

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

EXPERIMENTAL PERIODICALS
CO-PALLETIZATION DROPSHIP DISCOUNTS FOR
HIGH EDITORIAL PUBLICATIONS, 2004

Docket No. MC2004-1

RESPONSES OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES OF
TIME WARNER INC. (TW/USPS-T1-25-26)

The United States Postal Service hereby files the response of witness Altaf H.

Taufique to the following interrogatories of Time Warner Inc.:

TW/USPS-T1-25-26, filed on April 16, 2004.

Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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/s/ _____
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TW/USPS-T1-25. Please refer to your testimony's reference to "more fundamental change in the current rate structure" (p. 5, line 16) and to your answer to TW/USPS-T1-14, where you say in response to parts "c" and "d" respectively: "I am confident that the Postal Service will continue, in some form or another, to advocate providing *incentives for small publications* to combine their mail and enter it on pallets at an ADC or SCF" (emphasis supplied); and "I would expect that any future Postal Service proposals would be consistent with the objectives embodied in the current proposal, namely to make it *more likely that smaller mailers* would combine their mailings to achieve palletization and dropshipment." (emphasis supplied)

- a. Do these statements mean that you are confident that the incentives advocated for "small publications to combine their mail and enter it on pallets at an ADC or SCF" will be greater than any corresponding incentives for large publications to prepare pallets of similar postal cost incurrence and enter them at ADCs or SCFs? If not, please explain clearly what they do mean.
- b. When you say that "any future Postal Service proposals would be consistent with the objective[] . . . [of making] it more likely that small mailers would combine their mailings to achieve palletization and dropshipment," do you mean more likely with incentives than without incentives, or more likely than large mailers, or more likely than something else? Explain.
- c. Are you suggesting that small mailers should and will be singled out by applying some sort of arbitrary boundary (possibly focusing on their mailed circulation or their density) and given incentives beyond cost avoidances to prepare mail in ways specified by the Postal Service? If not, please explain what you do mean.
- d. Do you believe that it would be fair to give small mailers cost-based signals and then to allow them to choose what is best for them?
- e. This part focuses on the discounts proposed in Dockets No. MC2002-3 and MC2004-1. The references to cost savings are to cost differences and should not be interpreted as influenced by whether some mailers are already performing a specific worksharing activity.
 - (1) Do you agree that the savings behind the discounts proposed in MC2002-3 and MC2004-1 exist for considerable volumes of palletized and dropshipped mail that are *not* eligible for the discounts (i.e., both MC2002-3-type savings and MC2004-1-type savings would seem to exist for all pallets entered at a DSCF, though the discounts are available only to certain co-palletized entries, understanding of course that no mailer can claim both discounts)? Explain any disagreement.
 - (2) Leaving aside the question of whether any discrimination involved might be undue or unjustifiable, do you agree then that the discounts of MC2002-3 and MC2004-1 *discriminate* against these considerable volumes of palletized and dropshipped mail that

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do not qualify for the discounts? In this case discrimination means that the savings exist for both groups but only one group gets the discount. Explain any disagreement.

(3) Is this a kind of discrimination (in this case substantially between large and small mailers) that you would expect to see, in one form or another, in any future Periodicals rate proposals of the Postal Service? Explain.

f. As a reference point, consider the possibility of a cost-based rate structure in which the rates are based on mailings' costs through general recognition of containerization, presort, bundle makeup, and entry point, including associated interactions, with zoned pound rates applying to the publications' full weight. As one example of this kind of structure, see the proffered proposal of Time Warner et al. in Docket No. MC2004-1 [sic]. Within such a rate structure:

(1) Do you see any cost-based opportunity to exclude considerable volumes of palletized and dropshipped mail from a discount that would be available to certain co-palletized mailings? If you do, please explain.

(2) Do you see for "small publications" any cost-based opportunity for incentives that would *not* exist as well for large publications? Explain.

g. This part focuses on the discounts of Docket No. MC2002-3.

