

Postal Rate Commission  
Submitted 1/10/2005 1:41 pm  
Filing ID: 42655  
Accepted 1/10/2005

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

Complaint of Time Warner Inc. et al.  
Concerning Periodicals Rates

Docket No. C2004-1

REPLY BRIEF OF  
MAGAZINE PUBLISHERS OF AMERICA, INC.

January 10, 2005

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## I. Summary of Argument

The Magazine Publishers of America, Inc. (MPA) applauds the efforts of the Commission, the Complainants, and the Intervenors in this docket to examine the need for better cost-based classifications and rates for Periodicals. Cost-based rates, including those proposed by Complainants, are not “radical”, but rather are a means to move toward the goal of lowest-combined costs which will benefit all mailers. This docket is not a refight of the last major reclassification proposal (Docket No. MC95-1), and cost-based rates such as those proposed in this docket are consistent with the principles the Commission enunciated in that docket, including the tenets of efficient component pricing.

Contrary to suggestions of some Intervenors on brief, there will be adequate opportunity to mitigate adverse impact, if any, that could result from a Commission recommendation for better cost-based rates. MPA urges the Commission to move boldly in the direction of better 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.

## II. **Complainants and Intervenors recognize the USPS is moving toward rates that better align with costs; the Commission can and should take this opportunity to speed this along.**

MPA applauds the efforts of the Commission, the Complainants, and the Intervenors in this docket to examine the need for better cost-based classifications and rates for Periodicals. All have spent considerable time and effort building a record in

this docket which could result in Periodicals classifications and rates which are better aligned with costs than those in effect today. MPA believes all participants want a continued viable Periodicals industry that will help “bind the nation together.”<sup>1</sup> As it stated in its initial brief, MPA believes the Commission should seize this opportunity and move boldly in the direction of better cost-based rates and increased worksharing incentives. MPA Brief at 12. This will help ensure the viable Periodicals industry all wish for.

- a. The Commission has the authority to recommend Periodicals classifications which better align rates with costs.*

In its brief the Postal Service reiterates arguments it previously made in its original Answer to the Complaint.<sup>2</sup> It argues the Commission erred in establishing this docket, at least as a “complaint” case. Postal Service Brief at 3-7.<sup>3</sup> APWU supports this position. APWU Brief, Part IV. MPA simply notes that the statute is clear that “the Commission may submit to the Governors [of the Postal Service] on its own initiative, a recommended decision on changes in the mail classification schedule.”<sup>4</sup> The Commission should seize this opportunity to do so.

- b. Complainants and Intervenors alike recognize the Postal Service’s efforts, albeit limited, to better align rates with costs.*

The Postal Service says it “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.” Postal

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<sup>1</sup> See 39 U.S.C. §101(a).

<sup>2</sup> Answer of the United States Postal Service (February 11, 2004).

<sup>3</sup> See also PRC Order No. 1399 (March 26, 2004).

<sup>4</sup> 39 U.S.C. §3623(b).

Service Brief at 14. This would better align rates with costs. APWU recognizes that the “Service and non-complainant periodical mailers have every reason to want to reduce costs and the record shows they are working on various programs to reduce costs.” APWU Brief, Part II. Rates that are better aligned with costs will lead to cost reductions. MPA noted its approval of past Postal Service and Commission efforts “to modify Periodicals classifications and rates to better align them with costs.”<sup>5</sup> Even the most vocal opponents of the Complainant’s proposals, American Business Media (ABM) and The McGraw-Hill Companies, Inc. (MH), acknowledge “[t]he Complainants have, however, raised legitimate issues concerning the relationship between Postal Service costs and mail preparation that deserve further consideration by the Postal Service. Accordingly, the Commission should encourage the Postal Service to work with Periodicals mailers of all sizes to develop measured changes . . .”<sup>6</sup>

