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

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

Docket No. C2004-1

SURREBUTTAL TESTIMONY OF
JAMES O'BRIEN
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.

November 8, 2004

AUTOBIOGRAPHICAL SKETCH

My name is James O'Brien. I am the Vice President of Distribution & Postal Affairs for Time Incorporated, a division of Time Warner Inc. I am the former Chairman of the Magazine Publishers of America (MPA) Postal Committee and former Chairman of the Association for Postal Commerce (Postcom). I currently serve on the board of directors of Postcom and the Mailers Council. I am a member of the Periodicals Operations Advisory Committee (POAC), MPA Postal Committee, MPA Government Affairs Committee and the Mailing Industry Task Force. In 2004 I testified before the President's Commission on the United States Postal Service. I was a member of the Periodicals Operations Review Team that focused on the cause of rapidly rising Periodicals class costs in 1998. As a result of my work on the Review Team, I was a witness before the Postal Rate Commission in the Docket No. R2000-1 proceeding. I was the CEO of Publishers Express, an alternative delivery company that competed with the Postal Service. I have been employed by Time Incorporated for the past 26 years in a variety of positions related to the manufacturing and distribution of magazines. Prior to joining Time Incorporated, I worked for four years in the Production Department of U.S. News & World Report. I also worked at R.R. Donnelley & Sons Company in the pressrooms and binderies while in college.

My educational background includes a Bachelor of Science degree from the University of Illinois, and I am a graduate of the Program for Management Development at the Harvard Business School.

I. PURPOSE OF TESTIMONY

The purpose of my testimony is to rebut the testimony presented by American Business Media, McGraw Hill, and the National Newspaper Association by reviewing the genesis and purpose of this complaint proceeding and by providing the Commission with examples of opportunities for changes in mailer behavior that these parties claim do not exist. These examples will show that:

1. Mailers are far more capable of changing their mailing practices than they would have the Commission believe.

2. There has been and still is more than adequate time to change mailing behavior prior to a 2006 rate increase.

3. The printing industry is actively developing the capability to help smaller publishers to improve their mailing practices, and more change can be expected if the proposed rate structure is recommended.

4. Witness Cavnar has presented a misleading view of the publishing industry.

II. BASIS AND GENESIS OF THE TIME WARNER INC. ET AL. COMPLAINT

The five complainants initiated this proceeding in order to propose "fundamental reform of the Periodicals rate structure to achieve greater conformity with the ratemaking provisions of the Act."[1] We pointed out that the Postal Service "has long believed that changes in rate design are also needed in order to address the inefficiencies of the Periodicals class," that 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," and that the Commission "possess[es] the authority to remedy deficiencies in the Periodicals rate structure that prevent mailers from taking

[1] Complaint of Time Warner Inc. Et Al. Concerning Periodicals Rates, filed January 12, 2004 ("Complaint"), at 4.

steps to help themselves, steps that would reduce the costs and increase the efficiency of the Periodicals subclass overall." Id. at 5.

In particular, we identified a lack of congruity between the elements of the Periodicals rate structure and the actual cost-causing characteristics of Periodicals mail that has become increasingly troubling, and increasingly well understood, during nearly three decades of study and analysis since it was first identified.[2] We asserted:

> 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. . . . 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.

Complaint at 6.

We stated our intention 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." Id. More particularly, we alleged that "there exists a widespread practice among Periodicals mailers, large and small, of sending 'skin sacks' containing only one or two pieces" and that "such sacks would become rare if their rates reflected the associated cost incurrence." Id. at 7.

