

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

POSTAL RATE AND FEE CHANGES
PURSUANT TO PUBLIC LAW 108-18

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Docket No. R2005-1

INITIAL BRIEF OF
TIME WARNER INC.

September 26, 2005

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INITIAL BRIEF OF TIME WARNER INC.

Time Warner Inc. (Time Warner) hereby respectfully submits its initial brief in this proceeding.

A. The Settlement Agreement merits the Commission's approval but does nothing to address the need for fundamental reform of the Periodicals rate structure, which remains as pressing as ever

Time Warner is a signatory to the Settlement Agreement and, for the reasons propounded in the Initial Brief of the Periodicals Coalition, to which it is also a signatory, urges the Commission to approve the Settlement Agreement and to recommend the rate changes proposed by the Postal Service.

In section B below, we present additional reasons why the Commission should place confidence in the Postal Service's estimates of cost savings in Periodicals mail processing in the test year.

In section C, we explain why it is not possible, on this record, for the Commission to reliably update the estimated worksharing-related cost avoidances that are used to develop worksharing-related discounts within each subclass. We conclude that no sufficient basis exists, on this record, for the Commission to modify the existing rate design within subclasses and that the across-the-board increase therefore should be applied to individual rate elements as well as to subclasses.

The Postal Service proposal does nothing to address the need for fundamental reform of the Periodicals rate structure, which is the subject of an extensive record in the still-pending Time Warner Inc. et al Complaint case (Docket No. C2004-1). Rather its sole purpose is to "present[] a relatively modest revenue goal tied fundamentally to a single, unambiguous financial need in the test year (FY

2006), namely, the escrow requirement established by Congress in Public Law 108-18."¹ The case for rate structure reform remains as strong as ever, and, with the passage of another year since the Commission last had an opportunity to seriously address rate-structure and classification issues, is, if anything, more pressing than ever. Section D observes that the steps that the Postal Service is taking to reduce Periodicals costs, while valuable and laudable, do not amount to real rate reform. It urges the Commission to issue a decision on the issues pending in Docket No. C2004-1 and expresses the hope that the Postal Service's next omnibus rate filing will seriously address the need for reform of the Periodicals rate structure.

B. The proposed regulation changes combined with promised changes in the way facilities process periodicals will lead to substantial reductions in Periodicals costs

The Postal Service has in this docket described significant changes in the way that Periodicals mail is prepared and processed. These changes are projected to produce very substantial reductions in Periodicals costs.

Time Warner supports all the announced changes and believes they will help reverse the long -term trend towards ever higher Periodicals costs. However, we continue to believe, as expressed in Docket No. C2004-1 and in Section D below, that the Periodicals class also needs serious rate reform, and that there remain inefficiencies that can only be addressed by cost-based rates.

The promised changes include:

- (1) deployment of new technology, including faster bundle sorters, mechanizing parts of the costly "mail prep" operation for non-carrier route flats and further enhancements to the AFSM-100 machines;
- (2) major regulatory changes, including the imposition of a 24-piece sack minimum while providing mailers new ways to enter small residual volumes outside of sacks; and

¹ United States Postal Service Request for Expedition, filed April 8, 2005, at 6.

- (3) significant changes in the flow through the postal system of small and residual mail volumes that are entered at origin--essentially, the Postal Service plans to eliminate the unique outgoing network for Periodicals.²

One of the changes that will impact Periodicals mailers most is the imposition of a 24-piece sack minimum. According to the Postal Service's own estimates, this change alone will eliminate about 38 million Periodicals sacks per year - mostly 5-digit and 3-digit sacks that typically travel through several postal facilities and incur multiple sack sorting costs in addition to the costs of opening, shaking out and recycling the sacks themselves.³ As demonstrated by witness Stralberg in Docket C2004-1, using data provided by the Postal Service, each such sack typically costs \$3 or more to handle.⁴ That would indicate cost reductions just from this one regulation change of about \$100 million.

In Docket No. C2004-1, where Time Warner et al. proposed cost-based rates under which mailers would pay for the cost of each sack they use, some mailers argued that they needed to use sacks with just a few pieces in them in order to achieve "reasonable service," and that the imposition of cost-based rates therefore would have a devastating effect on them.