### **III. Cost-based rates are not “radical.”**

MPA is concerned with the characterization of the Complaint’s proposal as “radical.” Joint Brief at 2. ABM and MH repeatedly use this characterization seizing on one oral cross examination response of witness Stralberg that “[w]hat we are proposing in this case are far more radical changes” and inferring that this response suggests cost-based rates such as those recommended by the Complainants are “radical.” Joint Brief at 5 citing Tr. 5/1587. ABM and MH state that “[t]he ultimate issue in this proceeding thus revolves not around whether Periodicals rates should be modified to become more cost-based, but whether movement toward greater cost recognition

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<sup>5</sup> MPA Brief at 1, citing Docket No. R2001-1, Docket No. MC2002-3, and Docket No. MC2004-1.

<sup>6</sup> Joint Initial Brief of American Business Media and The McGraw-Hill Companies, Inc. (Joint Brief) at 1.

should be ‘measured’ or ‘*radical*.’” Ibid (emphasis added). In the pages following this last quote, the term “radical” is used five times in conjunction with the Complainant’s proposal. MPA does not believe that a classification proposal, such as the Complainants, which attempts to better align Periodicals classifications and rates with cost-causing characteristics is “radical,” nor does it believe that bold action to better align Periodicals classifications and rates with costs should be characterized as “radical.”

#### **IV. This docket is not a refight of Docket No. MC95-1, Mail Classification Schedule, 1995, Classification Reform I.**

In their brief, ABM and MH state that the Complainants’ proposal in this docket is similar to the Postal Service’s proposal in Docket No. MC95-1 and that the Commission’s reasoning in that docket militates against the Complainants’ proposal in this docket. Joint Brief at 16-21.

A more careful comparison of the two proposals shows that the ABM and MH claim is clearly erroneous. The Commission’s conclusion in Docket No. MC95-1 that “the most accurate productive efficiency signals are given by discounts from overall subclass rates that are set equal to the costs that the Postal Service avoids when the workshare component is supplied by the mailer”, (PRC Op. MC95-1, para. 4260)<sup>7</sup> in fact, supports bold movement in the direction of cost-based rates. In Docket No. MC95-1, the Postal Service proposed splitting the Periodicals Regular subclass in two. PRC Op. MC95-1, para. 5118. An implication of doing so is that, if each subclass is assigned

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<sup>7</sup> This approach is also referred to as efficient component pricing. In Docket No. R2001-1, the Commission reiterated its support for this approach, describing promoting efficient component pricing as a Commission goal. PRC Op. R2001-1, para. 3059.

the same markup, publications in the higher-cost subclass would make a higher unit contribution than those in the lower-cost subclass. As the Commission opined in that docket, this would be economically inefficient because it would equate to setting discounts for worksharing above the corresponding costs avoided. PRC Op. MC95-1, para. 5235.

In this docket and as would generally be the case for cost-based rates proposals, the Complainants do not propose that the Outside County subclass be split in two or that higher-cost and lower-cost publications make equal percentage contributions to institutional costs. See Tr. 3/803, 828, 836, and 851 (Mitchell). Rather, cost-based rates proposals would generally require each mailer to pay its attributable costs plus the same unit contribution to institutional costs.<sup>8</sup> Such an approach generates discounts that equal avoided costs (i.e., efficient component pricing) and, as the Commission stated, sends appropriate price signals to promote efficiency. PRC Op. MC95-1, para. 4260.

Further, the rate increases that high-cost publications could experience from cost-based rates proposals would not, as suggested by ABM and MH (Joint Brief at 20), be due to requiring them to make larger unit contributions to institutional costs than lower-cost publications. Rather, the rate increases would result from requiring them to make the same unit contribution to institutional costs as lower-cost publications. In contrast, the current Periodicals Outside County rate design allows higher-cost publications to make substantially smaller contributions to institutional costs than lower-cost publications. This is because many discounts are currently set significantly below

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<sup>8</sup> In fact, if passthroughs are set at less than 100 percent, higher-cost publications would continue to make smaller contributions (as is currently the case) to institutional costs than lower-cost publications.

avoided costs and other cost differences are not reflected in discounts at all. Tr. 6/2176-7 (Tang).

