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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

INITIAL BRIEF OF
MAGAZINE PUBLISHERS OF AMERICA, INC.

December 23, 2004

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I. Summary of Argument

MPA believes now is the time for Periodicals classification and rate reform. The importance and necessity for moving to postal classifications and rates that better reflect costs, i.e., cost-based rates, is well accepted, although opinions differ as to the appropriate pace for the move. The Postal Service, with the Postal Rate Commission's support, has taken steps, albeit small ones, to modify Periodicals classifications and rates to better align them with costs.¹

In this docket, the Complainants have offered a thoughtful proposal for moving toward Periodicals classifications and rates that better align with costs. They urge:

. . . some simple remedies that will make Periodicals rates far more reflective of the associated costs than they are at present:

- instead of deriving all Periodicals revenues from piece and pound rates, as is the case today, there should be separate charges for the bundles, sacks, and pallets used in each mailing;
- the rates should recognize both bundle and container presort levels, as well as the effect of entry point on costs incurred;
- the rates should recognize the importance of AFSM-100 machinability for non-carrier route flats; and
- while preference for editorial content in Periodicals should continue, the opportunity to earn lower rates by entering mail closer to its final destination should be extended to publications with high editorial content.

Complaint of Time Warner Inc., Conde Nast Publications, a Division of Advance Magazine Publishers Inc., Newsweek, Inc., The Readers Digest Association, Inc. and TV Guide Magazine Group, Inc. Concerning Periodicals Rates (January 12, 2004) at 7 (Complaint).

¹ In Docket No. R2001-1, the Postal Service proposed and the Postal Rate Commission recommended the establishment of pallet discounts. In Docket No. MC2002-3 and Docket No. MC2004-1, the Postal Service proposed and the Postal Rate Commission recommended the establishment of experimental discounts for co-palletizing and dropshipping pieces that otherwise would be sacked. As MPA noted in Docket No. MC2004-1, "these experimental rates are no substitute for the significant changes in the Periodicals rate structure that are needed to encourage wide-scale worksharing, improve efficiency, and reduce Postal Service costs." Docket No. MC2004-1, Magazine Publishers of America, Inc. Comments on Stipulation and Agreement (June 15, 2004) at 2.

MPA believes that cost-based rates would be beneficial to the Periodicals Outside County subclass as a whole. As discussed below, while undoubtedly some publications might incur higher rates under such proposals unless they change mailing practices and procedures, this can be mitigated through ample lead times. The Commission has said it will not recommend rate changes in this proceeding.² Further, it is well known that the Postal Service is committed to not changing postal rates until calendar year 2006, at the earliest. Thus, any rate changes that may eventually result from classifications recommended in this docket will have had the benefit of examination not just in this docket, but in the next omnibus rate case expected to be filed some time in 2005. Any rate changes would not take effect prior to calendar year 2006.

While concerns have been raised in this docket about potential rate increases for smaller publications, there are also potential beneficial impacts. Many publications (including a large number of very small ones, i.e., those with circulations no greater than 1,000) may well experience rate decreases under the Complainants proposal. In aggregate, very small publications would benefit from zoning editorial pound rates because many (e.g., local newspapers, church bulletins, and local interest group publications) are distributed locally. Further, many very small publications using large sacks would experience rate decreases under the Complainants proposal taken in its entirety. As discussed by witness Stralberg, additional very small publications would benefit if they begin using higher-volume sacks. Comments of Time Warner et al. Witness Halstein Stralberg on the Characteristics of Very Small Periodicals, In Response to Notice of Inquiry No. 1 (December 8, 2004) (Stralberg Response to NOI 1)

² Order No. 1399 (March 26, 2004) at 2.

at 1-5; Statement of United States Postal Service Witness Tang on Time Warner Inc. et al.'s Response to Notice of Inquiry No. 1 Concerning Periodicals Data (December 20, 2004).

Cost-based rates proposals are consistent with the statutory framework for Periodicals classifications and rates. As explained in section II, and contrary to suggestions of some intervenors, the provisions of the Postal Reorganization Act of 1970³ which continue, and in the case of 39 U.S.C. §3622(b)(8) expand, the historical postal rate preference afforded Periodicals do not militate against such rate changes. Cost-based rates are not inconsistent with the Act's command that ". . . The Postal Service shall have as its basic function the obligation to bind the Nation together. . . ." ⁴ Nor are cost-based rates inconsistent with taking into account the "educational, cultural, scientific, and informational value" (ECSI) of mail matter.⁵ MPA believes that cost-based rates and classifications and increased worksharing incentives can be "fair and equitable" as required by the Act.⁶ In section III we explain why the opportunity and ability to mitigate any adverse impact of cost-based rates ensures that any such classification system recommended by the Commission will yield a result that is "fair and equitable."