In this docket, however, the Postal Service, needing to achieve significant reductions in Periodicals costs, has announced its intention simply to disallow sacks with less than 24 pieces. USPS-LR-K-49 at 20. Time Warner supports the change, although it believes the preferable solution is that proposed in Docket No. C2004-1:

² Many of the regulatory and mail flow changes discussed here are described by witness McCrery (USPS-T-29) as parts of the "Periodicals Cost Reduction Initiative." Besides the description in his testimony, McCrery has been providing further details on the implementation of this multi-faceted and still unfolding initiative in industry forums, such as the Periodicals Operations Advisory Committee (POAC).

³ See witness McCrery's response to POIR 4, Question 6 (Tr. 1690) and USPS LR-K-91.

⁴ See Docket No. C2004-1, TW et al.-T-2, Table B1. Estimated Sack unit costs, which vary by entry point and presort level, are as high as \$3.58, assuming PRC costing methodology and TY03 (from Docket No. R2001-1) cost levels. The estimates were based on a modified version of USPS-LR-I-332, filed by the Postal Service in Docket No. R2000-1.

allowing mailers to use lower volume sacks as long as they pay for the costs of such sacks.

Curiously, the Postal Service's official estimate of the test year cost reduction from the 24-piece sack minimum is only \$22.3 million. Even witness McCrery appears to realize that this estimate is too conservative.⁵

To facilitate the move to fuller sacks without causing the loss of bundle presort, the Postal Service will allow carrier route bundles, which up to now may have been entered in carrier route or (5-digit) carrier routes sacks, to be entered in 3-digit sacks.

Additionally, the Postal Service has promised to ease many regulatory restrictions that in the past have limited the ability of mailers to avoid the use of sacks. For example, until now Periodicals pallets have been required to be presorted at least to the ADC level. Mailers who could not meet the pallet minimum for a given ADC area therefore had to use sacks, or join a co-palletization or comailing program. However, the Postal Service now intends to accept mixed-ADC pallets, which means that all residual volumes can be palletized instead of sacked. Even a small mailer will now have the ability to avoid sacks, provided he has enough volume to fill at least one pallet.

For mailers who do not have enough volume to fill even one pallet with outgoing mail, the Postal Service will make available options such as dropping flats bundles in tubs or rolling containers placed on postal platforms. And, for mail

⁵ See McCrery's response to POIR 4, Question 6, Tr. 1692. In fact, there are at least three ways in which the official estimate understates the likely cost avoidances that will result from fewer sacks. First, as McCrery admits, his estimate considers only the cost avoided at the destinating facility, although sacks that travel through the postal system in fact incur substantial costs also in originating and intermediate facilities. Second, even in the destinating facility the model relied upon ignores the fact that a sack arriving at, for example, a destinating SCF, must be sorted and that this sorting almost always is a manual and slow operation. And third, the official estimate only measures direct labor costs and not the corresponding piggyback costs. Since piggybacked costs are assumed volume variable to the same extent as direct labor costs, it follows that such costs will also be reduced if the number of Periodicals sacks is reduced.

entered at destinating post offices, the Postal Service will accept pallets with as little as 100 pounds.

With all of these changes, it is reasonable to expect that most Periodicals sacks, and the large costs caused by them, will soon disappear from postal facilities.

Another change that should lead to very large cost reductions, and could have both positive and negative impact on service, is the Postal Service's decision to dismantle the separate outgoing Periodicals transportation and processing network.

A small volume of Periodicals flats is currently entered at originating post offices in mixed ADC containers, which means that they must undergo outgoing bundle and piece sorting. Because the volume of this mail is small, and because post offices generally avoid mixing Periodicals with other classes in outgoing processing, it is more often than not processed manually and at high costs.

The Postal Service now says that it will consolidate the processing of outgoing Periodicals flats into a limited number of facilities, where they will be combined with either outgoing Standard or outgoing First Class flats in mostly automated operations. Outgoing Periodicals flats that are destined to areas where First Class is transported by surface rather than air will be processed together with First Class flats, provided mailers separate them from flats to more distant destinations, where First Class travels by air.⁶

Eliminating the very costly separate outgoing processing of this small portion of the Periodicals class has the potential for significant reductions in total costs.

⁶ See USPS-LR-K-49 at 21. The Standard class also has a relatively small volume needing outgoing processing and should benefit as well from the combination with Periodicals flats and consolidation into fewer facilities.

C. The across-the-board increase should be applied to individual rate elements as well as subclasses

In this docket, unlike Docket R94-1, the Postal Service has provided updated versions of the various mail flow models and other studies that it normally relies on to estimate worksharing-related cost avoidances and develop worksharing-related discounts within each subclass. The Postal Service did not, however, rely on these studies in developing the proposed rates, choosing instead simply to apply the same percentage increase to all rate elements. USPS-T-28 at 4.

