

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

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

Docket No. C2004-1

RESPONSES OF TIME WARNER INC. ET AL.
WITNESS HALSTEIN STRALBERG TO MH/TW ET AL.-T2-1-11
(June 22, 2004)

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. (collectively, Time Warner Inc. et al.) hereby provide the responses of witness Stralberg (TW et al.-T-2) to McGraw-Hill interrogatories MH/TW et al.-T2-1-11, filed June 8, 2004.

Each interrogatory is stated verbatim and followed by the response.

Respectfully submitted,

s/ _____
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**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
MCGRAW-HILL COMPANIES**

MH/TW et al.-T2-1. To the best of your ability, using R2001-1 test year (FY 2003) after rates volumes, please quantify the total number of sacks that contain only a single piece.

MH/TW et al.-T2-1. I do not know of any data that would permit such a quantification.

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MH/TW et al.-T2-2. With reference to your testimony at page 6, note 4, please state your understanding of why (a) a large-circulation mailer like Time Inc. and (b) a relatively small-circulation publication would mail sacks that each contained only one or just a few pieces, for service reasons or otherwise.

MH/TW et al.-T2-2. While there may be reasons I am not aware of, I believe the following may apply to both large and small mailers:

- (1) there appears to be a widespread perception that putting mail in sacks with a high level of presort will lead to faster delivery;
- (2) there are at present no rate consequences for using sacks in this manner;
and
- (3) mailers use fulfillment programs with a large number of optional parameters and may not have fully evaluated the impact of changing the values of these parameters.

Publications with large circulation tend to be produced in numerous versions, often with many versions going to the same carrier route. Depending on how the mailer's production is organized (e.g., whether he makes use of selective binding), he may or may not be able to produce all the versions for a given carrier route or ZIP code together, and so even a very large mailer could end up at some point in his production schedule with just a few copies going to one 5-digit or even 3-digit zone.

As to whether or not the perception that pieces put in a 5-digit sack and entered from a distant location will be delivered more reliably and faster than if they were in a 3-digit sack really is true, please see my answers to ABM/TW et al.-T2-6 and MH/TW et al.-T2-3, and witness Schick's answer to ABM/TW et al.-T4-6.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
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MH/TW et al.-T2-3. For a periodical that mails sacks that each contain only one or just a few pieces in order to achieve reasonable service levels, what are the actual and possible practical alternatives to such practice, in your view, that would enable the periodical to achieve reasonable service levels?

MH/TW et al.-T2-3. The question appears to assume that mailing sacks with just a few pieces in them really does achieve “reasonable service levels.” While it is unclear to me what you mean by “reasonable,” I tend to believe that this assumption may not hold true, at least not on a consistent basis.

To illustrate why I question the validity of this assumption, consider two weekly publications that each mail a bundle of six copies to the same 5-digit zip code. One puts the bundle in a separate 5-digit sack. The other puts the bundle in a 3-digit sack that also contains bundles for some other 5-digit zones. Both sacks are mailed, from zone 8, at the same time. It is my understanding that these sacks, barring any abnormal events, will travel together through the postal network until they get to the destinating SCF. They will probably both arrive at the SCF in a rolling container (hamper/APC) that remains on the platform until someone comes to sort the sacks. At that point the 3-digit sack will be identified as a “working” sack and taken inside the building to a bundle sorting operation, where bundles are dumped on a conveyor belt and sorted into 5-digit containers, which then are taken to the platform for dispatch to the DDU. The 5-digit sack will be placed in another 5-digit container and also taken to the platform area from which mail to the given DDU is dispatched.