The genesis of the decision to take the extraordinary measure of filing a complaint with the Commission is to be found in a history that is by now generally

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[2] See, e.g., PRC Op. R77-1 (May 12, 1978) at 349 ("As we have noted in prior rate decisions . . . the poundage rates for regular rate matter as a whole cannot reflect actual cost differences as long as the editorial rate remains flat. The Service and OOC correctly observe that the uniform editorial rate perpetuates an internal subsidy: editorial matter mailed a short distance is charged more than its true costs, and matter sent to the distant zones receives a 'free ride'").

well known. Although, as previously noted, dissatisfaction with the second-class rate structure's failure to reflect costs dates back to the earliest Commission proceedings, the distinctive "Periodicals cost problem" that has generated a growing sense of urgency (and a subclass cost coverage approaching zero) first came to light in Docket No. R90-1. In that case, as recounted in the Complaint (at 14), "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." The industry, the Postal Service and the Commission all devoted extensive attention to the problem, but Periodicals costs nevertheless continued to increase in excess of the CPI and Postal Service wage inflation.

Thus, in Docket No. R97-1, the magazine publishing industry joined together "in order to focus on a single overriding issue that has an immense, continuing adverse effect on all of us" and presented the Commission with a plea for attention to the unresolved problem of Periodicals costs.[3] The rates recommended by the Commission lowered the Periodicals class markup to 101 percent, the lowest level allowable under the Act.

Immediately after the issuance of the Docket No. R97-1 decision, American Business Press (Now American Business Media), the Magazine Publishers of America, and the United States Postal Service sponsored a joint industry/USPS Periodicals Operations Review Team to "identify the causes of the rapid rise in

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[3] See Docket No. R97-1, Trial Brief of 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. (February 10, 1998), at 4.

Periodicals costs over the past decade, identify opportunities to drive costs from the postal system, and make recommendations for industry and the Postal Service to capture these opportunities." [Report of the Periodicals Operations Review Team, March 1999, Executive Summary] The primary data gathering effort of the Team, of which I was a member, was a series of visits to postal facilities in the fall of 1998. During these visits, it became quite clear to me and the other members of the Team that in many instances the rates charged to Periodicals class mailers bore little relation to the costs incurred by the Postal Service to process and deliver the mail.

The Report of the Periodicals Operations Review Team, issued in March of 1999, identified fifteen issues that needed to be addressed. One of these was as follows; "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 Report explained:

> It is possible that the current Periodicals rate structure, which is generally package-based, may encourage the use of less finely presorted pallets and sacks than if the rate structure were container based. **. . .** As the further studies called for in these recommendations are implemented, the implications for rates should be examined.

The Report also contained the following action item: "Consider matrix approach to rates to account for all cost causing characteristics."[4]

Clearly, this team saw, almost six years ago, the potential benefits of a cost-based rate structure. In December of 1998, I created an initial draft of a cost-based rate grid with the assistance of Halstein Stralberg. This grid was shared with Postal Service representatives, who acknowledged the anomalies in the current rate structure and expressed interest in the concept. Since that time, I have continued to advocate a more cost-based rate structure. As word spread of the rate grid and the concept of cost-based rates, the idea began to gain support in the mailing

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[4] Report of the Periodicals Operations Review Team (March 1999) at 39.

community and became one of the focal points for the Postal Service's Product Redesign effort. Unfortunately, the Postal Service never filed its long awaited Product Redesign case and the burden of advancing the cause of cost-based rates fell to the mailing community.

The Complainants appreciate the Commission's willingness to provide a forum for the consideration of Periodicals class costs and rates. We hope that the testimony we have presented in our direct case, my rebuttal testimony and that of Halstein Stralberg, and the legal and policy arguments that we will be raising in further pleadings will indeed result in the most complete and balanced record possible for analyzing the issues we have raised, which are of fundamental importance to all Periodicals class mailers.

ABM, McGraw-Hill and NNA, parties that expressed opposition to the granting of a hearing in this case, are also opposed, not surprisingly, to the relief that we have requested. They have raised three arguments: (1) that some Periodicals mailers, "due to their size, their business models or other factors" (McGarvy at 13), will be unable to change their mailing practices in response to the incentives of a reformed rate structure; (2) that "countless" such publications will suffer severe financial harm if the proposed changes are implemented (id.); and (3) that the proposed elimination of the unzoned editorial rate "would undermine maintenance of a broad, vibrant and diverse Periodicals class" (Schaefer at 6-7), presumably by driving some of the aforementioned "countless" small publications out of business.

