

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

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

Docket No. C2004-1

BRIEF OF THE UNITED STATES POSTAL SERVICE

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Introduction and Background

On January 12, 2004, the Postal Rate Commission received a pleading styled as a complaint, filed by Time Warner Inc.; Condé Nast Publication, a Division of Advance Magazine Publishers Inc.; Newsweek, Inc.; the Reader's Digest Association, Inc.; and TV Guide Magazine Group, Inc.¹ By letter dated the following day, the Office of the Secretary, Postal Rate Commission, designated the docket number above and advised the General Counsel, United States Postal Service, of the Complaint's filing under Title 39, United States Code § 3662. The complaint is styled as "Complaint of Time Warner Inc., Condé Nast Publication, A Division of Advance Magazine Publishers Inc., Newsweek, Inc., the Reader's Digest Association, Inc., and TV Guide Magazine Group, Inc. Concerning Periodicals Rates" (Complaint). The Complaint requests that

the Commission promptly hold hearings on this Complaint under § 3624 of the Act and then issue a recommended decision under §§ 3622, 3623, and 3625 of the Act, recommending the adoption of cost-based periodicals Outside County rates that more fully reflect differences in operational and cost-causing characteristics within the Periodicals Outside County subclass, that discontinue the policy of maintaining an unzoned editorial pound rate, and that promote more efficient methods of mail preparation and entry by sending mailers better price signals.

Complaint at 21. The Complaint proposes "fundamental reform of the Periodicals rate structure," including new classifications for pallet, sack, and bundle rates, and the elimination of the flat editorial pound rates in the current rate structure. Complaint at 4-7.

¹ Complaint 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. Concerning Periodicals

On February 11, 2004, the Postal Service filed its Answer to the Complaint.² The Postal Service made clear that it does not oppose improved efficiency in Periodicals rate design, believes more can be done in this regard, and is exploring many of the structural changes Complainants propose. Answer at 2. At the same time, the Postal Service opposed any form of Commission action on the Complaint, other than summary dismissal.

On March 26, 2004, the Commission announced its intention to hold hearings under section 3624 to determine whether the allegations in the Complaint are valid.³ If the Commission finds that to be the case, it will issue a recommended decision on classification changes under section 3623. The Commission stated that its decision would not include a rate recommendation.⁴

As discussed in more detail below, the Postal Service believes that, regardless of any potential merit in the abstract, the Commission should not recommend any classification changes in response to this Complaint. The Postal Service believes that much more can be done to promote efficiency in Periodicals rate design, and is, indeed, considering changes that would move in the direction proposed by Complainants. But any classification changes would

Rates, January 12, 2004 (Complaint). These mailers are also collectively referred to in this brief as Complainants.

² Answer of the United States Postal Service (February 11, 2004).

³ Order No. 1399 (March 26, 2004).

⁴ *Id.* at 2.

best be proposed together with the associated rate changes, in a subsequent request by the Postal Service.

The Postal Service respectfully submits that the extensive record developed in this proceeding confirms that this complaint proceeding does not provide a legal basis for the Commission to recommend changes to the Periodicals rate structure. The factual foundation for recommending new Periodicals classifications also has not been established. Moreover, as will be discussed below, testimony by the Postal Service, along with intervenors American Business Media (ABM), the McGraw-Hill Companies, Inc. (McGraw-Hill), and the National Newspaper Association (NNA), has raised serious concerns about the cost basis and impact of Complainants' classification proposals.

For the reasons explained below, the Commission should not recommend any changes to the Periodicals rate structure. Instead, such changes should be left to the next omnibus rate case. Nonetheless, the Postal Service is interested in the Commission's perspective on changes to the Periodicals rate structure, in light of the record in this proceeding. The Commission's Order dismissing the Complaint might provide an opportunity for the Commission's comments.

I. Complainants Have Not Met the Requirements to Establish a Rate and Fee Complaint Under 39 U.S.C. § 3662 and the Commission's Rules of Practice and Procedure.

Section 3662 of the Act (39 U.S.C. § 3662) explicitly limits the bases on which a party may rest a complaint invoking the Commission's authority to act under the statutory scheme. It states:

Interested parties who believe the Postal Service is charging rates which *do not conform to the policies set out in this title* or who believe that they are not receiving postal service in accordance with the policies of this title may lodge a complaint with the Postal Rate Commission *in such form and in such manner as it may prescribe*.

