

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

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

Docket No. C2004-1

DIRECT TESTIMONY OF
JOSEPH E. SCHICK
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.

April 26, 2004

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**Direct Testimony Of
Joseph E. Schick**

PURPOSE

My name is Joseph E. Schick. I submit this testimony in support of the proposal advanced by Time Warner et al. The purpose of my testimony is to show how, in the real world, this proposed rate structure would move mailers and the Postal Service closer to a business and process model based on the principle of “lowest combined costs.” That model allows for each member of the process value chain to do the work that is most efficient and economical for them, creating the “lowest combined costs” from design to delivery – not just shifting the cost (and possibly increasing the combined costs) from one part of the process to another.

AUTOBIOGRAPHICAL SKETCH

I am the Director of Postal Affairs at Quad/Graphics, Inc., headquartered in Pewaukee, Wisconsin. Quad is the largest privately held printing and distribution company in North America. On an annual basis we produce more than 8 billion magazines, books, catalogs, direct mail pieces, and parcels that are then distributed through the United States Postal Service. That volume equates to an annual postage bill of more than \$2 billion for our clients.

I have more than 20 years experience in the post press production process, which includes postal affairs and distribution, and have been employed in my present position since 1990. I have participated as a witness in two previous rate case

1 proceedings.¹ I have served on numerous Mailers Technical Advisory Committee
2 and informal industry working groups, and was Chairman of MTAC from 1999-2000.
3

4 **1. CURRENT PRINTING AND MAILING INDUSTRY ENVIRONMENT**

5 Before I explain the need and importance of the proposed rate structure, I think it
6 important to understand where we are today and, more importantly, why new and
7 expanded opportunities for process improvement have not been realized.

8 When we enter into a contract to produce a product for our clients today, they are
9 looking for value for the cost. That value can be realized in a number of ways, such
10 as quality (really a given in today's environment), price (not always the lowest),
11 customer service, reduced cycle time, and availability of technology and innovation.

12 When the product is mail, the Postal Service obviously has a distinct impact on
13 some of the business decisions that are made. Postage rates dictate the way we
14 presort and package the mail, and speed of delivery dictates how we containerize,
15 transport, and distribute the mail. You would think that logical people would make
16 logical decisions, and in many cases that does happen. However, because of the
17 current rate structure, it doesn't happen enough. The result is win/lose/lose
18 situations for our customers, the Postal Service, and the mail service provider. We
19 are forced to make decisions that we know are not in the best interest of the "lowest
20 combined costs" model.

21 Sometimes the decisions are easy. If a customer is looking for the lowest postage
22 rates and nothing else, we will: create the best presort scenario (maximize carrier
23 route), automate/barcode as much of the non-carrier route mail as possible, and

¹ Docket No. R2000-1, Postcom et al.-T-2; Docket No. R97-1, AMMA-T-1.

1 then maximize the amount of dropship mail. In today's rate structure, those are
2 really the only three elements of worksharing that can impact postage rates.

3 Sometimes the decisions are a little more difficult. If the customer has a time-
4 sensitive product, they may be looking for the quickest delivery, be willing to pay
5 more for the transportation and distribution, and weigh that above all else. In that
6 case, we would still try to keep the postage rates down by maximizing presort and
7 automating the mail. But the way the mail is containerized, transported, and
8 distributed will probably be done in a much less efficient manner. For example, if we
9 were creating a mailing for a time-sensitive periodical, instead of building one ADC
10 pallet containing 100 packages (carrier route, 5 digit, etc.), we might create 50-75
11 individual 5 digit sacks with those same packages. The customer would choose this
12 preparation because in many cases, mail on ADC pallets would end up with slower
13 delivery because of the number of handlings needed to break down the pallet, sort
14 the packages, and move the mail to the next downstream postal facility. As opposed
15 to those same 5 digit or carrier route packages in a sack, whereas they would travel
16 directly to the DDU before being opened. In the end, the postage might be the same
17 if prepared either way, but the overall cost to everyone involved would be much
18 higher.

19 IN STYLE magazine provides a good example of changes in mail preparation that
20 can be done without negatively impacting the publisher, while having a positive
21 impact on the printer and Postal Service. IN STYLE reduced the number of sacks per
22 issue from 4,059 (October 2003) to 1,418 (April 2004), a reduction of 65%, merely
23 by altering the presort parameters. There was no added expense to Time Inc. to
24 make this change, but the elimination of 2,641 sacks significantly reduced USPS
25 costs. Those sacks would have been entered at origin at a cost of \$3/sack, while
26 the cost of mail on pallets entered at either the DSCF or DADC would be \$13/pallet

1 according to the data in witness Stralberg's testimony. The change from sacks to
2 pallets also created less cost and more efficient production for Quad.

3 And sometimes the decisions are very difficult. When the customer wants and
4 needs the lowest postage rates *and* the quickest, most efficient delivery, we must
5 maximize all of the worksharing opportunities available while expediting the
6 distribution process. In today's world, this *is* the scenario we are all presented with
7 by our customers each and every day. It *is* the scenario that is required because of
8 the competitive world we live in – the competition for information, advertising, and
9 speed to market.

10 Unfortunately, today the depth of worksharing discounts limits us. Opportunities are
11 restricted because the costs of increased investment in technologies, such as
12 comailing, copalletization, and investing in new technologies and processes
13 outweigh the return that we could get from the reduction in postage costs.

14 If the world of hard-copy, ink-on-paper distribution is going to continue to be a viable
15 medium, then the paradigm for the way postage rates are structured and the way
16 that worksharing is developed must change. The rate structure proposed by Time
17 Warner et al. would be the first step in creating the incentives needed to effect
18 changes that would help to lead to the viability of our industry now and in the future.