MPA urges the Commission to move boldly in the direction of cost-based rates and increased worksharing incentives. It should issue a recommended decision furthering Periodicals Outside County subclass classifications that more fully reflect differences in operational and cost-causing characteristics within the subclass and

³ The Postal Reorganization Act of 1970, Public Law 91-375, 84 Stat. 719 et seq., 39 U.S.C. §§ 101, et seq.

⁴ 39 U.S.C. §101(a).

⁵ 39 U.S.C. §3622(b)(8).

⁶ 39 U.S.C. §§3621, 3622(b)(1), 3623(c)(1).

promote more efficient methods of mail preparation and entry by sending mailers better price signals.

II. Cost-based rates are consistent with the statutes governing classifications and rates.

a. The history of rate preferences for magazines, newspapers and other periodicals.

The Complainants have thoroughly described the history of rate preferences for magazines and newspapers. Complainants' Memorandum of Law and Policy Relating to the Editorial Pound Charge for Periodicals (December 1, 2004) (Complainants' Memorandum). MPA fully supports the continuation of these preferences which, of course, are rooted in the law.⁷ MPA urged the continuation of these preferences before the President's Commission on the United States Postal Service.⁸ The President's Commission agreed.⁹ The most recent versions of postal reform legislation, approved

⁷ See 39 U.S.C. §101(a), 3622(b)(8).

⁸ "As the Commission is no doubt aware, select categories of mail – magazines, newspapers and books – have historically been given special recognition in the nation's postal law for their educational, cultural, scientific and informational value, a ratemaking factor in current law known informally as "ECST" value. This factor is used by the Postal Rate Commission to moderate rates for these types of mail because of their intrinsic public policy value.

Indeed, facilitating nationwide distribution of the printed word was a fundamental justification for the original establishment of America's government-sponsored postal system. Beginning with the 1792 Post Office Act, and reaffirmed in every major revision of postal law since then (1845, 1863, 1912, 1917, 1958, 1970), successive Congresses and successive Administrations have agreed that facilitating and encouraging the distribution of periodicals through the mail is in the national interest. We believe the historical recognition in postal law and policy for the important role magazines, newspapers, and books play in educating and informing the public is as important today as it was when the national postal system was first created over two hundred years ago – and should be continued. Magazines make a difference in people's lives, and in the life of the nation.

Furthermore, we believe that magazines play a crucial role in keeping the Postal Service strong. Magazines are one type of mail that people seek out and enjoy receiving – a reason people look forward to getting their mail delivery each day. Former Postmaster General William Henderson likened the place of magazines in the mailbox to the place of the "anchor store" in a mall – the reason people go there. Magazine publishers need the Postal Service and the Postal Service needs magazines." Comments of the Magazine Publishers of America to the President's Commission on the United States Postal Service, (February 2003) p. 2.

⁹ See *Embracing the Future, Making Tough Choices to Preserve Universal Mail Service*, Report of the President's Commission on the United States Postal Service (2003) at 67 (Pres. Comm. Report). (The Commission also believes that existing preferences for favorable rates for the mailing of periodicals and non-profit correspondence should be maintained.)

by committees in the House of Representatives and the Senate, would continue the command that the educational, cultural, scientific, and informational value of mail be recognized in establishing postal rates and classifications.¹⁰

New technologies such as the Internet and cable television have neither replaced the need for magazines nor eroded their importance as a necessary vessel for the dissemination of information. The Postal Service can deliver a newspaper or magazine to any address it serves; but the resident at that address may not be able to afford (or even have access to) cable television or the technology and equipment necessary to explore the Internet. Tr. 6/1738 (Cavnar). Even for those with Internet access, not all of the content of hard-copy magazines is available on the web. Tr. 6/1736 (Cavnar).

The continuation of a preferred status for magazines and newspapers, however, need not deter the adoption of classification proposals such as those presented in this docket which will result in better cost-based rates; nor does it require the continuation of an unzoned editorial pound charge (EPC).

b. The statutory underpinnings for the historical preference.