If the given facility meets its service commitments and gives priority to weekly and daily publications, as facility managers say they do, then it is my understanding that the two bundles, one from a 5-digit and one from a 3-digit sack, should arrive at the DDU at the same time and have an equal probability of being delivered the following morning. There should under no circumstances be more than a one day difference in delivery time. Yet I happen to know, as recipient of several small weekly publications mailed from out of state, that delivery is less reliable than that; in fact, sometimes an issue for a

given week arrives later than the issue for the following week. Such large discrepancies cannot possibly be explained in terms of whether 5-digit or 3-digit sacks were used. Even placing the mail in ADC sacks should never cause delays of more than one day.¹

My conclusion is that when publications are mailed from a high zone one cannot assume reliable and fast service no matter what sacks are used. The best way, perhaps the only way, to guarantee “reasonable service” is, in my opinion, to bypass as many postal operations and transportation steps as possible and enter the mail as close as possible to its final destination. Some weekly publications have recognized this and are therefore airlifting their mail to locations around the country.

¹ In the scenario described above I have assumed that both 5-digit bundles would be subject to manual incoming secondary piece sorting at the DDU. If the SCF processes flats incoming secondary for the given ZIP code on an AFSM-100, it may bring both bundles first to a prepping operation and then sort the pieces on a machine. It is possible, however, that the bundle in the 5-digit sack would go directly to the DDU where the pieces would be sorted manually, presumably at a higher cost than if done on the machine at the SCF. Under that scenario, the cost consequences of using the 5-digit sack may be even higher than indicated in my testimony. I believe if all service commitments are adhered to the conclusions presented above will not change.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
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MH/TW et al.-T2-4. With reference to your testimony at pages 5-7, please compare the Postal Service's investments over time in facilities, equipment and/or processes designed to facilitate the handling of (a) pallets and (b) sacks, respectively.

MH/TW et al.-T2-4. I do not have the information needed to quantify Postal Service investments over time in pallet and sack handling. In general, however, I think one can say that many older postal facilities, including the BMC's, tended to be equipped with extensive conveyor belts, slides and chutes for moving sacks and parcels but were not laid out in a way that facilitated movement and cross-docking of pallets and rolling stock. Many older facilities were multistory buildings in downtown locations where pallets, hampers and other rolling containers could only be moved to the workroom floor through elevators, which tended to form bottlenecks.

For example, in Docket No. R87-1, when I first testified in support of a pallet discount, the Commission stated that "no witness on the record . . . finds that palletization does not save postal resources" but, on the basis of Postal Service witness Dowling's rebuttal testimony that many USPS facilities were not at that time properly equipped to accept pallets, declined to recommend a discount. See PRC Op. R87-1, March 4, 1988, ¶¶ 5420-21 (pp. 556-57) ("if Postal Service facilities cannot handle pallet volume, then the time may not be ripe for any pallet discount").

In more recent years the Postal Service has been gradually upgrading its facilities to enable the movement of pallets and rolling stock on and off trucks, across platforms and to and from the workroom floor. Newer facilities tend, for example, to place more of the processing on a single floor, reducing or eliminating the dependence on elevators. I don't think one can characterize these improvements as being only to facilitate pallet handling, since they also facilitate the movement of hampers, APC's and other rolling stock as well as postal paks. They have also facilitated the movement of sacks, which nowadays are loaded on and off trucks in rolling stock, in operations that are much faster than when sacks were bedloaded in trucks. Please see also my response to ABM/TW et al.-T2-30.

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MH/TW et al.-T2-5. Please explain whether it is likely or conceivable in your view that under the proposed rate structure, mailers may have incentives to (a) switch from 5-digit sacks to fewer and heavier 3-digit sacks, and/or (b) switch from pallets to heavy sacks, and if so, (c) please explain the likely effect on mail processing costs.

MH/TW et al.-T2-5.

a. Yes, it is possible that some mailers would switch from 5-digit sacks to fewer and heavier 3-digit sacks. Note, however, that while such a move would reduce a mailer's sack charges, his bundle charges would be higher.

b. This too is possible, if the mailer has been in the habit of entering low-weight pallets far from their destination. I think, however, that this type of switch is less likely to occur than the one described in part a.

c. Per definition, cost based rates mean that when a mailer chooses an option that reduces his postage bill he will also reduce the Postal Service's costs.