19
20

1 **2. MAXIMIZING WORKSHARING AT QUAD IN THE CURRENT ENVIRONMENT**

2 As mentioned in the last section, today there are three main elements of
3 worksharing: presort, automation, and dropship. In maximizing each of those
4 elements, we can look at mailings individually or as groups of mailings being
5 combined into one. Volume generally dictates how much can be done and to what
6 extent.

7 At Quad/Graphics, we realized early in our corporate life that “pooling” product was
8 the only way that we could compete with our much larger competitors. The “pooling”
9 of product simply means combining multiple print jobs into one larger grouping.
10 That can be done within a package, on a pallet, or in a truck. It began for us in
11 distribution with the creation of a newsstand pool in the early ‘70s and then carried
12 over to mail in the early ‘90s when dropship discounts became available.

13 In the mid-‘80s, we used the same approach in developing our comailing (multi-mail)
14 operation. By combining a number of different periodicals into one presorted
15 mailing, we were able to improve presort for each title and at the same time create
16 more palletized mail. That process has proven to be one of the most important in
17 the growth of our business. It helped to differentiate us from our competition and
18 attract a number of publishers, with both large and small circulations.

19 A strange thing happens when developing technology and new processes. In
20 almost every case, the value is never really fully known until after implementation.
21 As we developed our comailing operation, our number one goal was to improve
22 presort for our customers and reduce their postage bills – making smaller circulation
23 periodicals look and feel the same as larger circulation periodicals. We soon
24 realized that there were many more benefits, such as: reduction in sacked mail

1 equating to savings associated with labor, material handling, and warehousing;
2 increased efficiencies on our binding lines because we move the addressing to the
3 offline comail process; product quality maintained through postal processing
4 because of fewer handlings; and package integrity maintained because package
5 handlings are reduced.

6 The Postal Service has also benefited from our move to comailing. At acceptance,
7 instead of verifying and accepting multiple mailings (in some comail pools we are
8 combining 35-40 different publications or versions of publications that would have
9 been separate, individual mailings), we present one mailing for verification and
10 acceptance. The documentation we provide to the Postal Service and our
11 customers is used to support the postage paid and discounts claimed by each
12 individual publication within the comailing. That same benefit is then carried over to
13 every step in postal processing (handlings associated with pallets, packages, and
14 pieces). In addition to the mail handlings that are reduced, the Postal Service also
15 sees benefits related to staging of pallets and the handling, transportation, and
16 inventory of MTE (Mail Transport Equipment – sacks and pallets).

17 As we continued to grow our comail operation, we also realized that we had to make
18 entry into the process as easy as possible for our customers, ensuring that they
19 would continue to stay in the program. The key to success has and will continue to
20 be volume. As a result, we have continued to upgrade the comailers with: levelling
21 tables to allow for variances in thickness; multiple choices for addressing, using
22 either inkjet and/or paper labels with the choice of permanent glue or releasable
23 glue; feeder pockets designed for perfect bound and saddle-stitched publications;
24 and video technology that can match each address to the appropriate magazine to
25 ensure that no subscriber will receive the wrong publication.

1 Today, we have more than 120 different publications participating in our comailing
2 program. The list size of those publications can vary from a main run of 500,000
3 copies to supplementals or back issues of 1,500 copies. Publications may also use
4 comailing for just a version or versions of their publication. We are comailing on a
5 weekly basis across five comailing lines in our Sussex, WI printing plant. In addition,
6 we have instituted what we are calling a co-wrap process in our Sussex plant for
7 polywrapped publications. It is designed in the same manner as our comail/multi-
8 mail program. In a short period of time, that program has attracted a number of
9 publications and has resulted in our need to purchase new wrapping equipment that
10 can accommodate more publications (more feed stations).

11 On average, we are comailing about 3-6 million pieces each week. The comail
12 result speaks for itself. The average percentage of carrier route presorted mail for
13 each publication is about 12-14% before comailing. After combining all of the lists
14 together and presorting as one comailing, the average carrier route presort
15 increases to about 75-85%, depending on the total number of copies. The comail
16 also results in mailings where 99%+ is palletized, and the only reason 100% is not
17 palletized is because of our segmenting process, which allows our customers to use
18 a number of versions within the comail and ensures maximum efficiency in our
19 production process. We will be upgrading our software in the near future to create
20 100% palletized comailings. In addition, we are able to dropship almost 90% of the
21 total copies in the comailing, despite the variance in advertising percentages of the
22 different publications. Of the total dropshipped, about 80% is at the DSCF level,
23 with the balance going to the DADC.

24 I have included as Exhibit A to this testimony the actual results from one comail pool
25 produced in our Sussex, WI facility. I chose a comailing that contained about 2.7
26 million copies. It should help to illustrate the positive movement of mail to finer

1 levels of presort, the reduction in the overall number of packages, the shift from
2 sacks to pallets, and the opportunities for increased dropshipping that result from
3 this process.

4 Quad is now also comailing Periodicals to varying degrees in some of our printing
5 plants outside of Wisconsin. These comailings are in the early stages of
6 development and lack the volumes to achieve the remarkable results that are
7 illustrated in Exhibit A. However, we know that any improvement is better than
8 none, and that you have to start somewhere. So if we're not able to achieve high
9 levels of carrier route, we at least are able to move basic rate mail to 3 digit, and 3
10 digit mail to the 5 digit level.

11 Harry Quadracci founded and built our company on the "Ready, Fire, Aim" theory.
12 That is why we started comailing in Sussex, and why we continue to expand that
13 process to other production plants. If you build it, they will come. A rate structure
14 with the proper incentives, such as what is proposed in the Complaint filing, would
15 facilitate each and every one of our print facilities to look for new and/or additional
16 opportunities in comailing, copalletization, and dropshipping, and then make the
17 necessary capital investments to initiate and develop the processes.