Remarkably, the witnesses testifying for these parties have not demonstrated that a single publication, either of their own or among the "countless small and under-represented publications" that they claim (on what basis they do not say) to represent, and whose identities they are unable to specify, would suffer the consequences they predict. They do not identify a single publication that would

disappear, or a single subscriber who would be cut off, if the proposed changes were implemented. All they are able to offer in support of their contentions are anecdotes, bald assertions, and pleas for sympathy.

In the absence of a rate structure that requires mailers to bear the costs that they impose on the system, it is understandable that mailers who benefit from the current system of cost averaging and inefficient mail preparation will continue to cling to it. Beneficiaries of the status quo always claim that very little change is possible. We continue to believe, however, that if presented with a rate structure that provides clear, accurate pricing signals, publishers, printers, fulfillment houses, and logistics companies will find that there are ways for them to create more efficient mail and help to control Periodicals class costs. My rebuttal testimony and Mr. Stralberg's, moreover, provide extensive examples demonstrating that this is so.

I am confident that when it examines the record in this proceeding, the Commission will find that our opponents have failed to substantiate their claims about what is *not* possible and that we *have* substantiated our claims about what *is* possible through a thorough, comprehensive presentation of specific facts and solid analysis.

III. OPPORTUNITIES FOR CHANGES IN MAILER BEHAVIOR

1. Mailers are far more capable of changing their mailing practices than they would have the Commission believe

Prior to printing any magazines, publishers prepare their subscriber files to meet the Postal Service's rules and regulations for presort. To accomplish this preparation, publishers generally use outside sources, such as fulfillment houses or printers, or commercially available software, such as that produced by Group One software, a division of Pitney Bowes. But the smallest publications may rely on manual sorting by individuals. Whether using a large fulfillment house such as CDS or sorting magazines on a kitchen table, everyone needs to make some decisions prior to the sort. One of the most basic decisions is the minimum number of copies to allow in a sack. A very low minimum will generate more sacks than a higher minimum. For fulfillment houses and software vendors, changing this minimum is a straightforward process that involves entering a new parameter into the presort program. This can be as simple as changing a number in the presort parameter field from six to 24 pieces per sack. I have actually performed this change for *Cottage Living* magazine, and it took me a total of 21 seconds. The system that was used in making this parameter change was based on Group One software and it is available to the general public. I have also verified with other fulfillment houses and software manufacturers that changing the package parameter is an easy change. A person doing a manual sort on his kitchen table would take even less time to make this change because he need only say to himself that he will not make any sacks with fewer than 24 copies. Certainly, a change that takes 21 seconds or less cannot be a burden to the industry. Witness Stralberg will provide evidence on the significant benefits that smaller publishers can achieve by making this simple change.

Mailers also need to analyze their mail preparation to determine if operational or business changes need to be made. A good example of this is an effort that Time Incorporated is currently pursuing with *Time for Kids* in anticipation of more cost-based rates. Today, *Time for Kids* mails firm bundles of magazines to individual classrooms throughout the United States. Each bundle contains a magazine for every student in the class and a teacher's guide. Under the current rate structure, these copies pay the firm bundle rate, which means the rate charged for each bundle represents one piece of Periodicals Class mail. These bundles are processed by the Postal Service on Small Parcel and Bundle Sorters or sack sorters and travel through the entire Postal system intact. The bundles are delivered unbroken to the school and distributed unbroken to individual classrooms within the school.

What does not appear to make sense under the current rate structure is the fact that *Time for Kids* pays a piece rate for mail that clearly is processed as a bundle. The *Time for Kids* bundles are never processed on an AFSM 100 or piece sorting operation, yet they are priced as if they were single pieces.

