$3.00	$3.39	$3.23	$2.77
	5-d	$0.93	$1.75	$2.12	$2.80	$3.31	$3.61	$3.42	$2.59
	5-d CR	$0.93	$1.75	$2.12	$2.80	$3.01	$3.42	$3.26	$2.47
	CR	$0.93	$1.75	$2.12	$2.80	$3.01	$3.53	$3.05	$2.33
Pallets	ADC			$13.79	$27.13	$33.93	$41.44	$41.22	$48.32
	SCF/3D		$13.79	$25.94	$27.13	$35.71	$41.42	$40.60	$42.61
	5D	$1.58	$17.20	$24.79	$30.72	$37.62	$44.76	$43.44	$26.55

[Complaint Of Time Warner Inc. et al. Attachment B]

Exhibit B, P. 2 of 5

Table B2a: Per-Bundle Unit Costs By Bundle & Container Presort Level
Excludes Weight Related Bundle Costs - Used In Mitchell's Rate Design

Bundle Presort	Sacks						Pallets		
	MADC	ADC	SCF/3-D	5-Digit	5-D CR	CR	ADC	3D-SCF	5-Digit
MADC	$0.2617								
ADC	$0.3207	$0.1047					$0.1047		
3-Digit	$0.3476	$0.1663	$0.1064				$0.1722	$0.1064	
5-Digit	$0.3772	$0.1956	$0.1744	$0.0000			$0.2051	$0.1814	$0.0908
CR					$0.0881	$0.0000	$0.2150	$0.1938	$0.0881

Table B2b: Weight Related Per-Bundle Unit Costs By Bundle & Container Presort Level

Bundle Presort	Sacks						Pallets		
	MADC	ADC	SCF/3-D	5-Digit	5-D CR	CR	ADC	3D-SCF	5-Digit
MADC	$0.0961								
ADC	$0.4469	$0.0855					$0.0855		
3-Digit	$0.5562	$0.2999	$0.0855				$0.3192	$0.0855	
5-Digit	$0.5903	$0.3200	$0.2271	$0.0382			$0.3433	$0.2438	$0.0382
CR					$0.0000	$0.0000	$0.3276	$0.2486	$0.0000

Table B2c: Total Per-Bundle Unit Costs By Bundle & Container Presort Level -
Includes Weight Related Costs

Bundle Presort	Sacks						Pallets		
	MADC	ADC	SCF/3-D	5-Digit	5-D CR	CR	ADC	3D-SCF	5-Digit
MADC	$0.3579								
ADC	$0.7676	$0.1901					$0.1901		
3-Digit	$0.9039	$0.4662	$0.1918				$0.4914	$0.1918	
5-Digit	$0.9675	$0.5156	$0.4015	$0.0382			$0.5484	$0.4251	$0.1290
CR					$0.0881	$0.0000	$0.5425	$0.4423	$0.0881

[Complaint Of Time Warner Inc. et al. Attachment B]

Exhibit B, P. 3 of 5

Bundle Level	Piece Type	Sacks						Pallets		
		MADC	ADC	3-D	5-D	5-D CR	CR	ADC	3-D	5-D
MADC	NBC/NM	$0.2893								
	NBC/M	$0.1559								
	BC/NM	$0.2391								
	BC/M	$0.1166								
ADC	NBC/NM	$0.1723	$0.1594					$0.1594		
	NBC/M	$0.1342	$0.1302					$0.1302		
	BC/NM	$0.1430	$0.1320					$0.1320		
	BC/M	$0.1034	$0.1002					$0.1002		
3d	NBC/NM	$0.1755	$0.1618	$0.1615				$0.1615	$0.1615	
	NBC/M	$0.1308	$0.1259	$0.1251				$0.1251	$0.1251	
	BC/NM	$0.1473	$0.1357	$0.1354				$0.1355	$0.1354	
	BC/M	$0.1016	$0.0976	$0.0969				$0.0970	$0.0969	
5d	NBC/NM	$0.0998	$0.0795	$0.0762	$0.0655			$0.0675	$0.0662	$0.0655
	NBC/M	$0.0813	$0.0714	$0.0682	$0.0603			$0.0618	$0.0608	$0.0603
	BC/NM	$0.0934	$0.0766	$0.0739	$0.0655			$0.0671	$0.0660	$0.0655
	BC/M	$0.0668	$0.0588	$0.0561	$0.0497			$0.0509	$0.0501	$0.0497
CR	NM					$0.0000	$0.0000	$0.0028	$0.0011	$0.0000
	M					$0.0000	$0.0000	$0.0023	$0.0009	$0.0000

**Table B3a: Unit Piece Processing Costs By Bundle & Container Presort Level & Piece Characteristics
Excludes Weight Related Costs - Used In Mitchell's Rate Design**

[Complaint Of Time Warner Inc. et al. Attachment B]