18 Comailing is not limited to Periodicals. We are also comailing Standard Mail in all of
19 our printing plants. The concept and results are the same, but the production
20 process is different. Where our Periodicals comailings take place offline (not on a
21 binding line), Standard Mail is almost always comailed inline while the catalogs are
22 being bound. There are three main reasons for that: 1) most catalogs still require
23 inside inkjetting on an order form, which is costly to do offline; 2) catalogs do not
24 usually require as many pockets (feed stations) on a binding line, which allows for
25 more than one to be bound at the same time; and 3) Periodicals generally require

1 more pockets (feed stations) on a binding line, eliminating the opportunity to add
2 one or more publications to the process. Just as with postal sorting equipment, our
3 binding lines don't know the difference between Standard Mail and Periodicals, so
4 the cost to do these processes for any class of mail is basically the same.

5 We are also comailing in our Direct Mail operations, combining unwrapped/non-
6 enveloped catalogs with Direct Mail in envelopes. Again, the concept and results
7 mirror what happens in the other comail processes.

8 As mentioned, comailing does create opportunities for dropshipping. In Standard
9 Mail and Bound Printed Matter, we always anticipate that on average we will be
10 dropshipping 95-98% of the mail. Our Parcel Direct subsidiary handles Parcel
11 Select, which is a product that is 100% dropshipped. However, when planning
12 distribution around Periodicals there is always a mystery about what percentage of
13 the mail will be cost-effective to dropship. The average percent of Periodicals that
14 we produce that will dropship is about 80-85%. Why? The reason is simply because
15 of the variability of weight, distance, and the advertising percentage. Weight and
16 distance are both variables in determining what will dropship in Standard and Bound
17 Printed Matter, but the advertising percentage is not a factor. In general, heavier
18 weight publications with low advertising will not be able to dropship based purely on
19 the postage savings versus cost of transportation. The unzoned editorial rate is a
20 major impediment to dropshipping, and it needs to be changed to reflect the realities
21 of logistics in today's world. However, I also realize that consideration and a
22 balance must still be maintained for ESCI value of periodicals. I firmly believe that
23 that balance is reflected in the proposed rate structure in the Complaint filing.

24

1 Note: When referring to dropshipping at Quad/Graphics, the average percentages of
2 mail entered at the destination postal facilities would be consistent across all of our
3 printing locations.

4

5 **3. CHANGING LANDSCAPE AS A RESULT OF THE NEW RATE STRUCTURE**

6 How would the rate structure proposed by Time Warner et al. in this proceeding in
7 impact mailers behavior? To answer that question, let's first look back at other
8 proposed changes to rates and discounts. Dropship discounts for Standard mail
9 were first introduced in 1991. There is a cost for transportation planning, staging,
10 routing, and trucks. The necessary incentives were created in the discount
11 structure, and mailers began to provide their own transportation and enter mail at
12 designated postal facilities. Automation discounts became available for flats in
13 1992. There is a cost to mailers to create mailing lists and mailpieces that will
14 qualify for automation discounts. When the necessary incentives were created in
15 the discount structure, mailers began to barcode flats.

16 Since 1992, in each subsequent rate case the differential between 5-digit automated
17 mail and carrier route mail has increased, resulting in more incentives to comail.
18 Quad and a few others in the industry had taken advantage of the savings potential
19 by comailing prior to that time, but the process had not caught on as a standard
20 practice in the industry. The price point had not gotten to where it was cost-effective
21 for mailers of all different sizes. In the last few years we have seen a number of
22 additional companies (large and small) make the move to some form of comailing as
23 the potential savings (discount structure that creates the differential between presort
24 categories) has continued to increase and the availability of comailing technology
25 has become more economically justifiable.

1 So in general, when provided with the proper incentives, the mailing industry will
2 react by changing mailing preparation to be able to capture the discounts offered.

3 I firmly believe that in a cost-based rate structure where there are natural incentives
4 to create finer sorts, fewer packages and containers (with greater incentives placed
5 on pallets), and more dropshipments, we will see more printers and other mailers
6 making investments in technology, software, and processes designed to create the
7 lowest cost mail while creating the most efficient production process. The net result
8 will be the “lowest combined costs” for the preparer of the mail and the Postal
9 Service.

10 In order to improve presort, more companies will begin to utilize comailing in some
11 form. One of the by-products of comailing is a reduction in the total number of
12 packages. It also results in more mail moving to pallets instead of sacks, and then
13 provides an opportunity to dropship the mail where there was none when the
14 mailings were prepared individually. In other words, comailing equals copalletization
15 without the extra work.

16 Many in the industry worry that small or mid-size printers and publishers will be hurt
17 by a cost-based approach to rates. That may be true for some who are in unique
18 situations and are unable to change anything in their mail preparation or mailpiece
19 design without negatively impacting their business model. However, I think that in
20 most cases such expectations sell our industry short. Printers and publishers,
21 provided with the necessary incentives, will utilize equipment already available to
22 them and be creative enough to build processes that will allow them to take
23 advantage of a new rate structure while enhancing their business model. They will
24 also develop comailing to fit their needs, and may in fact redefine what we call
25 comailing.

1 I also believe that if there is an opportunity to make money by consolidating
2 periodicals, American ingenuity will prevail and a new business will be created. It
3 happened years ago when presort bureaus were born, and it happened again about
4 6 years ago when Parcel Select was created and parcel consolidators (including our
5 Quad/Graphics subsidiary Parcel Direct) were born.

6 Quad/Graphics does not have a corner on the market for ways to create efficient
7 mail while maintaining “lowest combined costs.” In fact, the comailing process also
8 challenges us. We have been maximizing the opportunities to reduce postage costs
9 by comailing, but now must also reduce the time of production to help our clients
10 improve the speed to market, or as we refer to it “reduce cycle time.”

11 Additionally, the proposed rate structure includes a change to zone the full weight of
12 the publication. That would provide the extra incentive for a number of publications
13 with low advertising content to be able to dropship (or zone skip). As previously
14 mentioned, the advertising percentage of a publication usually dictates today
15 whether or not dropshipping makes economic sense, whether the savings offset the
16 cost of transportation that must now be provided by the mailer instead of the Postal
17 Service. In most cases today, publications with low advertising will not see enough
18 savings to justify the cost.

