

UNITED STATES OF AMERICA
POSTAL RATE COMMISSION

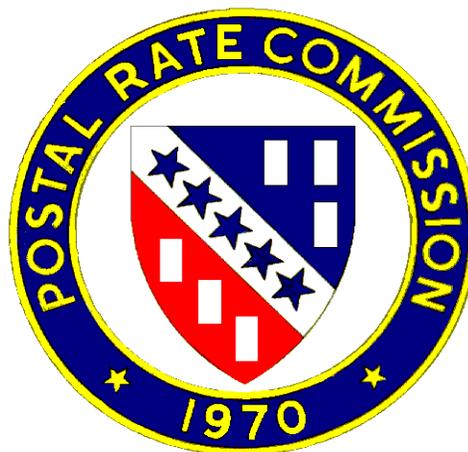
Before:

Chairman Omas,
Vice Chairman Tisdale,
and Commissioners Covington,
Goldway, and Hammond

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

Docket No. C2004-1

ORDER
ADDRESSING COMPLAINT
OF TIME WARNER ET AL.



Washington, DC 20268-0001
October 21, 2005

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I. INTRODUCTION AND FINDINGS

[1001] *Background.* In January 2004, five publishers — collectively referred to as Time Warner et al. or the Complainants — jointly filed a formal rate complaint with the Commission.¹ This complaint raises three main issues concerning the Periodicals rate structure and a host of ancillary questions. The main issues, in brief, are:

- whether the existing Periodicals rate structure is consistent with controlling statutory provisions;
- whether the Complainants’ efficiency-oriented alternative structure and its attendant rates are an appropriate replacement; and
- whether pursuing these issues in the context of the statutory complaint mechanism is appropriate.

[1002] The Complainants requested a full hearing on their claims, and recommendation of their proposed alternative rate structure.²

[1003] The Complainants’ alternative proposal retains some features of the existing rate structure without change, alters others, and adds several new elements. The most extensive revision consists of two related adjustments. One expands the basic “building blocks” of rates, which now consist of pieces and pounds, by adding bundles, sacks and pallets as fundamental components. The other adjustment establishes linkages between and among these new elements and other familiar components in the structure, such as presort level and entry point. This more dynamic approach flows from the Complainants’ contention that bundles, sacks and pallets have not only become the standard ways in which publications are prepared, processed and distributed in today’s environment, but have also emerged as significant cost drivers.

¹ 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.

² An early procedural ruling excluded specific rate recommendations from the scope of this case. PRC Order No. 1399, March 26, 2004 at 12-13.

[1004] Another change replaces both the flat editorial pound charge (EPC)³ and another element in the existing structure (the per-piece editorial benefit) with a single discount of 10.1 cents per pound, based on editorial percentage. This reflects Complainants' dual contention that the flat EPC is an outmoded, and perhaps counterproductive, policy preference, and that their approach to recognizing editorial content is more fair and effective.

[1005] Other important, but less extensive, changes include reconfiguring presort levels to mirror documented mail flows; adding direct entry at bulk mail centers (BMCs) to the existing array of dropshipping points to conform with real-world distribution practices; and recognizing mailpiece machinability, in addition to prebarcoding.

[1006] Complainants contend that their proposal, considered as a whole, will foster more efficient mailing practices, especially through sack charges, by providing mailers with better price signals; continue to provide appropriate recognition for editorial content (although this would be expressed differently); and avoid undue interference with delivery service. They acknowledge that rates for mailers who will not — or cannot — change their preparation practices will increase under their approach, but claim that there is adequate time and opportunity to mitigate any ensuing harm. Their supporting rationale includes sophisticated cost analyses; related rate design proposals; a legal memorandum on the flat editorial pound charge; and a critique of relevant classification criteria.

[1007] *Reaction.* The Complaint has the unqualified support of the Magazine Publishers Association and U.S. News & World Report, but meets with reservations or opposition from many other participants. Criticism focuses on four aspects of the proposal. One is the use of the complaint mechanism and the Commission's exercise of section 3662 jurisdiction. The others are the proposal's single-minded emphasis on efficiency; the departure from the traditional treatment of editorial content; and the impact on rates and service.

³ In this document, the phrase "editorial pound charge" refers to the uniform charge assessed on the weight of Periodicals nonadvertising content under the existing structure.

[1008] The concern about recognizing enhanced efficiency centers primarily on constraints that will (or might) interfere with some mailers' ability to adopt favored practices, given considerations such as low circulation per mailing; geographically dispersed subscribers; commitments with printers; a business interest in maintaining late advertising or editorial cutoff times; inability to use alternative containers; and postal regulations.

[1009] The commentary on rate impact raises several related issues: the extensive number of changes involved in the proposal; the disparate range of resulting rate increases and decreases; and the consequences in terms of the subclass profile. The last point, some emphasize, means that mailers that account for much of the volume, but relatively few of the titles, would receive rate decreases (sometimes with little or no change in their existing practices), while most of the titles would face significant increases. Additionally, service concerns are raised by those that doubt co-mailing and co-palletizing can work for mailers with time-sensitive publications, and those with an interest in the Outside County copies sent by small local daily or weekly newspapers.