Under the proposed rates, the postage bill of *Time for Kids* is projected to increase by 27%. Tr. 1/116. This increase is the result of the fact that the proposed rates reflect the cost of firm bundles being processed as bundles rather than pieces. I recently met with the Publisher, Editor, and Consumer Marketing Director of *Time for Kids* to discuss the situation and to brainstorm ideas on how we could reduce the impact of the proposed rates**.** When presented with the facts, the *Time for Kids* staff immediately began to develop suggestions for changing their mailing behavior. They determined that one of the primary factors driving the increase for *Time for Kids* is the fact that they presently ship individual bundles to approximately 150,000 classrooms, which are delivered to only 36,000 schools. They quickly determined that if they could find a way to ship a single bundle to each school, they would be

able to reduce their bundles by 114,000 each week throughout the school year. As a result, the Postal Service would be required to process 2,964,000 fewer bundles during the 26 weeks of the school year.[5] In addition, under the proposed rates, the bundles that the Postal Service processes would pay a rate that more accurately reflects the true cost of mail processing rather than the unrealistically low firm bundle rate.

As a result of our discussion, *Time for Kids* is now exploring ways to modify its postal sortation and binding to accommodate one bundle per school. If the proposed rate structure is approved by the Commission, *Time for Kids* will definitely change its preparation. In addition, because this issue was brought to its attention well in advance of 2006, it will have ample time to test its ideas prior to making any changes. This would not have taken place in the absence of the complaint case**.** *Time for Kids* enjoys an unrealistically low rate under the current rate structure and has no reason to change its mailing behavior unless it is required to pay for the Postal Service resources that it consumes.

This logic should also apply to business publications that use firm bundles to ship multiple copies to a single business address. If copies are processed as bundles, they should be charged as bundles.

Time Incorporated will evaluate the mailing practices of all its publications pending the approval and implementation of a more cost-based Periodicals class rate structure.

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[5] It is instructive to compare the nearly 3 million bundles that would be eliminated each year by *Time for Kids* alone under the proposed rates with the 1.7 million sacks that have been eliminated through September of this year by the Periodicals Co-Palletization experiment that was implemented in April of 2003. See *PostCom Bulletin* (October 29, 2004) at 7.

2. There has been and still is more than adequate time to change mailing behavior prior to a 2006 rate increase

Transworld, a division of Time Incorporated, has several small magazines that would see an increase in their postage if the proposed rate structure were approved and, most importantly, if they failed to change their mailing practices. *Motocross* has a circulation of 43,896 copies per issue and would experience a 12.45% increase. *BMX* has a circulation of 18,336 copies per issue and would experience a 5.19% increase.[6] *Skateboarding* has a circulation of 70,121 copies per issue and would experience a 3.98% increase. *Snowboarding* has a circulation of 83,537 copies per issue and would experience a 6.65% increase. *Ride BMX* has a circulation of 21,855 copies per issue and would experience a 6.17% increase. Just as witness Schaefer says he requires of his publications, Time Incorporated requires that each title stand on its own in terms of profitability. MH-T-1 at 6. We are therefore working with our suppliers to develop a plan to change the mailing behavior of these titles. Given their small circulation, all of these titles would benefit significantly from co-mailing. We are specifically focusing upon co-mailing for these titles and not co-palletization**,** because co-palletization fails to improve the presort level of the existing bundles. In addition, as witness Schick stated, co-mailing improves the presort level and palletization, and enables the mail to participate in a drop shipping program. Tr. 2/348. It does not surprise me that Witness Cavnar's co-palletization efforts only yield a 1% savings, since co-palletization fails to improve presort. ABM-T-1 at 3. I suggest that he explore co-mailing as we are doing with our smaller circulation Transworld titles.

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[6] The figures for *Motocross*, *BMX*, *Skateboarding*, *Snowboarding*, and *Ride BMX* appear at Tr. 1/117. *BMX* will cease publication after its January, 2005 issue. This decision had nothing to do with postage, since rates have been stable since 2002.