19 The math is very simple. Today the discount only applies to the advertising pounds
20 of the publication. However, freight is being paid on the full weight of the
21 publication. That would be like shipping oranges and paying freight on the entire
22 weight, but only being able to discount the weight of the juice. From a pure
23 transportation standpoint, it doesn't make sense. The discounts, like the freight
24 rate, should apply to the entire product (in this case publication) that is on the truck.

1 So zoning the full weight of the publication is the correct approach if the goal is to
2 incent more dropshipping. It will help move more Periodicals from postal-supplied
3 transportation to private transportation. If that does not happen, I think we will
4 continue to see Periodicals costs rise. Why? Because today the majority of
5 Standard Mail, Bound Printed Matter, and Package Services (Parcel Select being
6 100% dropship) are already utilizing dropshipment, while Periodicals are lagging far
7 behind. At some point, if that doesn't change, Periodicals will find themselves
8 sharing postal transportation with no one else and having almost all of the cost of
9 that transportation attributed to them. The result would be higher rates.

10

11

SUMMARY

12 Without the proper rate signals, costs will continue to rise, which will make printed
13 products less competitive. Neither our industry nor the Postal Service can allow that
14 to happen. Cost-based rates are one significant tool in helping to keep printing and
15 mailing competitive.

16 I do believe that a change is needed in the rate structure, and it must be substantial.
17 The days of trying to incent behavior by adding pennies to a disjointed discount
18 structure, when dollars are needed for capital investments to realize the benefits,
19 are gone. In order for the mailing industry to make the capital investments needed to
20 substantially change the way Periodicals are produced and distributed, we need a
21 clear signal from the Postal Service through a new rate structure, – a rate structure
22 that is more aligned with real world pricing that we all use in our businesses, where
23 you pay for what you use. That rate structure is reflected in the proposal included
24 with the Time Warner et al. complaint filing.

1 The printing and mailing industry will invest in the technology and software needed
2 to produce more cost-efficient mail. Technology is readily available today from a
3 number of different companies, including the suppliers of polywrap equipment. Our
4 own subsidiary, Quad/Tech International, has sold comailers to other printers and
5 distribution companies in the past. Routing and sorting software systems are
6 commercially available from major software suppliers. The use of the Mail.Dat file
7 format for moving and sharing postal information between list services, printers,
8 distribution companies, and the Postal Service has been commonplace for years,
9 and is readily accepted as the industry standard. So the reality of the situation is that
10 we are in a plug-and-play environment, and all that is needed to move the industry
11 forward are the proper rate incentives.

12 A cost-based Periodicals rate structure will provide the incentive for Quad/Graphics
13 to continue to build on what we do best, and to make new investments in
14 technology, processes, and systems that will help us to do things in the production
15 and distribution of mail that we aren't even thinking about yet. That is the beauty of
16 creating the incentives that will create the opportunities that will facilitate the goal of
17 "lowest combined costs".