For example, the Postal Service currently provides mailers with discounts ranging from 0.5-cents to 1.5-cents for palletizing Periodicals<sup>9</sup> while the average container-handling cost difference between palletized and sacked Periodicals is approximately eight cents per piece.<sup>10</sup> Also, there currently is no discount for increasing the number of pieces in a sack, for example from 6 pieces to 24 pieces, despite the fact that the cost difference between 6-piece sacks and 24-piece sacks can be more than 40 cents per piece. Joint Brief at 27, fn. 21; Tr. 6/2177 (Tang).<sup>11</sup>

Moving boldly in the direction of cost-based rates therefore is entirely consistent with the Commission's Docket No. MC95-1 recommendation to recognize cost distinctions through discounts in order to send technically efficient price signals.

## **V. Impact and mitigation**

### *a. Very small publications*

Several intervenors express concern that cost-based rates would have a dramatic impact on the 15,000 publications with circulations of less than 1,000 and that

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<sup>9</sup>In addition to these discounts, the Postal Service has also established relatively small experimental discounts for co-palletizing periodicals that otherwise would be sacked. It is worth noting that, contrary to ABM and MH's suggestion that new rate elements introduced over the years have primarily benefited large publications (Joint Brief at 3), the experimental co-palletization discounts almost exclusively benefit small publications.

<sup>10</sup>The average per-piece sack-handling cost was calculated by dividing the total sack-handling cost by the total number of sacked pieces. TW et al.-LR-1 (Revised 4-26-04), Costs\_Volumes.xls, worksheets "Containers" and "Pieces". Similarly, the average per-piece pallet-handling cost was calculated by dividing the total pallet-handling cost by the total number of palletized pieces. TW et al.-LR-1 (Revised 4-26-04), Costs\_Volumes.xls, worksheets "Containers" and "Pieces".

<sup>11</sup>On this point, we urge the Commission to strongly encourage the Postal Service to establish rate incentives to promote the use of larger sacks in the next rate case, as the Postal Service discussed in its Initial Brief. Postal Service Brief at 14.

this would undermine diversity of editorial content. Joint Brief at 25; Postal Service Brief at 15-17; OCA Brief at 2.

The record in this docket supports the conclusion that many, if not most, very small publications would actually benefit from cost-based rates, rather than be harmed by them. MPA pointed out in its initial brief that many small publications (such as church bulletins, local interest group publications, and newspapers) are distributed locally and therefore would immediately benefit from zoned editorial pound rates and cost-based rates as a whole. Others that currently use small sacks could begin to enjoy postage savings from cost-based rates simply by increasing their sack minimums. MPA Brief at 2-3, 8.

Further, just as cost-based rates would lower postage for many existing local publications, they would also reduce postage costs for new local publications. It is conceivable that lower rates for these publications would encourage new small publications, and therefore result in additional diversity of content.

*b. Weeklies*

While ABM and MH claim that co-mailing and co-palletization are not feasible options for weeklies due to their tight schedules, they ignore the fact that entering weeklies in sacks at origin postal facilities may also be detrimental to tight schedules, especially in light of recent Postal Service operational changes, such as elimination of sack sorting machines.<sup>12</sup> As witness Schick testified, to meet tight schedules (e.g., printing on weekends for delivery on Monday morning), publishers today frequently use

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<sup>12</sup> See Joint Brief at 23. In fact, Periodicals that are co-mailed or co-palletized and dropshipped receive service equal to and often much better service than Periodicals that are entered in sacks at origin facilities. See, e.g., Tr. 6/1956-60 (Schaefer); Tr. 5/1439 (O'Brien).

private transportation by truck or air and enter their magazines at the appropriate sectional center facility. Tr. 2/373 (Schick).<sup>13</sup>

Weekly publications that are concerned about potential service issues associated with co-mailing or co-palletization can still elect to dropship. As discussed by witness Stralberg in the context of very small publications, Periodicals (including weeklies) that are entered at destination facilities would benefit from a zoned editorial pound charge. Further, simply by avoiding the use of high-cost small sacks, these publications would benefit from cost-based rates proposals taken in their entirety. MPA Brief at 2-3, 8.