Exhibit B, P. 4 of 5

Bundle Level	Piece Type	Sacks						Pallets		
		MADC	ADC	3-D	5-D	5-D CR	CR	ADC	3-D	5-D
MADC	NBC/NM	$0.0506								
	NBC/M	$0.0501								
	BC/NM	$0.0506								
	BC/M	$0.0501								
ADC	NBC/NM	$0.0346	$0.0346					$0.0346		
	NBC/M	$0.0326	$0.0326					$0.0326		
	BC/NM	$0.0346	$0.0346					$0.0346		
	BC/M	$0.0326	$0.0326					$0.0326		
3d	NBC/NM	$0.0262	$0.0291	$0.0262				$0.0291	$0.0262	
	NBC/M	$0.0262	$0.0291	$0.0262				$0.0291	$0.0262	
	BC/NM	$0.0262	$0.0291	$0.0262				$0.0291	$0.0262	
	BC/M	$0.0262	$0.0291	$0.0262				$0.0291	$0.0262	
5d	NBC/NM	$0.0000	$0.0000	$0.0035	$0.0000			$0.0000	$0.0032	$0.0000
	NBC/M	$0.0000	$0.0000	$0.0035	$0.0000			$0.0000	$0.0032	$0.0000
	BC/NM	$0.0000	$0.0000	$0.0035	$0.0000			$0.0000	$0.0032	$0.0000
	BC/M	$0.0000	$0.0000	$0.0035	$0.0000			$0.0000	$0.0032	$0.0000
CR	NM					$0.0000	$0.0000	$0.0000	$0.0000	$0.0000
	M					$0.0000	$0.0000	$0.0000	$0.0000	$0.0000

Table B3b: Unit Piece Processing Costs By Bundle & Container Presort Level & Piece Characteristics Weight Related Costs Only

[Complaint Of Time Warner Inc. et al. Attachment B]

Exhibit B, P. 5 of 5

Bundle Level	Piece Type	Sacks						Pallets		
		MADC	ADC	3-D	5-D	5-D CR	CR	ADC	3-D	5-D
MADC	NBC/NM	$0.3400								
	NBC/M	$0.2060								
	BC/NM	$0.2898								
	BC/M	$0.1667								
ADC	NBC/NM	$0.2069	$0.1940					$0.1940		
	NBC/M	$0.1669	$0.1629					$0.1629		
	BC/NM	$0.1776	$0.1666					$0.1666		
	BC/M	$0.1360	$0.1328					$0.1328		
3d	NBC/NM	$0.2017	$0.1910	$0.1877				$0.1906	$0.1877	
	NBC/M	$0.1570	$0.1550	$0.1513				$0.1543	$0.1513	
	BC/NM	$0.1735	$0.1648	$0.1616				$0.1646	$0.1616	
	BC/M	$0.1278	$0.1267	$0.1231				$0.1261	$0.1231	
5d	NBC/NM	$0.0998	$0.0795	$0.0797	$0.0655			$0.0675	$0.0694	$0.0655
	NBC/M	$0.0813	$0.0714	$0.0717	$0.0603			$0.0618	$0.0640	$0.0603
	BC/NM	$0.0934	$0.0766	$0.0774	$0.0655			$0.0671	$0.0693	$0.0655
	BC/M	$0.0668	$0.0588	$0.0596	$0.0497			$0.0509	$0.0533	$0.0497
CR	NM					$0.0000	$0.0000	$0.0028	$0.0011	$0.0000
	M					$0.0000	$0.0000	$0.0023	$0.0009	$0.0000

Table B3c: Unit Piece Processing Costs By Bundle & Container Presort Level & Piece Characteristics
Includes Weight Related Piece Handling Costs

[Complaint of Time Warner Inc. et al.
Attachment B]

Exhibit C, P. 1 of 1

SERVICE TERRITORY OF ORIGINATING FACILITIES, FOR CONTAINERS ENTERED AT ORIGIN

Table C1: Service Territory Of OAO, For Containers Entered At OAO				
	DSCF	DADC	DTH	OTH
MADC SACK	0.00%	0.00%	0.00%	100.00%
ADC SACK	0.00%	11.76%	6.25%	81.99%
3DG/SCF SACK	17.51%	20.68%	9.67%	52.14%
5DG SACK	37.15%	28.42%	9.21%	25.23%
5DG RTS SACK	28.52%	46.62%	1.96%	22.90%
CR SACK	25.70%	54.65%	15.55%	4.11%
ADC PALLET	0.00%	0.00%	5.70%	94.30%
3DG/SCF PALLET	5.77%	1.77%	0.00%	92.46%
5DG PALLET	26.36%	73.64%	0.00%	0.00%

Table C2: Service Territory Of OSCF, For Containers Entered At OSCF			
	DADC	DTH	OTH
MADC SACK	0.00%	0.00%	100.00%
ADC SACK	5.01%	7.96%	87.03%
3DG/SCF SACK	11.02%	5.90%	83.08%
5DG SACK	20.74%	14.14%	65.12%
5DG RTS SACK	24.99%	15.38%	59.63%
CR SACK	49.66%	3.02%	47.32%
ADC PALLET	6.95%	4.22%	88.83%
3DG/SCF PALLET	10.04%	12.08%	77.88%
5DG PALLET	19.87%	5.67%	74.46%

Table C3: Service Territory Of OADC, For Containers Entered At OADC		
	DTH	OTH
MADC SACK	0.00%	100.00%
ADC SACK	13.29%	86.71%
3DG SACK	15.88%	84.12%
5DG SACK	34.87%	65.13%
5DG RTS SACK	50.14%	49.86%
CR SACK	32.59%	67.41%
ADC PALLET	13.64%	86.36%
3DG PALLET	20.83%	79.17%
5DG PALLET	20.95%	79.05%