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MH/TW et al.-T2-6. With reference to your testimony at page 7, lines 11-14 that “mailers themselves will be able to figure out how far to go in producing pallets with finer presort, by weighing the higher price of using more smaller pallets against the lower bundle prices that result from finer pallet presort levels,” and your testimony at page 8, lines 9-10 regarding “letting mailers figure out how many bundles to make by pricing both bundles and pieces in accordance with actual costs,” please discuss the extent to which under the proposed rate structure, mailers of varying size and sophistication will be confronted with more complex decision-making among a myriad of options and tradeoffs that cannot readily be resolved.

MH/TW et al.-T2-6. I presume that small mailers will rely on their printers or other agents to select the most favorable mail preparation and entry options and to modify their own operations in response to the challenges and opportunities presented by the new rate structure. Larger mailers might be more likely to rely on staff within their own organization.

I believe almost all mailers today rely on some kind of fulfillment software to determine precisely how the mail is going to be prepared. Without such software, preparing mail in a way that meets all the very complex postal regulations, even for relatively small mailings, might be a near impossible task. The developers of such software are the ones who will be challenged to make optimal use of the new and more cost based rate structure.¹

¹ I realize that there may be very small mailers who perform all their fulfillment and mail preparation functions manually. But already under current rates, such a mailer would need to determine, for example, whether he has six or more pieces to each given 5-digit zone, then after that whether there are as much as six left over pieces in a given 3-digit zone, then he needs to count the bundles he has to each zone in order to determine whether he is required to make up a sack to a given 3-digit , SCF, ADC, etc. I don't believe the proposed rates would make things more difficult than they already are for such a mailer.

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MH/TW et al.-T2-7. Having reference, by way of example, to your testimony at pages ii-iii, page 9 lines 6-20, and page 30 lines 18-25, please discuss the potential problems of basing de-averaged rates on costs that are ill-defined.

MH/TW et al.-T2-7. Perhaps you mean costs that are not known with perfect precision, rather than costs that are ill-defined. My testimony in the locations you refer to doesn't call any costs "ill-defined" but explains why some of the productivity rates and other data used may not be 100% accurate. It also points out inconsistencies in assumptions used in the past by different postal witnesses.

This is nothing new. Postal Service witnesses in rate and classification cases often do not bother to explain, unless explicitly asked, the origin of many of the data they use or the fact that some of the productivity rates used in their models may originate in industrial engineering estimates developed 30 years ago, or earlier. I thought it was better to be as explicit as possible about the inconsistencies in postal data that I had to rely on. These facts do present challenges to developers of future mail flow and cost analysis models. Of course, only the Postal Service has the ability to collect new and more accurate data on its own operations.

In explaining why some of my sack handling productivity rates may understate the true costs of sack handling (because the industrial engineering standards they are based on tend to be optimistic), while some of the pallet related productivity rates may overstate the true costs (e.g., cross-docking costs), I am simply pointing out that the resulting sack charges presented by witness Mitchell still may not reflect the full costs of sack handling, while the proposed pallet charges could be too high. Since the proposed rates nevertheless tend to be viewed more favorably by mailers who mostly use pallets than by those who mostly use sacks, one could perhaps argue that such shortcomings in the data used serve to mitigate, to some extent, the impact of switching to fully cost based rates.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
MCGRAW-HILL COMPANIES**

MH/TW et al.-T2-8. With reference to your testimony at page 39, line 28 through page 40, (a) please discuss generally the potential problems of maintaining cost-based de-averaged rates when “[p]rocessing methods and mailer practices are changing continually;” (b) please discuss the extent to which the unit costs of Postal Service transportation, and its unit costs of handling sacks, can be expected to increase assuming that mailers engage in increased dropshipping and reduce their use of sacks; and (c) please discuss how frequently in your view a rate structure similar to that proposed here would require updating in order to “be a suitable and accurate tool for the determination of unit costs and the development of truly cost based Periodicals rates.”