Id. (emphasis added). Likewise, Commission rules governing complaints clearly specify both the scope and nature of permissible complaints and the contents of filings under section 3662. Rule 82 states:

The Commission shall entertain only those complaints which *clearly* raise an issue concerning whether or not rates or services *contravene the policies of the Act....*

39 C.F.R. § 3001.82 (emphasis added). Rule 83 states:

each complaint shall include the following information...(b) a full and complete statement of the grounds for such complaint, including specific reference to the postal rates or services involved and the policies to which it is claimed *they do not conform....*

39 C.F.R. § 3001.83 (emphasis added).

As the Postal Service discussed in substantial detail in its February 11 Answer (see pages 3-6), Complainants nowhere in their filings specifically allege that the existing rates, fees, or classifications for Periodicals mail do not conform to specific policies in the Act. Instead, they purport to seek a rate structure which would achieve “greater conformity” with the policies of the Act. Such an objective cannot be reconciled with the purpose of section 3662, which is to address complaints regarding rates which complainants believe “do not conform to the policies” of title 39. As indicated in the Postal Service’s Answer, because the pleadings submitted to initiate this case failed to meet the statutory

prerequisites for a rate complaint proceeding, the Commission should have declined to entertain this case as a rate complaint proceeding.

In Order No. 1399, however, which accepted the complaint over the Postal Service's objections, the Commission relied heavily on statements it had made in Docket No. C99-4. Those statements, which the Complainants in this case had also cited, were to the effect that the Commission is free to make recommendations in a complaint proceeding if it determines that the relevant facts and circumstances, on balance, call for changes, regardless of whether it finds that the rates at issue are, in fact, unlawful. See Order No. 1399 (March 26, 2004) at 7, 10-11. In their June 5, 2000 Decision in Docket No. C99-4, the Governors specifically rejected those claims. Nevertheless, Complainants in this proceeding cited the earlier statements by the Commission as general support for the proposition that, if the Commission can recommend rate changes in a complaint case without a finding that current rates are unlawful, then potential complainants can initiate a complaint without any allegation that the current rates are unlawful.

As demonstrated in the Postal Service's Answer in this case at pages 8-13, such claims are fundamentally at odds with the language of the Act, and the courts' interpretation of the respective roles of the Postal Service and the Commission within the ratemaking framework intended by Congress. In Order No. 1399, the Commission appeared to endorse its earlier statements, but made no attempt to address, much less refute, the reasons advanced by the Postal Service showing those claims to be unsustainable. The Postal Service strongly

reiterates that the Commission cannot lawfully use section 3662 rate complaints as a mechanism to shift to itself the discretion granted the Postal Service in section 3622 to control the initiation of rate changes.

Perhaps in recognition of the weakness of the ground on which it was advancing, the Commission initiated this proceeding as a complaint case, but simultaneously announced an intent to refrain from recommending any rate changes. Order No. 1399 at 12-13. In effect, the Commission was limiting itself to provision of the same relief available at the conclusion of a section 3623 mail classification case – the potential recommendation of changes in the mail classification schedule. In answering the complaint, the Postal Service did not contest the Commission’s authority to initiate a section 3623 mail classification case in response to the parties’ filing. Answer of the United States Postal Service at 13.

By insisting on handing the matter as a section 3662 rate complaint, however, the Commission has further constrained its options. If the Commission were acting under section 3623, it would be free to recommend classification changes as long as it determined that those changes would be in accordance with the policies of the Act and the factors of section 3623. Under the plain language of section 3662, however, the Commission never even reaches the merits of potential changes unless and until it can determine that the complaint has been justified (i.e., the Postal Service is currently charging rates which do not conform to the policies of title 39). By treating this as a complaint case, the Commission has imposed the additional burden on the moving parties of proving

that, not only would the proposed classifications be beneficial under the relevant statutory factors, but that the current classification structure actually results in rates which do not conform to the policies of the Act. No amount of wriggling can allow the Commission to escape the explicit limitation on its authority to issue recommended decisions pursuant to section 3662 to those instances in which the complaint has been justified.

Complainants have not even come close to meeting their burden in this regard. Even within the context of one subclass of mail (in this instance, Outside County Periodicals), there are an infinite set of rates and rate structures which could be implemented to generate any given level of net revenue. It is probably fair to suggest that all Periodicals mailers recognize that the current rate structure may not be perfect. It is also fair to suggest that certain mailers believe (with appropriate support from certain parts of the record and with respect to certain statutory factors) that specific changes in the rate structure would improve the quality of the rate structure. But it is also clear that certain other mailers believe (with appropriate support from certain parts of the record and with respect to certain statutory factors) that those specific changes would reduce the quality of the rate structure. As will be discussed in more detail below, it appears, on balance, that there are genuine prospects for some types of improvement. But it is equally clear that serious concerns exist about exactly the best way to go about achieving the benefits of those improvements without imposing undue harm on mailers whose options are more limited. Such

conclusions, which is the most the current record will support, simply cannot be equated with a finding that the complaint has been justified.