Since the estimated costs corresponding to individual rate elements have changed unevenly, while the proposed rates reflect a uniform increase, it follows that many of the proposed worksharing discounts reflect “passthrough” percentages very different from those that the Commission has approved in previous rate cases. It might therefore be tempting for the Commission to modify the rate design within a subclass, even if it applies the overall across-the-board rate increase to the subclass as a whole. However, for reasons explained below Time Warner strongly opposes such an approach.

Because most participants, including Time Warner, have refrained from submitting testimony in this docket, in anticipation of a settlement agreement, the mail flow models and other studies used to estimate worksharing cost avoidances have not been subjected to the same scrutiny and challenge that they would have faced in a normal rate case. These unchallenged cost estimates, and the worksharing passthrough estimates that they imply, are therefore not reliable and should not be used for rate development.

While similar comments may apply to many subclasses, we will focus on the Postal Service's flats mail flow model for Periodicals, contained in USPS LR-K-43 and sponsored by witness Miller (USPS-T-19). Had this been a normal rate case, Time Warner would have submitted testimony pointing out several inaccuracies in

that model. It would have shown that correcting those inaccuracies leads to substantially different estimates of the cost differentials between Periodicals flats at different presort levels. Furthermore, had the previous rate case (R2001-1) not been decided by a settlement agreement, Time Warner would also in that case have submitted challenges to the forerunner of the present model, contained in USPS LR-J-61 and supported by Miller's testimony in that docket (USPS-T-24).⁷

With regard to the present version of Miller's flats mail flow model, there is one particular mistake that Miller all but admitted to in his responses to a series of Time Warner interrogatories, TW-USPS-T19-1 through TW-USPS-T19-6; Tr. 1798-1808. Just correcting this one mistake would, as confirmed by Miller, raise the estimated mail processing cost differentials between carrier route presorted flats and all other flats by 1.535 cents per piece under USPS costing or 1.623 cents per piece under PRC costing, thereby altering substantially the "passthrough" percentages implied by the proposed rates. The reasons that such an adjustment to Miller's model is necessary are as follows.

Since the deployment of the AFSM-100, postal facilities have moved the preparation of flats bundles that need piece sorting to a separate operation referred to as MODS operation 035. Previously, this preparation work was often done by the sorting clerks, and its costs were therefore included in the piece sorting costs. The 035 operation has turned out to be highly labor intensive and adds substantially to the total cost of sorting flats. Miller's model distributes the cost of the 035 operation equally over all flats, even though the operation is bypassed by carrier route presorted flats and its costs are incurred only by non-carrier route flats. Therefore,

⁷ The forerunner of Miller's R2001-1 flats mail flow model was the model presented in Docket R2000-1 by witness Yacobucci (USPS-T-25) and contained in USPS LR-I-90. Time Warner did challenge certain aspects of that model, particularly its treatment of the costs of bundle breakage, through the testimony of witness Stralberg (TW-T-1). The Commission agreed with those challenges and adopted the alternative model proposed by Stralberg as the basis for its recommended rate design. PRC Op. R2000-1, ¶¶ 5648-5652.

the adjustment described above, distributing the 035 costs to non-carrier route flats rather than to all flats, is necessary.⁸

There are other problems as well in Miller's flats mail flow model that would need to be addressed before such a model could be used as a basis for ratesetting, including the way in which the model represents the costs associated with bundle breakage. Time Warner looks forward to addressing these issues in the rate case that the Postal Service has said it will file next year. For the purposes of this docket, however, we simply conclude that the Commission should not rely on the worksharing related costs in Miller's flats model or in other worksharing models submitted by the Postal Service. Instead, the Commission should apply the same uniform increase to all rate elements in all subclasses, as proposed by the Postal Service and accepted by the parties to the settlement agreement.