MH/TW et al.-T2-8.

a. The Postal Service’s processing methods and mailer practices have been changing continually since at least 1970. Such changes present an ongoing challenge to update the rates to reflect new realities, but the inevitability of change should not be used as an excuse to fail to update an already severely outdated rate structure. The fact that the Postal Service was planning to automate letter mail processing (I remember viewing an experimental OCR letter sorter and an automated carrier sequencer in Cincinnati in 1973) could have been used in the 1970s and 80’s as an excuse to postpone indefinitely the offering of presort discounts. Fortunately, presort discounts were introduced, leading to major new mail categories such as First Class presort and Standard ECR, and a whole new industry engaged in the use and preparation of such mail.

The fact is that many things are not likely to change. One thing that will not change is that each time the Postal Service touches a sack, a pallet or a bundle it incurs costs. The rate structure will be improved if that fact is recognized in the rates. Another thing that has become quite clear in recent years and is not likely to change is that private industry is capable of transporting mail at much lower costs than the Postal Service can do. This too should be fully recognized in the rate structure.

b. The question of whether attributed unit costs of a postal operation such as transportation or sack handling will increase when volume declines can be restated as a question of whether or not the attributed costs are the true marginal or volume variable

costs. If the costs attributed to Periodicals are equal to the marginal costs, then removing some Periodicals from the system will not change the unit costs for the volume that remains. It is true that a postal operation may have some fixed costs in addition to the marginal costs, and your question appears to express a concern that the fixed costs would be supported by fewer Periodicals. However, fixed costs are considered institutional costs, and Periodicals pay only a very small proportion of institutional costs. It is true that when volume declines dramatically the marginal costs might increase for the volume that remains. However, most postal operations used by Periodicals are shared with other mail classes so that even a dramatic drop in Periodicals volume should not cause a major change in overall volume or in marginal costs.

For operations whose costs are fully volume variable, there are no fixed costs and the departure of some volume should have no effect on the unit costs for the volume that remains.

Taking transportation as an example, the Postal Service purchases many different modes of transportation in order to move Periodicals between postal facilities. The table below shows, for FY2001, the major modes used by Periodicals, the costs attributed to Periodicals, the portion of total attributed costs that was attributed to Periodicals, and the volume variability for each transportation mode. As can be seen, the Periodicals class is a relatively small user of most transportation modes. For example, it uses 8.67% of the Inter-SCF highway, 8.53% of Intra-BMC highway and 14.27% of Inter-BMC highway transportation. Even if almost all Periodicals were to disappear from those types of transportation, there would be little impact on the remaining volume. Note also that each of these transportation modes has a high volume variability and, as pointed out above, the Periodicals class is little affected by the remaining fixed costs.¹

¹ Highway transportation is performed under contracts which take time to renegotiate, so it may take the Postal Service some time to realize the full savings from reduced volumes. Nevertheless, in recent rate cases the Postal Service and the Commission have agreed that these transportation modes have a high long run volume variability.

There are, however, three transportation modes of which the Periodicals class is the dominant user. One is AMTRAK. In FY2001 Periodicals used about \$57 million in AMTRAK costs. But these costs are 100% volume variable. The Postal Service pays AMTRAK per cubic foot used, and if it uses less it pays proportionately less. In other words, those costs will really disappear if mailers dropship more. AMTRAK may lose revenue, but the costs to the Periodicals that continue using it should not change.