18

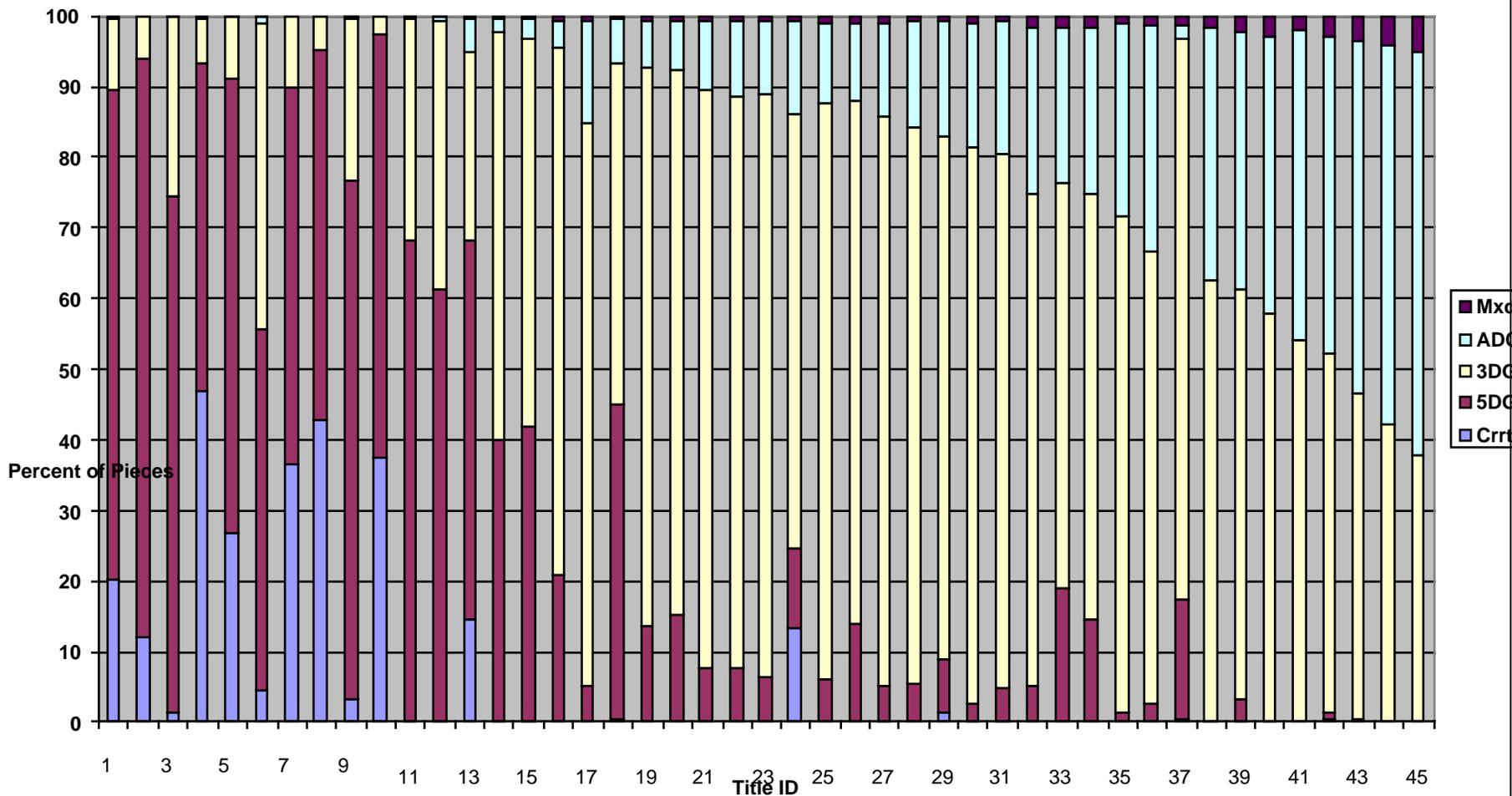
EXHIBIT A

Summary Of Containers With Singular And Combined Sorts					
		Singular Sorts		Combined Sort	
		Containers Created	Pieces on Containers	Containers Created	Pieces on Containers
Pallet Types	5DG CRRTS	13	6,562	167	154,287
	5DG	35	37,526	233	242,528
	SCF	1,036	1,461,575	978	2,194,411
	ADC	689	834,112	157	185,481
	Total Pallets	1,773	2,339,775	1,535	2,776,707
	Total Sacks	10,282	449,775	283	12,843

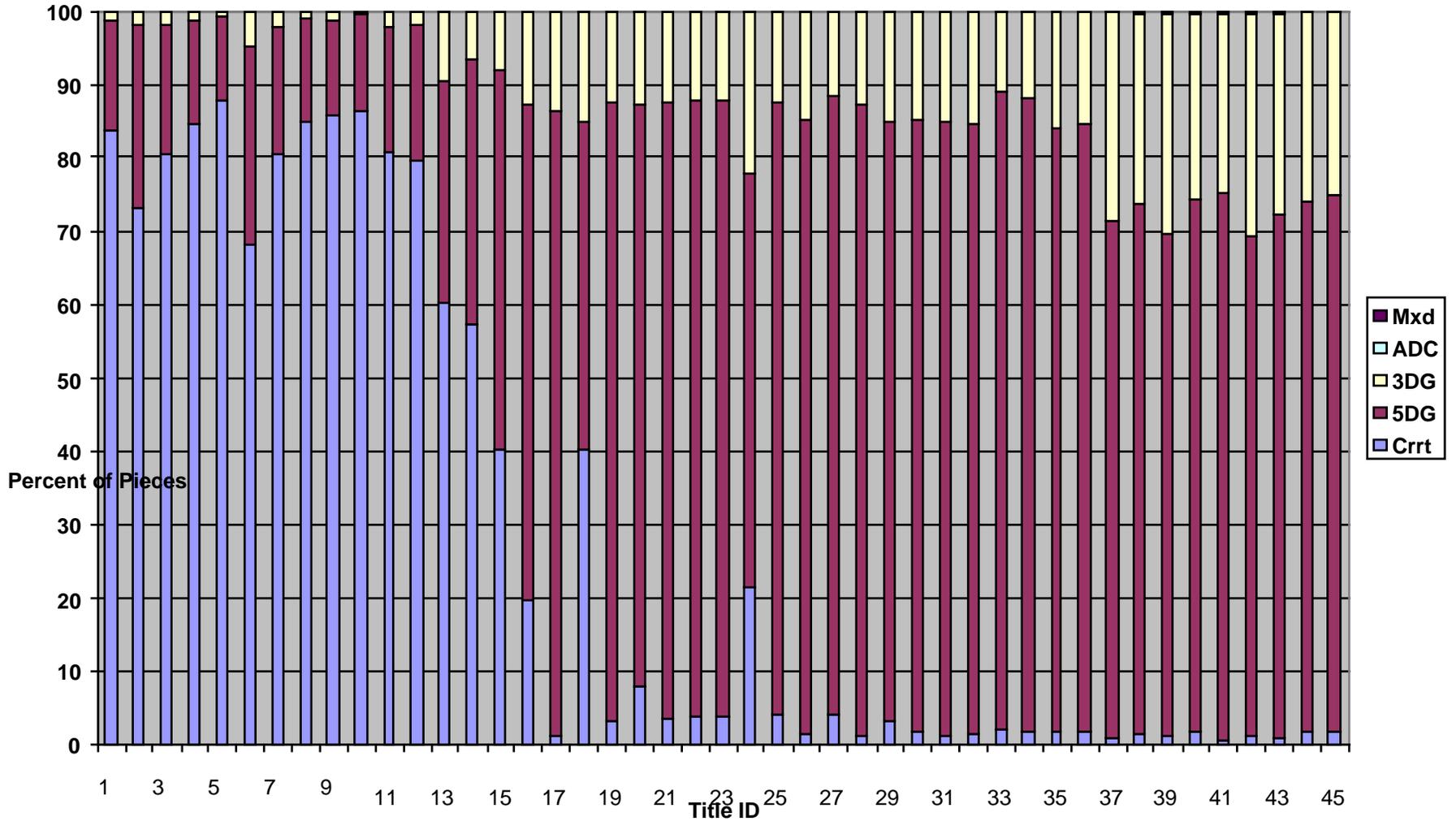
**Summary of Titles Used in Co-mail Analysis
(First 13 of 45 Titles)**