In developing a solution for these Transworld titles, our experience has been the exact opposite of what has been stated by the ABM and McGraw Hill witnesses. These witnesses claim that contractual obligations and a lack of co-mailing or drop shipping capacity at their current printers preclude them from becoming more efficient. As the following example indicates, this is not the case. The Transworld titles are printed at Brown Printing, which does not have its own co-mail program at this point.[7] In addition, these titles have a multi-year agreement that does not expire until June, 2006. Transworld could easily make the assertions that our opponents make by saying that its printer doesn't have the capability to co-mail and it is locked into a contract. But while it is true that Brown Printing doesn't have the ability to co-mail, other printers do and are willing to accept product from competing printing companies. Quebecor World Logistics recently announced an expansion of its co-mailing capabilities and its willingness to accept product from other printers. On August 2, 2004 it issued a press release announcing a "short-run co-mail platform to cut costs and improve service for magazine publishers." Jennifer Lukasiak, Quebecor World Logistics Marketing & Business Manager, stated: "We will look to include publishers who print at Quebecor in the program first; then extend it to others." On August 31, 2004, I met with Brad Nathan, President of Quebecor World Logistics to discuss their new program and to verify that, in fact, they would be willing to accept our Transworld titles in their co-mail pool even though they were printed at Brown. He indicated that Quebecor World would indeed accept the Transworld products. Efforts like Quebecor's should be applauded and emulated throughout the printing industry.

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[7] Brown Printing announced that **it** will begin offering a co-palletization and pool shipping program through Fairrington Transportation. Neither company has announced a co-mailing program at this time.

Having addressed the issue of co-mail capacity, let me turn to contractual issues. In a prior position, I was Time Incorporated's Director of Field Operations and was responsible for all of the printing plants that produced Time Inc. products throughout the United States. In that capacity, I became intimately involved in all of the printing contracts. In my 30 plus years in the publishing industry, I have never seen a printing contract stipulating that the publisher must distribute its publications through the printer's network. The Transworld contract with Brown contains very detailed information about the pre-press, printing, and binding of the magazine, but when it comes to distribution, there are no specific clauses that indicate that the publisher must distribute its periodicals through the printer's transportation network. In fact, our generic printing contract contains the following "boilerplate" language: "Printer shall prepare all copies of the Magazine for mailing or other shipment in accordance with Publisher's instructions and all United States Postal laws and regulations applicable to the Magazine's postal classifications." As a result, Transworld can simply ship unlabeled copies to Quebecor World's co-mail operation without any effect upon the contract with Brown Printing.

Like most publishers, we try to maintain an excellent relationship with our print vendors, so I met with our Sales Representative from Brown to discuss the matter. Brown was completely sympathetic with the plight of the Transworld titles and agreed that they would not stand in the way of having these titles entered into the Quebecor World co-mail pool.

There are two key points that I ask the Commission to take away from this chain of events. First, the issue of contractual obligations is a red herring. Printing contracts do not dictate distribution methods. Second, printers work very hard at being good business partners for their customers and do not want to lose their pre-press, press, and bindery work because of a distribution issue. Most printers will

elect to cooperate with their customers and help them to stay in business even if it means allowing the product to be co-mailed and drop shipped by a competitor.

In terms of timing, Quebecor World indicated that they will begin their co-mail program with their existing client base and expand it to outside customers in 2005. If the proposed rates were approved, we could have the Transworld titles in Quebecor World's co-mail pool in the third quarter of 2005, well in advance of a 2006 rate change. The issue of having an inadequate amount of time to prepare for cost-based rates is completely unfounded.

The complaint was filed approximately five years after the Periodical Operations Review Team's report was issued, and *any* rate implications will not take effect prior to 2006, or seven years after publication of the report, which was developed with input from both American Business Media and McGraw Hill. Is seven years an adequate amount of time to prepare for a change in the rate structure? I believe that is a more than sufficient amount of time to prepare.

3. The printing industry is actively developing the capability to help smaller publishers to improve their mailing practices, and more change can be expected if the proposed rate structure is recommended

Witness Schick's direct testimony in this proceeding discussed Quad Graphics' extensive co-mail and drop shipping capabilities and noted that Quad has co-mailed versions of magazines with a national print order of 1,500 copies. Clearly, co-mail is available at Quad to mailers of almost all sizes. In addition, Quad is looking toward further improvements to its co-mail program**,** especially if the proposed rate structure is approved.

The capabilities that publishers will require in a cost-based rate environment are not exclusive to large printers. In fact, several small and medium sized printers are developing co-mail, co-palletization, and drop shipping capabilities.