(1) For the additional rate reductions (or discounts) of MC2002-3, do you agree that the cost basis focuses on unrecognized (i.e., not given to the mailer through the zoned advertising pound rates) savings for publications of *average* editorial content and therefore that high-advertising publications (receiving the co-pallet discount and a substantial discount on advertising pounds) receive rate reductions that are larger than the actual savings (i.e., the savings on the actual weight, except for an effect due to the 95 percent passthrough) and that high-editorial publications (receiving the copallet discount and a minuscule discount on advertising pounds) receive rate reductions that are smaller than the actual savings? Explain any disagreement.

(2) Do you agree that the structure described in part 1 discriminates against high-editorial publications and in favor of high-advertising publications? In this case, discrimination means that the high-advertising publications receive a larger discount relative to cost avoidance than the high-editorial publications. Explain any disagreement.

(3) Does the pattern of discounts in MC2002-3, as described in part 1, represent a kind of advertising vs. editorial treatment that you would expect to see in any future Periodicals rate proposals from the Postal Service? Explain.

h. Consider a co-pallet (or regular pallet) entered at an origin office, in a high zone, average in terms of its weight and its number of pieces.

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(1) Do you agree that all of the savings behind the 1-cent pallet discount of Docket No. R2001-1 exist for this co-pallet (or regular pallet) but that this co-pallet (or regular pallet) does not receive the 1-cent discount? Explain any disagreement.

(2) On this basis, then, do you agree that this co-pallet (or regular pallet) is discriminated against in the current rate structure, whether unduly or not being a separate question? That is, the savings exist for both the dropshipped and the non-dropshipped pallet, but only the dropshipped pallet gets the discount. Explain any disagreement.

(3) Is this a kind of discrimination against non-dropshipped pallets that you would expect to be part of any future Periodicals rate proposal of the Postal Service? Explain.

i. Consider *sacks* that would normally be entered at an origin office but that are dropshipped instead to a DSCF and that receive both the 0.8-cent per-piece discount and the per-pound discount on advertising.

(1) Do you agree that all of the dropship savings (or avoidances) behind the discounts of MC2002-3 and MC2004-1 exist for these sacks but that they are not eligible for the discounts? Explain any disagreement.

(2) On the basis that the savings occur but the discounts *are not* given, while for the co-pallets of these two cases the savings occur and the discounts *are* given, do you agree that these sacks are discriminated against in the current and proposed rate structures, whether unduly or not being a separate question? Explain any disagreement.

j. Consider a mailer contemplating entering either sacks or co-pallets (or regular pallets) at an origin office, where the pieces on the pallets would receive the existing one-half-cent pallet discount.

(1) Do you agree that the one-half-cent discount is based on pallet savings occurring at the destination office and does not include any savings associated with handling pallets instead of sacks between the origin office and the destination office? Explain any disagreement.

(2) Do you agree that if the Postal Service, *ceteris paribus* (including the same postage, except for the one-half-cent discount), had a choice between handling the pallets and handling the sacks, in each case from the origin office to the destination office, it would prefer handling the pallets? Explain any disagreement.

(3) Do you agree that if the sacks were dropshipped instead of being entered at the origin office, the cost avoidance would be larger than that caused by dropshipping the pallets? Explain any disagreement.

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(4) Assuming the Postal Service to have a preference for handling pallets instead of sacks, as suggested in part 2, please explain the basis for offering special discounts for dropshipping the pallets, including as applicable (a) the discounts from MC2002-3 and MC2004-1 and (b) a decision to grant the otherwise-withheld one cent pallet discount (which is based on savings that occur whether or not the pallet is dropshipped), but not arranging any special discounts for dropshipping the sacks, when the savings for dropshipping the sacks is larger than the savings for dropshipping the pallets, as suggested in part 3. Note: it should be understood that both the sacked mail and the palletized mail would receive in equal amounts certain dropship discounts in the basic rate structure.