The other transportation modes where Periodicals is the major user are highway and rail plant loads, whose costs are respectively 90% and 99% volume variable. Plant loads are arranged on a case by case basis when there is a large volume that can be taken directly from a plant to a downstream postal facility. But such volumes could then just as well be taken by a printer or consolidator, who in all likelihood would do it for less. Again, there is no need for concern that disappearance of Periodicals from these transportation modes would cause hardship to remaining non-dropshipped Periodicals.²

Major Postal Transportation Modes Used By Periodicals				
		Periodicals Cost (\$1,000's)	Periodicals % of Total	Volume Variability
Air		21,235	1.33%	87.21%
Highway	Intra-SCF	64,669	10.79%	63.29%
	Inter-SCF	47,537	8.67%	90.27%
	Intra-BMC	23,948	8.53%	98.42%
	Inter-BMC	41,900	14.27%	97.97%
	Plant Load	19,800	49.65%	89.80%
Rail	AMTRAK	56,851	78.40%	100.00%
	Freight Rail	10,459	18.21%	100.00%
	Plant Load	6,780	69.90%	99.03%

Regarding sack sorting and other sack handling operations, there may be some disagreement over how volume variable those costs are. I do not know the answer to that question. However, the Periodicals class is not a dominant user of the Postal

² Prior to 1991, the Periodicals class was a small user of plant loading compared with third and fourth class (Standard and parcel services.) But with the introduction of stronger dropship incentives for those mail classes, starting with the R90-1 rate case, they have been using fewer and fewer plant loads arranged by the Postal Service, leaving Periodicals behind as the predominant user of plant loads.

Service's sack sorter machinery and does not support, to any significant degree, the fixed costs associated with sack handling.

c. I do not think it is possible to achieve a rate structure that is perfect at all times. Such a pursuit may be a fool's errand because, for one thing, the data on which rates are based will never be perfect. If a reasonably cost based rate structure of the kind proposed in this case were in place, it would not be necessary to modify it more often than rates normally are modified now. It would, however, be a mistake to continue to live with a structure as imperfect as the one that now exists just because a perfect structure is unattainable.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
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MH/TW et al.-T2-9. With reference to your testimony at page 10 note 8 that “[t]hese categories were present also in the Postal Service’s R2000-1 and R2001-1 mail flow models” but that “in both cases the USPS witness combined the more detailed set of categories into the much more limited number representing current presort/automation rate levels”, please set forth your understanding of why the Postal Service adopted that approach rather than the approach advocated by you in this case.

MH/TW et al.-T2-9. I cannot speak for the Postal Service. I do not always understand why it takes the positions that it does. However, I believe many people in the Postal Service realize the need for the types of rate reform being proposed in this case.

It obviously was easier for the Postal Service, whose main objective after all was higher overall rates, to propose rates based on the same presort/automation categories that already had been established in the past. In R2001-1 the Postal Service did propose other changes in the Periodicals rate structure that it evidently believed more important, or perhaps just less controversial.

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MH/TW et al.-T2-10. Referring to your testimony at page 10 note 7, please explain whether the described rate differential could just as well be characterized as an inappropriate penalty for the non-barcoded piece.

MH/TW et al.-T2-10. I think such a characterization would be misleading. The anomalous situation described in that part of my testimony is that an effective discount that far exceeds the benefits of barcoding is being extended to a relatively small number of mail pieces. The cost of this largesse is borne by the whole subclass, whose overall rate level would be lower if the barcode discount to those mail pieces were limited to the actual benefits of barcoding.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
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MH/TW et al.-T2-11. Referring to your testimony at page 32 lines 16-22, (a) please confirm that the estimated costs for a 5-digit pallet entered at the OAO reflect an average of costs for such pallets that are entered close to destination (e.g., in the DSCF or DADC service area) and costs for such pallets that are entered further from destination, or explain if you are unable to confirm, and (b) please confirm that under the proposed rate structure 5-digit pallets entered at an OAO close to destination would be subsidizing 5-digit pallets entered at an OAO further from destination, or explain if you are unable to confirm.

MH/TW et al.-T2-11.

a. Confirmed.

b. Yes, you could put it that way. The pallet entered nearby would pay lower pound charges, but the pallet charge would be the same as for the pallet entered in a far-away location, even though the latter probably would incur more pallet handling costs. The proposed rates are still not 100% disaggregated, which I think would be an unattainable goal, but they go a long way without introducing excessive complexity.