[1010] *Observations and conclusions.* The Complainants' filing marks the latest in a series of cases raising significant concerns about Outside County Periodicals costs and rate design. It is distinguished, however, by several unique features. These include the existence of considerably more — and better — data than previously available; the presentation of the most sophisticated Periodicals cost analysis and rate design theories; and the opportunity to devote resources to exploring pressing Periodicals cost and policy issues outside the constraints of an omnibus rate or major reclassification case.

[1011] Periodicals mailers and the Postal Service have exhibited an extraordinarily high degree of cooperation in resolving potential problems and developing a useful record. Notable examples include Complainants' willingness to supply others with a computer program that analyzes the rate impact of their proposal, along with any necessary technical assistance, and the Postal Service's prompt production of expanded Periodicals data in response to a Commission request. The Commission acknowledges that these efforts exceed the basic requirements that attach to participation in agency

proceedings. It appreciates the willingness of these participants and others to devote time and resources to important issues affecting Periodicals mailers.

[1012] On the question of jurisdiction, the Commission confirms its finding in Order No. 1399 at 11, that acceptance of the complaint is within the scope of its statutory complaint authority. Arguments to the contrary are based on an inappropriately narrow view. On the question of the complaint's disposition, the Commission notes that the Complainants have faced a substantial legal hurdle in attempting to fully establish their claim that the existing structure is so defective that the rates it generates no longer comply with the Postal Reorganization Act. They have presented a well-documented case that there are significant inefficiencies in the Periodicals rate structure, and that some structural and administrative improvements are appropriate and desirable. At the same time, encouraging enhanced efficiency — while a significant concern in devising a rate structure — is only one of many considerations that enter into this task. The nature and extent of the potential impact on rates and service are also important factors. When these considerations are taken into account, the record does not support a finding that the existing structure is fatally flawed in the statutory sense advanced by the Complainants.

[1013] Thus, the Commission does not “issue a recommended decision which shall be acted upon (by the Governors) in accordance with the provisions of section 3625... .” This does not mean that the Commission finds no merit in the proposal. Significantly, while the evidence of record shows that full implementation of the Time Warner et al. proposal would have substantial adverse rate impact on thousands of small publications, it also shows that progress towards a more cost-based structure is both possible and necessary. There are several options open to the Postal Service by which it could immediately begin to better align the Periodicals rate structure with the costs imposed on the Postal Service by various existing mailing practices. The Complainants have made a major contribution by identifying and quantifying cost drivers associated with bundles, sacks and pallets.

[1014] In the following sections, the Commission provides its analysis of the evidence presented, and identifies a number of areas where improvements in the Periodicals rate structure may be both possible and warranted. A complete review of the presentations of Complainants' witnesses and the responsive filings of other participants is presented in Appendix A. The primary legal controversy — the justification for continuing the flat editorial pound rate — is addressed in Appendix B.

[1015] The Commission sees many possibilities for positive action that should not cause undue disruption. For example, the proposed machinability distinctions in piece charges would recognize the additional costs of processing nonmachinable mail. These distinctions exist in other classes and as flats automation progresses they will become more important. They should be seriously considered within the context of changing operations. The proposed presort levels refine existing presort elements by creating additional divisions. The additional dropship incentive would give mailers the option of entering publications at BMCs. Each of these elements have considerable potential.

[1016] The cost analyses that have been the focus in this case reflect processing practices that are now somewhat out of date. The Postal Service should update these analyses, evaluate the impact of potential rate changes on various categories of Periodicals mail, and suggest incremental changes that will foster efficient mailer practices without undue disruption.

[1017] The Commission recognizes that it is initially the responsibility of the Postal Service to review the materials provided herein and choose a path for improving the efficiency of Periodicals consistent with rates that do not unreasonably impact any segment of that class. Appendix C provides for Postal Service evaluation and consideration one possible means for achieving that goal referred to as the "opt-in" approach.

[1018] The record before the Commission contains substantial information on the mailing profile of Periodicals. Appendix D describes the information provided by the Postal Service in response to a Commission Notice of Inquiry that allows for analysis of small circulation publications. Appendix E contains a guide to publications' profile data

and information provided by other participants during the course of this proceeding. Appendix F contains an econometric analysis of publications' profile data. This analysis was undertaken by the Commission to identify correlations between mailer attributes and the impact of the rate design proposed by Complainants.

[1019] Major Commission Findings and Recommendations

1. The Commission finds that after consideration of the record made in this case, the existing rate structure for Periodicals mail is not violative of the policies of the Postal Reorganization Act, and therefore, it does not issue a recommended decision to be acted upon by the Board of Governors.
2. The Commission finds that although full implementation of Complainants' proposal would have substantial adverse rate impact on thousands of small publications, progress toward a more cost-based structure is both possible and necessary to increase efficiencies in the Periodicals rates.
3. The Commission recognizes that it is initially the responsibility of the Postal Service to review the materials provided herein and choose a path for improving the efficiency of Periodicals consistent with rates that do not unreasonably impact any segment of that class.
4. The Postal Service should review each of the rate design features in the context of the current and planned processing and transportation network for Periodicals mail. The focus should be on quickly incorporating the most promising and least disruptive components. Efforts to develop a less costly container than the sack should be emphasized as a better way to reduce the number of sacks in the postal system than imposing rate penalties on captive users.
5. The Commission strongly urges the Postal Service to investigate whether, and to what extent, the use of skin sacks by Periodicals mailers actually improves speed and consistency of service and urges mailers to cooperate fully in this endeavor.