In other words, the rate impact on many weeklies could be substantially mitigated by dropshipping and could be eliminated altogether by also using large sacks. Further, better aligning dropship discounts with avoided costs will undoubtedly increase the volume of periodicals being dropshipped.

*c. Third-Party Consolidators*

ABM and MH also assert that short-run publications that are printed at small printers without current co-mailing and co-palletization programs will not be able to avail themselves of opportunities to mitigate rate impact due to contractual obligations. Joint Brief at 24. This assertion is baseless.

In addition to the strong possibility that many small printers would develop additional capabilities in response to cost-based rates, TW et al. witness O'Brien testified that printing contracts are not impediments to improved mail preparation because they "do not dictate distribution methods." Tr. 5/1437 (O'Brien). In other

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<sup>13</sup> It is widely recognized in the industry that private air freight companies transport many nationally-distributed weekly business publications. See, e.g., Tr. 2/373, 480 (Schick); Tr. 6/1907 (Schaefer).

words, publishers using small printers could arrange with their printers to use third-party consolidators for co-mailing, co-palletization, and distribution services in response to cost-based rates while continuing to use their current printer for print services.

Further, before any cost-based rates could be implemented as a result of this docket, at least two companies – Quebecor World Logistics (Tr. 5/1436 (O'Brien)) and Fairrington Transportation (Tr. 6/1958 (Schaefer)) – will be providing co-mailing and co-palletization services for publications printed by other companies. MPA expects that additional consolidators will begin offering these services in response to the anticipation of better cost-based rates.

**VI. Average revenue per piece has been affected by worksharing, not Postal Service cost control.**

The Postal Service, ABM, and MH cite the fact that the actual revenue per piece for Periodicals has increased at a rate below inflation to argue that Periodicals costs are under control. Postal Service Brief at 13; Joint Brief at 2-3. These arguments are unpersuasive because the trend in Periodicals actual revenue per piece is a testament to increased worksharing, not Postal Service cost control.

Increased worksharing by publishers has significantly reduced the amount of work that the Postal Service must perform on each Periodicals mailpiece. For example, from 1989 to 2003, the proportion of Periodicals Regular pieces that were carrier-route presorted increased from 26 to 42 percent; the proportion of Periodicals Regular non-carrier route pieces that were bar-coded increased from 0 to 80 percent; and the proportion of Periodicals Regular pieces that were dropshipped increased from 21

percent to 53 percent.<sup>14</sup> Without this increased worksharing, Periodicals actual revenue per piece would have increased at a much faster pace. Further, cyclical factors (e.g., average advertising percentage) affect actual revenue per piece despite having no relation to Periodicals costs. Such factors make actual revenue per piece an inaccurate indicator of Postal Service cost-control trends. The index of Periodicals rates, at a constant markup index, presented by witness Mitchell, Tr. 3/806-7 (Mitchell), is a more accurate indicator of cost control trends. This index clearly shows that increases in Periodicals costs have far outpaced inflation since 1985. Ibid.

Classifications and rates that better align with costs and greater worksharing incentives are needed to achieve lowest-combined costs.

## **VII. Conclusion**

MPA believes the record in this docket is sufficient for 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.

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<sup>14</sup> Docket No. R2000-1, Tr. 24/11269 (Cohen); USPS Billing Determinants, Fiscal Year 2003 (filed at Postal Rate Commission on August 20, 2004).

Respectfully submitted,

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January 10, 2005  
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