(5) Based on evidence of providing special discounts for pallets-but not-sacks to dropship, please explain an apparent Postal Service interest in biasing rates so that it has sacks-but-not-pallets on its trucks.

RESPONSE:

- a. My answer was formulated from the perspective and within the context of the current proceeding, where the Postal Service's principal objective is to establish incentives for smaller publishers to combine mail. I did not mean to suggest any conclusions about comparisons with larger mailers. These statements do not imply or mean that the future incentives for smaller publications would be greater than incentives for large publications.
- b. Please see my response to part (a) above. There would be incentives to encourage co-palletization is the gist of my statement. The only meaning that I am trying to convey in both statements referenced in your question is that we strive to provide consistent signals to smaller mailers. In this experimental docket, we are providing additional incentives for heavier, smaller, high-editorial publications, because we believe that otherwise this mail would not be palletized and dropshipped. There is no implication that these discounts would only apply to small mailers.
- c. No. Please see my responses to parts (a) and (b) above.

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- d. What might or might not be fair must be evaluated in a specific context. In the context of the Postal Service's proposal in this proceeding, I believe that giving mailers cost-based signals is one factor that makes rates fair.
- e. (1) The savings as expressed in this case are savings relative to the status quo. I agree that some mailers are already preparing their mail on pallets and dropshipping their mail. However, that is not the case for many small circulation, high editorial publications. This case is focused on changing their behavior, to create new cost savings.
- (2) The Postal Service's proposal discriminates only in the sense that any classification discriminates, or differentiates, among types of mail or service. The current proposal is not attempting to overhaul the entire Periodicals rate design and thus does not rectify all perceived injustices in rate design. The current proposal was, as I explained in my response to ABM/USPS-T1-41(a), developed out of discussions with one mailer, and therefore targets a limited type of mail. The bigger goal in this docket, as well as in Docket No. MC2002-3, was to test incentives to improve preparation and dropshipment that would ultimately reduce Periodicals costs. We believed then, as we do now, that these experiments have a broader goal that would help the Periodicals class. In its Recommended Decision in Docket No. MC2002-3, the Commission indicated its approval of this Postal Service goal:

The Service will collect data pursuant to an expanded data collection plan and file related periodic reports during the course of the experiment. Analysis of these data, along with review of anticipated data on two recently-implemented pallet-based Periodicals discounts, will assist not only in determining the effectiveness of this experiment, but in assessing broader efforts to

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curb costs and the appropriate direction for future Periodicals rate policy and design.

This experiment focuses on an especially challenging aspect of cost control. The Periodicals intervenors' unanimous support for it builds on a tradition of cooperation with the Postal Service in exploring cost reduction opportunities. The experiment's success in logistical terms will rely to an unprecedented degree on cooperation among Periodicals mailers, printers and consolidators throughout the planning, production and distribution process. The Commission acknowledges the joint efforts that have gone into developing this proposal and the continuing commitment to cooperation that will be required throughout the experiment.

PRC Op., Docket No. MC2002-3, at 1 - 2.

(3) As stated in my response to TW/USPS-T1-14 (c), I cannot predict the nature of specific future pricing proposals for Periodicals. But, I did not intend to imply that distinctions between large and small mailers would be the foundation of future pricing proposals for Periodicals.

f. I have not studied the issues raised by Docket No. C2004-1 in any depth, so I have no basis for answering your specific questions directly.

(1) As I have repeatedly stated, the Postal Service's proposal in this proceeding is focused on a limited objective with regard to the behavior of smaller publications. In general, for a purely cost-based rate design such as you have described, one would have to consider the relative volumes of different mailers, including smaller mailers who could not qualify for the lower priced options. I would also note that the pricing criteria of the Postal Reorganization Act are not limited to cost-based decision-making.

(2) I believe that the Postal Service's proposal in this proceeding is reasonable, because the proposed incentives can reduce Periodicals costs relative to the status quo. Once again, the Postal Service's objectives in its

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proposal are not invalidated because they focus on the behavior of small publications.

g. (1) I agree that in the example you provided, the rate reductions due to dropshipment for high-editorial publications are lower than the rate reductions for high-advertising publications. A key consideration this example fails to express is that the base postage for high-editorial publications is lower than the base postage for high-advertising publications, *ceteris paribus*.