Title ID	Production Run Type	Postal Class	Rate Type	Processing Category	Mailed Pieces	Piece Weight by Version	Ad% by Version
1	Main Run	Periodical	Regular	Flat	571,558	0.7310	41.39
						0.7009	40.73
						0.7009	41.39
						0.3494	34.00
2	Main Run	Periodical	Regular	Flat	511,771	0.6560	46.53
3	Main Run	Periodical	Regular	Flat	288,024	0.5319	49.85
						0.4601	39.70
						0.4033	47.91
4	Main Run	Periodical	Non-Profit	Flat	266,824	1.2863	52.00
						1.2765	52.00
						1.2589	52.00
						1.2492	52.00
						1.2394	52.00
						0.6177	33.52
5	Main Run	Periodical	Non-Profit	Flat	185,140	0.2660	43.00
6	Main Run	Periodical	Regular	Flat	164,576	1.2472	52.00
						0.4073	47.91
						0.3671	34.00
						0.3641	43.78
						0.3604	43.78
7	Main Run	Periodical	Regular	Flat	113,926	1.2198	52.00
8	Supplemental	Periodical	Regular	Flat	103,613	1.2316	52.00
9	Main Run	Periodical	Regular	Flat	92,495	0.5887	35.00
10	Supplemental	Periodical	Regular	Flat	77,757	1.2668	52.00
11	Main Run	Periodical	Regular	Flat	72,045	0.4422	38.05
12	Main Run	Periodical	Regular	Flat	52,453	0.6433	52.43
13	Supplemental	Periodical	Regular	Flat	38,073	1.2687	52.00
						0.7323	42.03
						0.6890	56.25
						0.6650	59.14
						0.6550	58.24
						0.6192	35.00

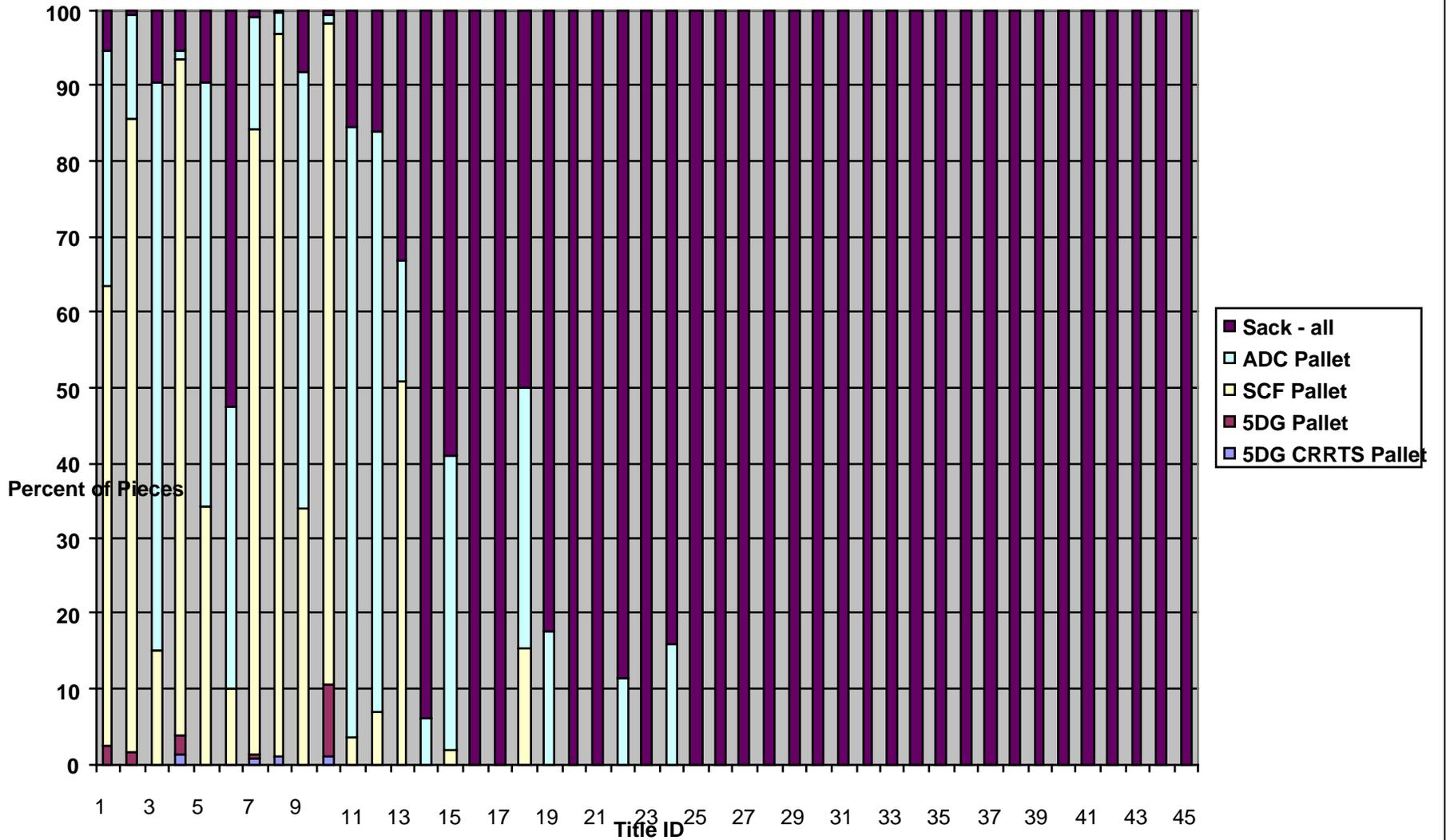
Percent of Pieces by Title by Presort Package
Singular Presort