Two statutory provisions support the historical preference for magazines and newspapers. 39 U.S.C. §101(a) provides “. . . The Postal Service shall have as its basic function the obligation to provide postal service to bind the Nation together through the personal, educational, literary, and business correspondence of the people. . .”. This requirement has been in the Act since its enactment in 1970. 39 U.S.C. §3622(b)(8), added to the Act by amendment in 1976,¹¹ says that one of the “factors”

¹⁰ S. 2468, § 201(a) (39 U.S.C. §§ 3622(b)(11), 3622(e)(2)(D)) *108th Cong. 2nd Sess.*; H.R. 4341, §201(a) (39 U.S.C. § 3622(b)(11), §206(a) (39 U.S.C. §3687 (a)(4)) *108th Cong. 2nd Sess.*

¹¹ Postal Reorganization Act Amendments , Public Law 94-421 (approved September 24, 1976), §10, 90 Stat. 1311.

the Commission shall take into account in recommending postal rates or fees is “the educational, cultural, scientific, and informational value to the recipient of mail matter. . .” Complainants in their Memorandum of Law and Policy have discussed in detail why neither provision precludes recommendation of cost-based classifications and rates. MPA agrees.

MPA believes that measuring whether cost-based rates and classifications are consistent with section 101(a), as the Commission must, requires examining whether the adverse impact of the classifications and rates, if any, is severe, and if so whether that impact can be reasonably mitigated. In essence, one must conduct an impact analysis to determine whether the proposed classifications and rates would impair the ability of postal services “to bind the Nation together.” MPA believes that section 3622(b)(8), the ECSI provision which is a ratemaking not a classification standard, should be applied in determining the appropriate cost coverage for the Periodicals Outside County subclass. Section 3622(b)(8) should not, as some intervenors suggest and as the Commission has opined in the past, be viewed as justification for not basing classifications or rates on costs.¹²

An “impact analysis” such as MPA suggests should be performed with respect to classification (and rate) changes since in making a recommended decision on establishing or changing the classification schedule the Commission is required to strive

¹² The Commission has relied on section 3622(b)(8) to support continuation of the unzoned EPC. See e.g., PRC Op. MC76-2 (Advertising and Editorial Matter (September 30, 1977)), pp. D-9, 10; PRC Op. R77-1, p. 350. MPA believes this section is better applied for purposes of determining cost coverage as the Commission has also done in the past. See e.g., PRC Op. R2001-1, para. 3175. In any event, Complainants have persuasively argued that continued reliance on section 3622(b)(8) to support unzoned EPC is questionable as a result of the decision in *Mail Order Ass’n of America v. United States Postal Service*, 2 F.3d 408 (D.C. Cir. 1993). See Complainants’ Memorandum pp. 39-48.

for a “fair and equitable classification system.”¹³ MPA believes the statutory requirement that rates and classifications be fair and equitable is not inconsistent with cost-based rates.

III. Fair and equitable cost-based classifications and rates—impact and mitigation.

a. Impact—adverse and beneficial.

Given the significant value of Periodicals to the American Public and the statutory considerations discussed above, it is appropriate for the Commission to pay close (although not exclusive) attention to the impact any rate or classification proposals will have on segments of the Periodicals industry as well as on the industry as a whole. In analyzing impact in this docket, MPA believes it is important for the Commission to keep three points in mind.

- The impact estimates on the record are based upon the assumption that publishers do not change their mailing practices in response to the introduction of a new set of rates. Tr. 6/1691 (Bradfield); Tr. 6/2228 (Tang). As discussed below, many publishers can and will change their mailing practices to mitigate impact.
- No particular set of rates will be recommended in this docket.¹⁴
- If the PRC recommends classification changes in this docket, no rate changes will result until calendar year 2006 at the earliest and then only following extensive review in an omnibus rate case.

This means the Periodicals industry will have substantial “lead” time to adjust as necessary to a new classification structure (and any resulting rate changes). Also, in the next rate case, the Commission could mitigate impact by recommending less-than-100% passthroughs (as it often does when new discounts are introduced). For example, the Commission could mitigate rate impact on publishers that use small sacks by initially

¹³ 39 U.S.C. §3623(c)(1); see also 39 U.S.C. §§ 3621, 3622(b)(1).

¹⁴ Order No. 1399 (March 26, 2004) at 2.

basing sack charges on less-than-100% passthroughs. Similarly, if the Commission decides the editorial pound charge should be zoned, it could initially base the zoned rates on less than the full cost avoidance. The Postal Service has expressed concerns regarding impact. Tr. 6/2225 (Tang). It will have an opportunity to suggest methods to mitigate any rate impact when it proposes rates in the next omnibus rate case.