Critically lacking from the record, moreover, is any basis to find that the basic rate structure recommended by the Commission at least twice (i.e., Docket Nos. R2000-1 and R2001-1) in the three years immediately preceding the filing of the complaint somehow fell out of compliance with the policies of the Act over that time period. In their filing, complainants themselves stress the fact that the conditions which their proposals seek to alleviate did not arise over the last three years, but instead over the past two decades. See Complaint at 4, 18-19.

Regardless of the extent to which the current rate structure could be improved (which is a perfectly suitable subject of a mail classification proceeding), it cannot credibly be found, based on this record, to fail to conform to the policies of the Act (which is, by statute, the mandatory threshold issue in a complaint proceeding). By proceeding under section 3662, the Commission has deprived itself of the opportunity to make a recommended decision in this proceeding. Because the complaint has not been justified, the Commission should announce that fact and terminate the proceedings without a recommended decision.

II. The Evidentiary Record Does Not Establish that Complainants' Proposal Is a Good Way to Improve the Periodicals Rate Structure

Even if the Commission were to find that the current Periodicals rate structure resulting from Docket No. R2001-1 does not conform to the policies of the Act (a conclusion which, as discussed above, cannot credibly be sustained

by the evidentiary record developed in this proceeding), the record nonetheless shows that Complainants' proposal should not be substituted.

1. Complainants' Testimony

Complainants filed four pieces of direct testimony in support of their complaint. Witness Mitchell (TW et al.-T-1) describes what he considers to be deficiencies in the Periodicals rates, and proposes alternative rates that he claims give appropriate, cost-based signals to Periodicals mailers. Tr. 3/793-866. Witness Mitchell proposes to reduce cost averaging across the Outside County subclass, by basing rates for pallets, sacks, and bundles directly on costs, rather than relying on worksharing discounts. Tr. 3/803, 826-28, 832-33. Witness Stralberg (TW et al.-T-2) provides a Periodicals cost analysis underlying witness Mitchell's proposed rates. Tr. 1/13-66.

Witness Gordon (TW et al.-T-3) reviews technological developments in communications in the United States, to support his view that zoned editorial rates for Periodicals are not needed to make the United States "socially and culturally cohesive." Tr. 3/610-27, 688, 714-15. Witness Schick (TW et al.-T-4) argues that witness Mitchell's proposed rate structure would move mailers and the Postal Service closer to achieving the principle of lowest combined costs. Tr. 2/336-60.

2. Intervenor Testimony

Three intervenors, ABM, McGraw-Hill, and NNA, filed testimony raising serious concerns about Complainants' proposal. ABM witness Cavnar (ABM-T-1) explains why ABM opposes significant Periodicals rate structure changes,

absent several preconditions: an alternative to sacks for those that cannot palletize; protection for mailers that cannot change; better information on the effect of Delivery Point Sequencing, Automated Package Processing deployments, and other upcoming changes; a convincing case that the Postal Service can actually capture theoretical savings; and reasonable notice and phasing of major changes. Tr. 6/1721-49, 1745-46. ABM witness Bradfield (ABM-T-2) argues that, while some modest Periodicals rate design changes might be reasonable, the Commission should reject the major rate design overhaul proposed by Complainants. Tr. 6/1686-1701. ABM witness McGarvy (ABM-T-3) asserts that the Time Warner restructuring proposal is too much, too fast. Tr. 6/1775-91.

McGraw-Hill witness Schaefer (MH-T-1) describes the impact that the rates proposed by Complainants would have on McGraw-Hill publications. He also indicates that McGraw-Hill supports appropriate discounts from rates based on averaged costs, rather than the de-averaging of Periodicals costs and rates advocated by Complainants. Tr. 6/1916-60. National Newspaper Association (NNA) witness Heath (NNA-T-1) explains why newspapers use sacks, and describes how the rates proposed by Complainants would hurt small newspapers. Tr. 6/2061-75. NNA witness Crews (NNA-T-2) discusses how the proposed rates would harm readers of newspapers in rural areas. Tr. 6/2022-37.

In support of Complainants' proposal, U.S. News & World Reports, L.P. witness Armstrong (USNews-T-1) argues that the proposal would cause publishers to change their mailing behavior in ways that would improve the

overall efficiency of mailing operations, so as to limit future increases in Periodicals rates. Tr. 6/2114-17.