D. Cost-based pricing remains the best way to reduce costs while serving the real needs of Periodicals mailers

In Docket C2004-1, witnesses for Time Warner et al. demonstrated that current Periodicals rates, combined with the current regulatory scheme, encourage inefficient mail preparation and fail to provide proper incentives for mailers to help reduce Postal Service costs. For example, witness Stralberg showed that some

⁸ While confirming the adjustment to mail processing costs of carrier route and non-carrier route flats suggested in the Time Warner interrogatory, Miller's answer speculated that there might be an offset to this adjustment in in-office delivery costs, since carriers need to remove the bundling material from carrier route bundles. Tr. 1807-08 However, Miller's testimony dealt with mail processing costs, and there is no evidence that his expertise extends to delivery costs. In fact, a carrier's handling of a carrier route bundle is nothing like the slow "mail prep" operation performed on non-carrier route bundles in mail processing facilities. After a carrier removes the bundling material from a carrier route bundle he holds in his hand a set of flats of identical size, with the address in the same position on each piece and the pieces arranged in walk sequence. This makes it very fast and easy to sort those pieces into his flats case. By contrast, when he picks up a bundle of non-carrier route flats which have been through a prior piece sorting operation, those pieces typically are of many different sizes, making them more difficult to handle; they have address information in different locations, requiring a different orientation of each piece; and they are in random order as opposed to the walk sequencing of the carrier route bundles. In fact, IOCS data clearly demonstrate that carrier route presorted flats are sequenced substantially faster than non-carrier route flats, despite the extra time used to remove bundling material. See the responses of witness Taufique to POIR No. 3, question 2, and witness Kelley to POIR No. 2, question 1. See also PRC LR-1.

sacks cost over \$3 for the Postal Service to handle, yet there are millions of such sacks that carry just a few pieces of mail. Witness Mitchell proposed a set of cost-based Periodicals rates, including per-bundle, per-sack and per-pallet charges in addition to per-piece and per-pound charges. Complainants showed how adoption of this type of cost-based rates would quickly mobilize the creativity and abilities of publishers, printers, fulfillment houses and others to prepare mail in ways that would sharply reduce postal costs while meeting the real service needs of mailers.

In this docket, the Postal Service has espoused a different approach to reducing Periodicals costs. Some of the effects of the Postal Service's approach overlap those that would result from establishment of cost-based rates as proposed in Docket No. C2004-1. For example, the Postal Service will eliminate skin sacks by simply outlawing them. The approach proposed in Docket No. C2004-1 would have eliminated most skin sacks by making mailers who use them pay for what they cost.

Time Warner appreciates all the positive steps to reduce Periodicals costs that the Postal Service has announced and currently is implementing. But the need for real rate reform remains. Following are just a few examples that illustrate this need.

1. Assume that a Periodicals mailer concludes that it would be desirable to mail sacks containing fewer than 24 pieces to certain locations even if he has to pay for the costs of each such sack. For example, he may want to put 12 pieces in a sack that will cost the Postal Service \$3.60, or 30 cents per piece, in the belief that the 12 pieces thereby will be delivered faster than they would be if they were entered in a larger sack with lower presort. Why could not the Postal Service just accept the additional revenue, along with the sack?
2. Container presort level has a major impact on Periodicals costs, yet does not impact current rates except in the case of non-automation flats entered in sacks. Were container presort reflected in the rate structure, mailers would enter more deeply presorted pallets, thereby reducing bundle sorting costs in postal facilities. For example, there could potentially be many more 5-digit pallets than there are today. Placing flats bundles on 5-digit pallets, rather than on 3-digit or ADC pallets, saves bundle sorting costs and eliminates premature bundle breakage,

and the pallets can normally be dock transferred directly to the DDU. But presorting pallets to the 5-digit level is inconvenient to printers who would rather dispatch mail on fewer and larger pallets. In the absence of a rate incentive, many mailers will make up 5-digit pallets only when they are required to do so, i.e., when they have more than 500 pounds to a given 5-digit zone.

3. As the Postal Service has continued to improve the AFSM-100, the cost differential between flats that can be sorted on these machines and those that cannot has continued to increase. Yet this differential is not reflected in the rate structure.⁹ Mailers may have reasons to choose a layout of their Periodicals that falls outside of the machinability limits for the AFSM-100, but the rates should reflect the cost consequences of such choices.
4. The Postal Service has indicated that it will accept pallets weighing as little as 100 pounds. This will no doubt make possible the elimination of many residual sacks. But on the other hand, each such pallet will incur pallet handling costs that differ little from those incurred by a pallet weighing 1,500 pounds. Cost-based per-pallet charges, along with per-sack and per-bundle charges, would allow mailers to make rational decisions about how many separate pallets to use.

These are just a few examples of the desirability of more cost-based rates. Time Warner hopes that the Commission will soon rule on the proposals made in Docket No. C2004-1, and that the Postal Service will seriously address the need for rate reform in the next rate case.

⁹ Qualifying for the current flats automation discount requires only that a flat be machinable on the UFSM-1000, a requirement met by practically all flats.

Respectfully submitted,

s/

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