Publishers Press, a small, family owned printer that has been in existence since 1866 has developed a very effective co-palletization pool for its small-circulation publishing clients. Its co-palletization program began in 1997, out of the desire to "get out of sacks." In addition, it found that co-palletization resulted in less damage to products, saved delivery time, provided the ability to track the product, and saved money for their clients. In 2002, this program saved Publishers Press' customers $495,000. In 2004, the savings are estimated to be $800,000. In its advertising, Publishers Press states: "With our CPDS distribution system, 100% of your magazines can be co-palletized and the majority drop shipped to maximize postal savings and delivery."[8]

Fry Communications is another family owned business and has been in operation since 1934. Fry has developed a co-mailing operation that utilizes a state of the art co-mailer purchased from Quad Graphics. Fry also uses Donnelley Logistics Services to drop ship its customers' products into the Postal Service system. Fry offers the following services: ink-jetting, selective binding, polywrapping, presorting, mail list processing, drop shipping, and co-mailing. On its web site, Fry states: "We've helped our customers save millions of dollars by working with them to choose the right distribution method." From the perspective of its customers, Fry is a small printer that offers the co-mailing and drop shipping capabilities of Quad Graphics and R.R. Donnelley.

Perry Judd, a medium sized printer, announced that it would expand its Strasbourg, VA publication plant by 62,000 square feet by September 2004 for co-mailing and co-palletizing.[9]

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[8] *m10* (July/Aug. 2004) at 27.

[9] ***Graphic Communication World* (June 7, 2004).**

According to Mike Winn, Director of Postal Affiars, RR Donnelley currently offers comailing, copalletization of periodicals, dynamic entry, and other mailing services to their customers. RR Donnelley's goal is to maximize penetration into the USPS distribution system and minimize postage for their customers of all types and size. They also have plans in place to expand their menu of services.

The September 13, 2004 issue of *Business Mailers Review* contained the following item:

> Fairrington Transportation announced recently that it has completed contractual negotiations with several major clients to begin providing co-palletization services for their clients' Periodicals sacked mail. Fairrington says co-pal pools will be run daily and the automated process has the capability to process double the estimated annual volume.

Fairrington Transportation Corporation is an independent transportation vendor who will accept product from any printer into its drop shipping pool.

Clearly, both small and large printers are developing the capacity to co-mail, co-palletize, and drop ship in anticipation of more cost based rates. In addition, small printers have several drop shipping pools available to them from companies like R.R. Donnelley and Fairrington. There is no excuse for any printer to not move forward in these areas.

In addition, I have had confidential conversations with representatives of two companies that are planning to enter the co-mail business if the proposed rate structure change is approved and implemented. One company is in the process of securing financing and the other is seeking internal approval of its business plan.

Clearly, the industry is positioning itself in anticipation of a more rational rate structure for Periodicals. These important developments run 180 degrees counter to witness Cavnar's statement that co-palletization and co-mailing "will not be available to many periodicals for a number of reasons." ABM-T-1 at 2.

4. Witness Cavnar has presented a misleading view of the publishing industry

Witness Cavnar states that "there will be publications that have no choice but to continue mailing mail in sacks . . . because alternatives are precluded by their mailing characteristics." ABM-T-1 at 5. Cavnar would like the Commission to believe that some publications' mailing characteristics are completely static, which they are not. Consider *Fortune* magazine, which had a trim size of 10 1/2 inches wide by 13 inches long in its May 1945 issue. As postage rates increased over the years, *Fortune* refused to bear the full brunt of the impact and elected instead to reduce its trim size and paper basis weight several times. Today, *Fortune* measures 8 inches wide by 10 7/8 inches long, after having reduced its width by 2 1/2 inches and length by 2 1/8 inches. In spite of the significant change in mailing characteristics, 59 years later *Fortune* is still in business and the *Fortune* magazine brand is as strong as ever. Contrary to Cavnar's testimony, publishers do have a choice in determining their mailing characteristics. If they choose to create pieces that must be manually processed, their rates should reflect the costs incurred.