3. Postal Service Testimony

The Complainants' testimonies read as if the Periodicals rate structure is in a total state of disarray. In reality, the Postal Service has accomplished a great deal in recent years when it comes to enhancing the Periodicals rate structure. In Docket No. R2001-1, the Postal Service proposed Destination Area Distribution Center (DADC) dropship discounts and pallet discounts. The Commission recommended, and the Governors subsequently approved, the implementation of these discounts. Furthermore, under experimental rules and procedures, co-palletization discounts were instituted in 2002 and 2004 (see Docket Nos. MC2002-3 and MC2004-1, respectively).

The Postal Service prefers more incremental Periodicals rate schedule changes, applying a variety of elements such as those described above, to the drastic changes proposed by complainants in this docket. The testimonies of two witnesses were presented to support this view.

Postal Service witness Miller (USPS-RT-1) discusses several cost-related issues. Despite the claims made by complainants about Periodicals costs, witness Miller shows that those costs have leveled off to some extent. Tr. 6/2155-56. This cost trend is not surprising, given the cost reduction programs and equipment deployments that have been instituted during the past several years, along with the more recent rate design changes described above. There

are many cost drivers affecting Periodicals costs, but it is not always possible to incorporate all cost drivers into the rate schedule. *Id.* at 2157.

While Complainants may believe that their “cost-based” rates proposal is preferable to the current rate structure, the Commission must also consider whether the data presented in this case support their analysis. As witness Miller describes, the Complainants’ testimonies rely on a methodology similar to that used in Docket No. R2000-1, USPS LR-I-332. *Id.* at 2161-62. Library Reference I-332 contains broad cost savings estimates that were not intended to measure cost differences at the rate category level. Furthermore, the analysis presented by Complainants in this docket relies on the same data that have historically been used to support Postal Service proposals in omnibus rate cases. While these data may have been appropriate when used to support presorting and prebarcoding discounts, they may not be appropriate when used as a basis for justifying separate and distinct container, bundle, and individual piece rates. *Id.* at 2162-65. As confirmed by witness Stralberg, the costs for containers, bundles, and individual pieces are causally linked. Tr. 1/188-89. Consequently, the development of a rate schedule based on separate “bottom-up” container, bundle, and piece costs could be somewhat problematic.

Even if it were determined that “cost-based” rates provide the most efficient pricing signals in the long term, the Commission would still need to evaluate whether such a system should be implemented at the present time. The current flats automation program is similar to the letters automation program of the late 1980s and 1990s. The system is constantly changing. As witness Miller

described in his response to TW et al/USPS-T1-9a, the AFSM100 – the current workhorse of the flats automation program – has changed significantly since its initial deployments, and it will continue to change. Tr. 6/2143-44. Under the proposed rates, these changes represent a significant risk when one considers the fact that the Periodicals cost coverage has recently hovered around the 100-percent mark.

These costs considerations are not the only reason why the Postal Service prefers an incremental approach. Postal Service witness Tang (USPS-RT-2) shows the impact of Complainants proposal on a variety of Periodicals publications. Tr. 6/2222-35. See also witness Tang's response to Presiding Officer's Information Request No. 2. Tr. 6/2237-51. In particular, she shows that the impact on small publications could be substantial. She demonstrates the importance of considering the impact of proposed rate changes on the whole variety of Periodicals mailers, and shows that the rate increases from Complainants' proposal could be greatest for the 84 percent of all publication titles with mailed circulations under 15,000 copies. Tr. 6/2229, 2231-33; 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). Finally, witness Tang supports the current rate structure's consistency with the policies of the Act by showing that rates (presented in terms of revenue per piece) recently have increased less than the consumer price index. Tr. 6/2233-35.

4. Complainants' Surrebuttal Testimony

In response to the intervenor testimony, Complainants' witness O'Brien (TW et al.-RT-1) presents examples of opportunities for changes in mailer behavior to reduce Periodicals costs and avoid some of the rate increases that could result under Complainants' rate proposal. Tr. 5/1424-44. Witness Stralberg (TW et al.-RT-2) asserts that small publications generally should be able to avoid large rate increases under Complainants' proposal, without drastic mail preparation changes. Tr. 5/1537-81. In particular, he indicates that many of the greatest increases are for publications that are mailed in low volume "skin" sacks. Tr. 5/1546-57.