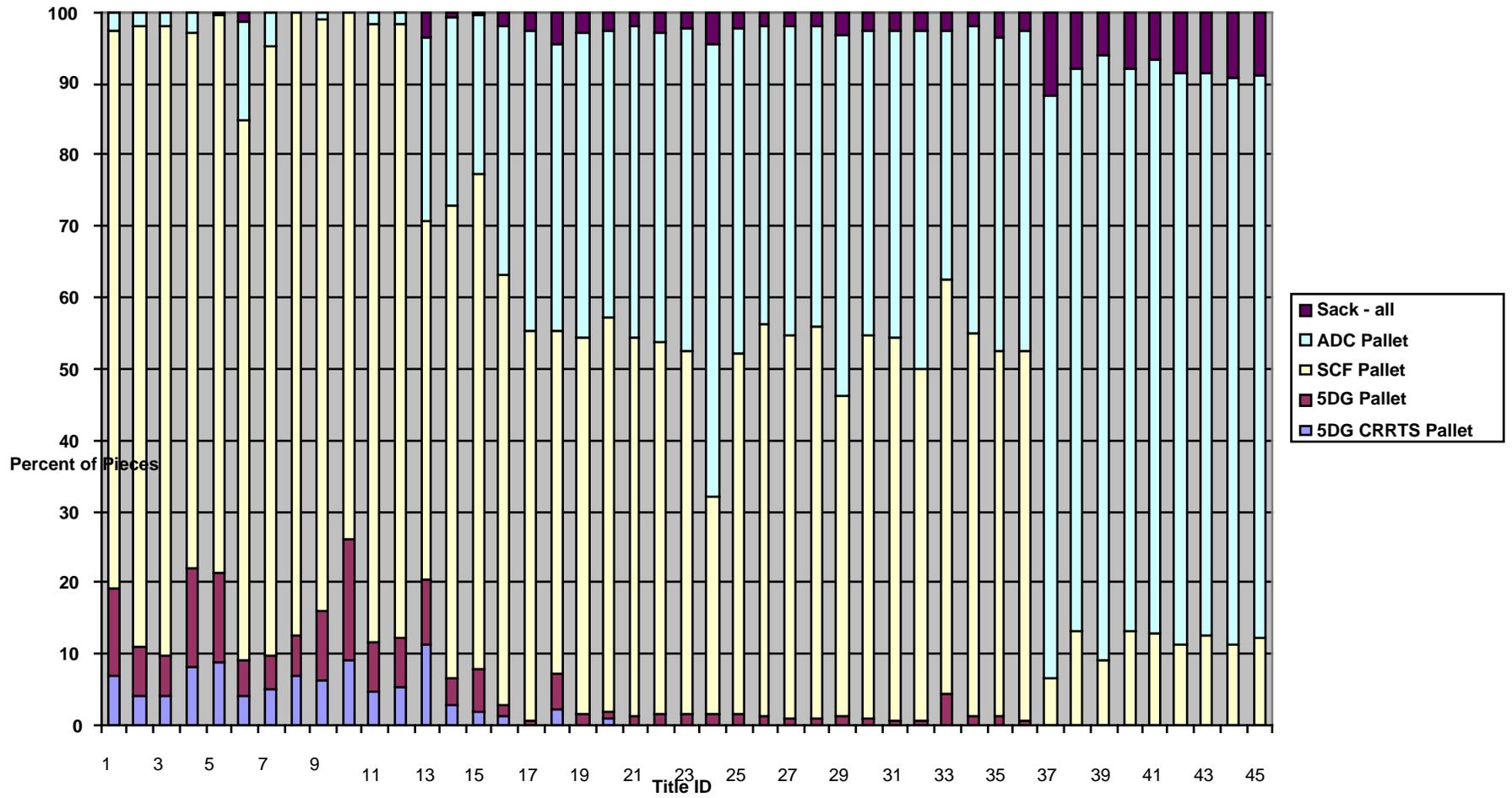
**Percent of Pieces by Title by Presort Package
Combined Presort**