Of course, impact can be beneficial as well as adverse. Establishing a “fair and equitable” classification schedule requires balancing the good with the not so good. Thus, in this docket the Commission should not make its recommendation based solely upon potential negative impact on just some publishers. Somewhat surprisingly after assertions by some intervenors, the responses filed late in this docket to Notice of Inquiry No. 1 (November 19, 2004) show that many small publications (such as newspapers, church bulletins, and interest group publications) are distributed locally and would benefit from the proposed zoned EPC, as well as the Complainants proposal taken in its entirety.¹⁵

¹⁵Stralberg Response to NOI 1 at 1-5; Statement of United States Postal Service Witness Tang on Time Warner Inc. et al.’s Response to Notice of Inquiry No. 1 Concerning Periodicals Data (December 20, 2004)(Tang Response to Stralberg). Further, in her response to witness Stralberg’s comments regarding Notice of Inquiry No. 1, witness Tang notes that a large proportion of very small Periodicals (those with circulations no greater than 1,000) are not the outside county portion of in-county newspapers. Instead, many very small Periodicals have no in-county volume and many others that do have some in-county volume appear to be church bulletins and local interest group publications. Tang Response to Stralberg.

While this additional information may provide useful insight into the composition of very small Periodicals, it does not contradict witness Stralberg’s conclusion that many of the “smallest Periodicals would end up with lower postage if the proposed rates were to take effect.” Stralberg Response to NOI 1 at 5. Further, witness Stralberg’s conclusion is just as applicable to locally-distributed church bulletins and interest group publications as it is to newspapers. In other words, similar to locally-distributed newspapers, many locally-distributed church bulletins and interest group publications would experience rate decreases under the Complainants proposal.

Witness Tang also notes that many very small Periodicals appear to be low-advertising content academic journals that are distributed nationally and that these publications “could face a substantial postage increase under the proposed rates.” Tang Response to Stralberg.

Many of these journals would be able to mitigate the impact of cost-based rates by co-palletizing and dropshipping. As MPA noted in Docket No. MC2004-1, Frank Lynn, the Corporate Director of Postal Affairs and Strategic

The Commission must also take into account the benefits of cost-based rate classifications which are many, including:

- Cost-based rates would reduce the combined costs of mailing Periodicals as a whole by encouraging the private sector to perform activities that it can perform better and at lower cost than the Postal Service.¹⁶ Reducing combined costs is essential to maintaining a healthy Periodicals industry.
- Cost-based rates would contribute to the Postal Service's goals of "reducing the number of sacks in the Periodicals mail stream and encouraging Periodicals to be entered closer to their destinations" to "allow the Postal Service to process Periodicals mail more efficiently." Tr. 6/2169 (Tang). Increasing efficiency is critical to controlling Periodicals rates over the long run.

There is no question that cost-based rates would better align Periodicals rates with Periodicals costs, making the rate schedule more fair and equitable, and better recognizing the degree of preparation of mail and its effect upon Postal Service costs.

b. Mitigation

MPA acknowledges there are potential adverse rate consequences for some mailers (including MPA members) from classifications such as those proposed by the Complainants if they do not act to mitigate those adverse effects. MPA believes, however, and the record shows publishers can act to mitigate adverse effects by co-palletizing, co-mailing, dropshipping, and increasing sack size.

Distribution at Cadmus Specialty Publications (the largest print supplier to the scientific journals market) stated in a letter to the Honorable Dana B. Covington that the "proposed rates [in Docket No. MC2004-1] provide just enough additional financial incentive for higher weight and low advertising content publishers to participate in the co-palletization program." Docket No. MC2004-1, PRC-LR-PO-1; Docket No. MC2004-1, Magazine Publishers of America, Inc. Comments on Stipulation and Agreement (June 15, 2004) at 1-2.

¹⁶ On the importance of lowest combined costs, see the Presidential Comm. Report p. 31 ("The Postal Service should outsource functions that can be performed better and at lower cost by the private sector").

As evidenced by the significant amount of dropshipping currently occurring, dropshipping services are widely available.¹⁷ Appropriate discounts, however, are necessary to make dropshipping cost effective for more publishers. Currently, high-editorial content publications cannot cost effectively be dropshipped because the flat editorial pound rate does not provide the appropriate incentive. Tr. 2/346 (Schick). If an incentive were provided to dropship editorial pounds, MPA believes many of these publications would immediately begin dropshipping thereby mitigating any adverse impact and potentially benefiting from cost-based rates.