(2) I agree that the current rate structure treats high editorial and high advertising publications differently both in the calculation of overall postage and in providing incentives for dropshipment.

(3) Please see my response to subpart (e)(3) above.

h. The savings referred to in your question were in lieu of the dropship rates for editorial pounds that were proposed by the Postal Service in Docket No. R2001-1 (see my response to Presiding Officer's Information Request (POIR) Number 10, Question 1, part b in Docket No. R2001-1). Therefore, the primary justification for these savings was dropshipment of this mail. In this POIR response I further supported this discount through cost savings at the destination plant when mail is on pallets rather than sacks.

(1) I disagree. The main justification for this discount was dropshipping, not palletization.

(2) I disagree. See my response to part (1) above.

(3) Please see my response to subpart e(3) above.

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i. Please see my response to interrogatory TW/USPS-T1-22 for the discussion of bundling palletization and dropshipment in both Docket No. MC2002-3 and the current docket. The idea behind our approach is very simple. One reason mailers are not able to dropship is that they do not have the density to make a pallet. If the Postal Service offers incentives to mailers to achieve the density by combining their mailing on pallets, dropshipping would become an easier choice. To ensure that this whole process would work, our eligibility requirements in both experiments require co-palletization and dropshipment. This requirement was especially important because the discounts were developed using transportation and to a degree non-transportation cost differences between the origin entry and destination ADC or SCF. The Docket No. MC2002-3 proposal was for a per-piece discount suitable for average advertising content publications. The special nature of high-editorial publications dictated the choice of discount structure in this docket.

(1) Yes.

(2) Yes. The goal was and is to move mail out of origin entered sacks onto destination entry pallets. Also, my understanding is that only a small portion of sacked mail is actually dropshipped. Most sacks are entered at the origin.

j. (1) Yes.

(2) Yes, in most cases. The goal in this docket as well as in Docket No. MC2002-3 is not only to get mail out of sacks, but also to get it dropshipped. The goal is to avoid sacks both in transit and at the destination.

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(3) Agreed. Currently our focus is twofold: palletization and dropshipment. See my response to part (i) above.

(4) (a) Please see my response to part (i) above.

(b) Please see my response to part (j) above.

(5) The Postal Service seeks to move mail out of origin-entered sacks onto destination-entered pallets. The Postal Service's proposals are not directed at keeping sacks on trucks. Please see my response to parts (i) and (j) above.

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TW/USPS-T1-26. Please see your response to ABM/USPS-T1-17, where you say:

“My reference to mail preparation in an ‘efficient fashion’ refers to mail preparation that lowers the costs imposed on the Postal Service, rather than the efficiency of the mailer’s operations.” See also your response to TW/USPS-T1-17, where you say: “The goal is to provide incentives for changing behavior that is costly both to the mailers and the Postal Service.” In addition, note part “d” of the same interrogatory that asked: “If under the efficient component pricing rule a mailer decides to purchase a high-cost service instead of a low-cost service, do you know of any basis for concluding that this is an undesirable outcome?”

a. Would you agree that the Postal Service offers mailers a broad range of services and that it costs the Postal Service more to provide some of the services than to provide others? Explain any disagreement.

b. Consider two services offered. Service A involves accepting, processing, and delivering mail that is tendered on *pallets*, and providing it costs the Postal Service 15 cents per piece. Service B involves accepting, processing, and delivering mail that is tendered in *sacks*, and providing it costs the Postal Service 20 cents per piece.

(1) Please explain whether it is your contention that, because the cost of Service A is lower, mailers wishing to purchase Service A are preparing their mail in an “efficient fashion” and mailers wishing to purchase Service B are preparing their mail in an inefficient fashion.