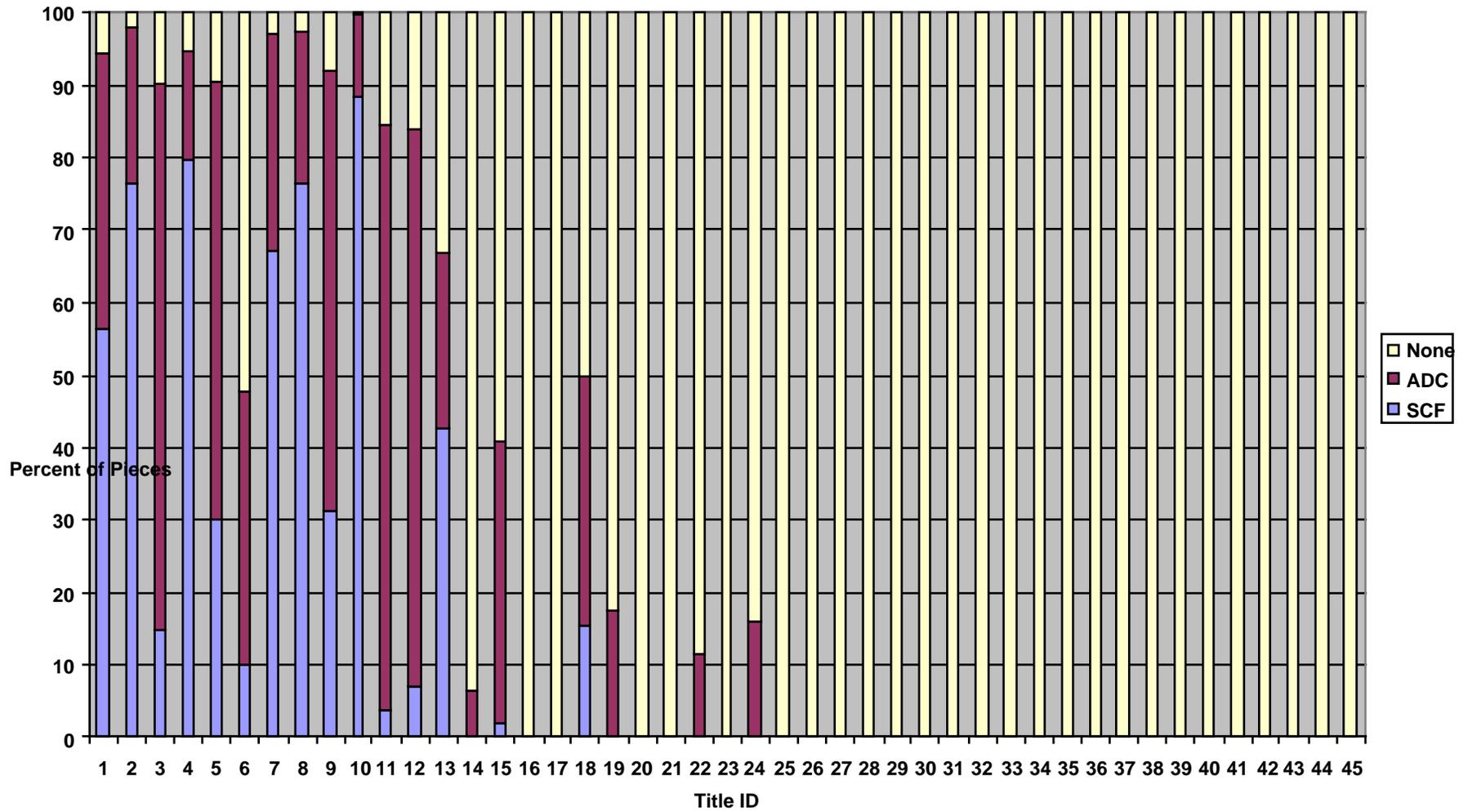
Singular Presort Containerzation



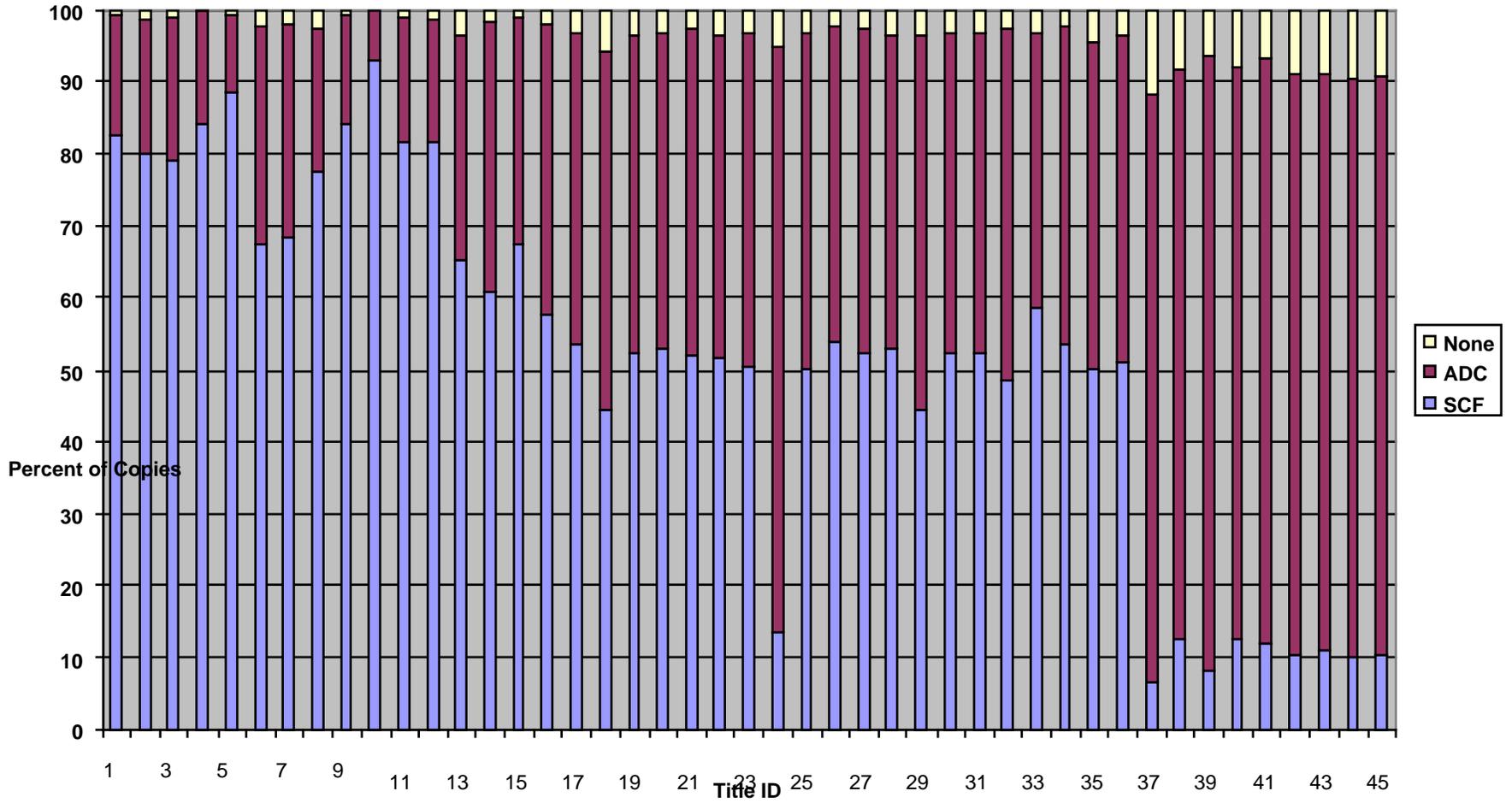
Combined Presort Containerization



Singular Presort Entry Point Discount



Combined Presort Entry Point Discount



CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with § 12 of the rules of practice.

s/ _____
Timothy L. Keegan

April 26, 2004
Washington, D.C.