5. Postal Service Analysis

The Postal Service is considering rate structure changes that would encourage more efficient dropshipping and containerization. In particular, testimony in this proceeding shows that the use of skin sacks could be reduced without substantially burdening Periodicals customers, if proper rate incentives were in place. Tr. 5/1549, 1551-52, 1557, 1562-65. Rate changes focused on this issue could provide substantial benefits for all Periodicals customers. Moreover, more limited rate changes could be supported by more narrowly defined cost studies, avoiding the costing risks raised by witness Miller. Tr. 6/2161-65. As witness Miller concluded: "it is preferable and easier to rely on more narrowly defined cost studies that focus on measuring the impact of specific identified cost drivers." *Id.* at 2158.

In Docket No. MC95-1 the Postal Service proposed a bifurcation of the Periodicals class. One subclass, Publications Service, would have provided rate benefits to high-density publications that met a group of other characteristics. By using broad structural change to try to drive costs out of Periodicals, the Docket No. MC95-1 proposal was similar to the Complainants' proposal in this docket.

In rejecting the Postal Service's Docket No. MC95-1 proposal, the Commission expressed its:

fundamental disagreement with the Service on several essential points. These include . . . the heavy emphasis on 'changing mailers' behavior' and 'driving costs from the system,' without full appreciation for the impact this may have on many second-class publishers who cannot qualify for Publications Service (or who could do so only after considerable adjustments in almost every aspect of their operations); and ... the total disregard for the possibility of meaningful improvements, through rate category treatment, within the existing subclass.

PRC Op., MC95-1, at V-59.

In this Complaint case, Time Warner is not proposing a new subclass, but it is proposing drastic rate structure changes. Moreover, it is disregarding the possibility of meaningful improvements through more focused changes, such as rate disincentives for skin sacks. Based on the record in this proceeding, the Commission has no basis to abandon its Docket No. MC95-1 opposition to fundamental change in the Periodicals rate structure.

Of particular concern, most of the smallest Periodicals publications do not appear to be represented by any participant in this proceeding. In response to Notice of Inquiry No. 1, witness Tang provided data on over 25,000 publications with mailed circulation less than 15,000 copies. Of these, over 15,000 have

mailed Outside County circulation of less than 1,000 copies. Response to Notice of Inquiry No. 2, Item 1. While some of these publications also have in-county circulation, nearly two-thirds do not. Statement of Postal Service Witness Tang in Response to Comments of Witness Stralberg Regarding NOI No. 1, at 1. Perhaps half of the publications with in-county volume do not appear to be newspapers. Witness Tang identified many church bulletins and local interest group publications that are probably not represented by ABM or NNA. *Id.* Moreover, NNA identified only 140 member publications with under 1,000 copies of circulation, and another 445 non-member newspapers with that small a circulation. Response of National Newspaper Association to Notice of Inquiry No. 1 Concerning Periodicals Data, Item 2.

Over half of the publications identified by witness Tang contain no more than 10 percent advertising, while NNA reports that almost all newspapers have more than 10 percent advertising. Response to Notice of Inquiry No. 1, Item 5; Response of National Newspaper Association to Notice of Inquiry No. 1 Concerning Periodicals Data, Item 5. Thus, it does not appear that a large portion of the 15,000 publications with mailed circulation of 1,000 or less are newspapers represented by NNA.

Witness Tang concluded that the smallest publications include many academic journals, likely to be of national distribution. Such publications are at risk of facing a substantial rate increase under the Complainants' proposal in this docket. Statement of Postal Service Witness Tang in Response to Comments of Witness Stralberg Regarding NOI No. 1, at 2. Thus, while a substantial record

has been developed in this proceeding, the impact of the proposed changes on a large number of publications is not clear, and could lead to rate shock for many of them. Moreover, the costs underlying the proposal are outdated and were not designed to support this type of proposal. For all of these reasons, the Postal Service urges the Commission to dismiss this Complaint, without recommending any changes to the Periodicals rate structure. Nonetheless, the Postal Service appreciates the input of a wide variety of Periodicals mailers in this proceeding, and expects to consider the record in this proceeding when developing proposals for Periodicals in the next omnibus rate case.

Conclusion

Before issuing a recommended decision pursuant to section 3662, the Commission needs to determine that the Complaint in this proceeding was justified. In order to reach such a conclusion, the Commission must find that the current Periodicals rates are not in accordance with the policies of the Act.

Complainants have not met their burden of providing the evidence necessary to support such a finding. The Complaint therefore should be dismissed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that, in accordance with section 12 of the Rules of Practice, I have this day served the foregoing document upon all parties of record in this proceeding.

/s/

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