(2) Under the conditions assumed in this question, would the Postal Service have an interest in discouraging mailers from purchasing Service B, because the Postal Service’s costs of providing that service are higher?

(3) Can you think of any private firms that discourage customers from buying their higher-cost services, such as General Motors discouraging the purchase of automobiles that cost more, as might be the case for buyers wanting convertibles or extra features like traction control? If so, please discuss them as examples.

(4) If the purchasers of Service B are charged a rate that is based on the 20-cent cost, can you think of any reason for concluding that they are purchasing in an inefficient fashion or are doing something wrong, or that they should be discouraged from their purchasing?

(5) If the rates for Service A are based on the costs of Service A and the rates for Service B are based similarly on the costs of Service B, would it be your view that mailers should be permitted to choose freely which service they wish to purchase and that there is nothing wrong with purchasing Service B? Explain.

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(6) If the rates for Services A and B are based respectively on the costs of Services A and B, and the Postal Service breaks even, can you think of any reason why the Postal Service is better off with more of Service A and less of Service B? Explain.

(7) If the difference between Service A and Service B were that one is dropshipped and the other is not, or that one is presorted and the other is not, would your answers to any parts (accordingly adjusted) of this question change?

RESPONSE:

Before proceeding to answer these questions I would like to note that the proposal in this docket is not intended to overhaul the Periodicals pricing structure. Given the current rates and mailer behavior, this proposal seeks to bring about some additional changes in mailer behavior that would be beneficial for the mailers, including those who do not participate, and the Postal Service. There are longer term benefits for the Postal Service in removing sacks from its operating environment.

- a. Yes.
- b. (1) My contention is simply that given the current rate structure and mailer behavior, the Postal Service and Periodicals mailers would be better off if my proposal was implemented. This would allow high-editorial content, heavier weight, small-circulation publications an opportunity (such as the ones that Cadmus Communications and others can produce) to combine mail on pallets and dropship these pallets to a destination ADC or SCF. In the context of the current rate structure and mailer behavior, co-palletization and dropshipping are more efficient because they lower costs for the Postal Service, and therefore for Periodicals as a class.

(2) Yes. Given the context that I provided on page 2 of my testimony in Docket No. MC2002-3, I believe that the Postal Service has an interest in discouraging

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Service B and encouraging Service A. Here is part of the rationale for filing the first co-palletization case:

One of the key Periodicals issues in recent rate cases has been the need to control cost increases. The Postal Service employs worksharing incentives to encourage palletization and dropshipping, thus mitigating increases in processing costs. As of the base year in Docket No. R2001-1, about 69 percent of Periodicals mail was presented on pallets, and about 44 percent was dropshipped to destination facilities.

Even with worksharing incentives, Periodicals volume still includes a substantial amount of sacked, non-dropshipped mail. More importantly, this volume accounts for a disproportionate amount of Periodicals processing costs, primarily because the same amount of mail requires the handling of many more sacks than pallets.

Docket No. MC2002-3, USPS-T-1, at 2.

(3) My understanding is that, in general, private firms do not consider the ECSI value of the product that they provide, as the Postal Service does for Periodicals, and for other classes of mail. Moreover, they do not file rate or classification cases to change product offerings or prices. What I am suggesting is that this comparison with private firms is not appropriate. The Postal Service proposes price and classification changes in the context of its own almost unique circumstances.

(4) No. Once again I would note that our proposal promotes improved efficiency in the context of the existing Periodicals rate structure, with respect to co-palletization and dropshipment.

(5) Yes.

(6) In the context of the existing Periodicals rate structure and current customer behavior, I have provided a number of reasons why not just the Postal Service

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but also its Periodicals customers are better off with more of Service A and less of Service B. Please see my testimony, USPS-T-1, in Docket No. MC2002-3.

(7) Please see my response to subpart (6) above. Similar logic applies in all of these cases. Pricing and classification changes are not done in a vacuum. We usually start out with a rate structure in place.

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 section 12 of the Rules of Practice.

David H. Rubin

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