The record shows that more printers and third-party vendors are offering co-mailing and co-palletization services than in the past. Witness O'Brien pointed out:

- Recent announcements and discussions with printers indicate increased availability. Tr. 5/1436-40 (O'Brien).
- Some printers and third-party vendors now accept publications from other printers into their worksharing programs, making these services available to more publishers. Tr. 5/1436-8 (O'Brien).
- Printing contracts are not impediments to improved mail preparation. Tr. 5/1437 (O'Brien).

O'Brien's observations are supported by Postal Service witness Tang's confirmation of the success of co-pallet and pallet discounts in encouraging mailer behavior. Tr. 6/2176 (Tang). This success, however, is limited because increased discounts are necessary to make co-mailing and co-palletization services attractive to more mailers.

While the pallet/co-pallet discounts have been successful in increasing the amount of mail that is co-palletized, they have only moved 73 million pieces out of sacks

¹⁷In FY 2003, 49 percent of Periodicals and 71 percent of Standard Mail were dropshipped. USPS Billing Determinants, Fiscal Year 2003 (filed at Postal Rate Commission on August 20, 2004).

through September 2004; a very small fraction of the billions of sacked Periodicals Outside County flats mailed each year.¹⁸ As witness Tang stated, “much more can be done” to encourage publishers to “utilize effective worksharing.” Tr. 6/2176 (Tang). The existing financial incentives are just not large enough to spur significant improvement in mail preparation, as MPA warned in its comments in Docket No. MC2004-1.¹⁹ Cost-based rates and classifications would address this as explained by witnesses Schick and O’Brien. Tr. 5/1440 (O’Brien); Tr. 2/347-50 (Schick).

c. Sacks

The use of sacks has been much discussed in this docket. The number of mail pieces in a sack (the “size” of the sack) is completely under the control of the mailer. Tr. 5/1432 (O’Brien). The use of sacks and the potential rate implications for those who use them under the Complainants classification proposals deserve careful consideration. Under the Complainants proposals, the most significant adverse impact would accrue to publishers that currently employ a mail preparation practice that is very costly to the Postal Service – entering mail in “small” sacks, i.e., sacks containing fewer and often many fewer than 24 mail pieces. Tr. 6/1731 (Cavnar); Tr. 5/1541 (Stralberg).

When preparing a mailing, publishers specify the minimum number of pieces that should be placed in each sack. Using a low sack minimum (e.g., 6 pieces) results in the sacked portion of a mailing being shipped in small, highly-presorted sacks while using a higher sack minimum (e.g., 24 pieces) produces larger, less-presorted sacks. Given

¹⁸ Tr. 6/2171 (Tang); Witness Stralberg estimated that more than three billion Periodicals Outside County pieces were sacked in FY 2003. TW et al.-LR-1, Table 5.

¹⁹ As MPA noted in Docket No. MC2004-1, “Improving how Periodicals are prepared and entered into the postal system is critical to controlling future increases in the Postal Service’s costs (and therefore rates) for Periodicals. These improvements will be realized only when the Postal Service implements changes in Periodicals rate design that appropriately encourage preparation and entry options that lower Postal Service costs and increase efficiency.” Docket No. MC2004-1, Magazine Publishers of America, Inc. Comments on Stipulation and Agreement (June 25, 2004) at 2-3.

this, sack size can be increased simply by changing the sack minimums specified when preparing a mailing. Tr. 5/1432 (O'Brien).

While no empirical data has been presented to support the perception²⁰, the record in this docket shows that the primary concern preventing mailers from putting more pieces in sacks is the perception that doing so could adversely affect delivery service. Fortunately, there is ample opportunity to address this issue before rates would be proposed in the next omnibus rate case. In the interim, MPA believes the Postal Service should investigate and report on whether lower-cost mail preparation options, such as using fuller, less-presorted sacks or possibly even flats tubs, have any effect on delivery service.

If the Postal Service finds that using lower-cost mail preparation options negatively affects the quality of service received by Periodicals, it should make the operational changes necessary to correct the situation. This will allow mailers of small sacks to substantially mitigate rate impact (and at the same time reduce Postal Service costs) with no adverse effect on service.

IV. Conclusion

MPA urges the Commission to move boldly in the direction of cost-based rates and increased worksharing incentives. It should issue a recommended decision furthering Periodicals Outside County subclass classifications that more fully reflect differences in operational and cost-causing characteristics within the subclass and promote more efficient methods of mail preparation and entry by sending mailers better price signals.

²⁰ In fact, the only data on the record suggests that using small, highly presorted sacks hurts delivery service. Tr. 5/1564 (Stralberg).

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