On page 17 of his testimony, Witness Cavnar states "It ought to be clear that if a publication folds due to high costs, such as high postage costs, its website(s) are highly likely to disappear along with it." The July/August 2004 issue of the *m10* magazine contained the story of *Microsoft Certified Professional*, a publication that derives 53% of sales from e-media**.** In this case, it appears that the electronic publication is the primary revenue driver and would succeed in the absence of the print component. In addition, the August, 2004 issue of *Folio* magazine contains the story of Hope magazine which was founded in 1996 and is perilously close to folding. The story contains the following quote from the publisher: "Wilson, naturally, is not giving up hope. He is appealing to readers to support the magazine with gift subscriptions. If that doesn't get the circulation up to 80,000 in six months,

he'll pull the plug. Even if he does, Wilson says, he'll keep his vision alive by publishing the content in another format, such as a newsletter or Website." It appears that this publisher disagrees with Witness Cavnar and will continue to provide content in a form other than print.

I also find it interesting to note that business-to-business publishers emphasize how valuable print is to their business, yet they are aggressively pursuing digital alternatives. The May/June 2004 issue of *m10* magazine contained an article on "B-to-B Circ's New Strategy" in which several publishing executives discuss their strategy. In the article, Gloria Adams of PenWell Publishing, an American Business Media member, says: "an emerging circulation strategy is to focus on digital copies of print magazines. 'We have anywhere from 1,000 to 8,000 digital editions on probably more than half of our magazines,' she says, adding that the cost savings on a sub are significant… I've been surprised at the number of people who say they'll take digital magazines, both domestic and international readers." Yet, on page 18 of his testimony, Cavnar states that "many of our readers simply will not accept the same information on a computer." It appears that ABM members don't agree with Cavnar's statement and have actual data to back up their strategy. From my perspective, it appears that business publishers have a strategy of attempting to hold onto a favorable postage rate through the use of cost averaging, while at the same time developing their exit strategy from printed products. The question that this raises in my mind is: how long should we allow these publications to hold veto power over the balance of the publishing industry that is ready to roll up its sleeves and take action to drive costs out of the system in an effort to solidify our future?

IV. CONCLUSION

The notion of rates that recognize important cost drivers and require mailers to face the cost consequences of the preparation decisions they make is neither new nor radical. It is based upon the simple truth that if a rational rate structure exists, mailers will act appropriately and change their mailing practices to align with the rates. People can become very creative when they are faced with a challenge and the necessary information and opportunity. The *Time for Kids* example clearly demonstrates how quickly and effectively a team can develop solutions when faced with a 27% rate increase. We have seen such change in other classes of mail, and I believe that Periodicals Class mailers are no different. If mailers are presented with a rational rate structure that results in mailers being charged for the resources that they consume within the Postal Service, they will change their mailing practices, just as Time Incorporated's smaller titles are doing.

The barriers to change are minimal at best and declining. Printers are developing co-mail, co-palletization, and drop shipping. For those printers who do not have these capabilities, others currently offer these services, and more alternatives are being developed in anticipation of cost-based rates. In addition, the assertion that long term printing contracts preclude our opponents from taking advantage of more efficient mailing practices is not credible. Printing contracts pertain to the physical production of the magazine and not the distribution method that a publisher must utilize.

One of the other mythical barriers is changing software parameters to decrease sacks, bundle size, and pallet weight. My own experience shows that this hurdle is highly exaggerated. Software must change each time the Postal Service changes its rates under the existing rate schedule or when they alter a preparation

rule. The proposed rates will cause software providers to modify their products, but this is entirely normal for their industry.

The bottom line is that cost based rates were not designed to hurt any individual publisher or group of publishers. The proposed rate structure was developed with one simple goal, to design rates that reflect the costs of the resources that individual publishers consume within the Postal Service. I believe that our rebuttal testimony has shown that publishers will have both the means and motivation to change their mailing behavior and will drive costs from the system if the proposed rates are approved. I strongly encourage the Commission to approve this rational rate structure and help ensure the future health of Periodicals Class mail.