6. To minimize disruption, the Postal Service should provide Periodicals mailers with notice that pieces that are nonmachinable will become subject to rates that reflect higher processing costs.
7. The Commission agrees that the adjustments to presort tiers (separating the basic tier into mixed ADC and ADC tiers, and reconfiguring the 3-digit tier to include pieces sorted to SCF bundles) proposed by witness Mitchell appear to reflect mail flows, and that these refinements may be an improvement for that reason.
8. The Commission encourages the Postal Service to investigate the feasibility of incentives for entering Periodicals mail at destination BMC facilities in terms of both internal operations and service considerations, but also to identify any potential physical impediments to widespread BMC entry point use in this manner.
9. The Commission finds that the flat editorial pound charge in Periodicals effectively fosters the public policies of the Act.
10. The Commission recommends that the Postal Service consider, and confer with a broad cross-section of Periodicals mailers, concerning the potential benefits of implementing a bifurcated opt-in rate schedule for Outside County Periodicals.

II. PROCEDURAL HISTORY

[2001] The Complainants jointly submitted a filing captioned “Complaint Concerning Periodicals Rates” on January 12, 2004, pursuant to section 3662 of the Postal Reorganization Act. The filing included information addressing applicable Rule 83 provisions, as well as detailed commentary on Periodicals issues and recent initiatives. This commentary provides a description of developments leading to the creation of a joint industry/Postal Service Periodicals Mail Processing Review Team in 1998; a review of certain Task Force recommendations; and comments on AFSM-100 productivity. Complaint at 16-18.

[2002] The initial filing also includes two exhibits and an extensive evidentiary proffer consisting of the prepared testimony of two witnesses (Robert W. Mitchell and Halstein Stralberg) and an indication that the testimony of two other witnesses would likely be forthcoming.

[2003] A copy of the Complaint was sent to the Postal Service’s General Counsel. See Letter of Steven W. Williams, Secretary of the Postal Rate Commission, to Mary Anne Gibbons, General Counsel, United States Postal Service, January 13, 2004. The Service, in an Answer filed February 11, 2004, (Answer), stated that it did not oppose improved efficiency in Periodicals rate design, believed more can be done in this regard, and was exploring many of the structural changes proposed in the Complaint. Answer at 2. However, it opposed any form of Commission action on the Complaint, other than summary dismissal due to alleged deficiencies in form and substance. *Id.* at 8.

[2004] *Initial Commission action.* The Commission found that the Service’s motion to dismiss failed to acknowledge the core of the Complaint: that the filing was, in essence, a challenge to the continued efficacy of Outside County Periodicals rates, charging that the rate structure is so outmoded that the rates it generates *ipso facto* violate controlling provisions and policies of the Postal Reorganization Act. Order No. 1399 at 11.⁴ Thus, the Commission said that it would consider these issues, seek and

⁴ Order No. 1399 was published at 69 FR 17244 (April 1, 2004).

review data as appropriate to inform its deliberations, and, if necessary, recommend changes to that structure. At the same time, the Commission said that practical considerations militated against recommending rates. *Id.* at 12-13.

[2005] *Participation.* In addition to the Postal Service and the Office of the Consumer Advocate (OCA), 16 intervenors participated in this case. They include: Alliance of Nonprofit Mailers (ANM); American Business Media (ABM); American Postal Workers Union, AFL-CIO (APWU); Association of American Publishers (AAP); Dow Jones & Company, Inc. (Dow Jones); Hearst Communications, Inc. (Hearst); Magazine Publishers of America (MPA); Mail Order Association of America (MOAA); The McGraw-Hill Companies, Inc. (McGraw-Hill); National Newspaper Association (NNA); Newspaper Association of America (NAA); Pitney Bowes Inc.; David B. Popkin (Popkin); U.S. News & World Report, L.P. (U.S. News); Valpak Dealers' Association, Inc. (VPDA); and Valpak Direct Marketing Systems, Inc. (VPDMS). Initial briefs were filed by the Complainants; ABM (joined by McGraw-Hill); APWU; MPA; NNA; the Postal Service; and OCA. The same participants, with the exception of APWU and OCA, submitted reply briefs.

[2006] The Commission, sitting en banc, held hearings during which Complainants' witnesses testified. By agreement of the participants, the testimony and designated written cross-examination of other witnesses were entered into the record administratively.

[2007] *Significant developments.* Significant developments include the Commission's resolution of a jurisdictional challenge in favor of accepting the complaint under section 3662; a related decision not to recommend rates in any ensuing decision; and issuance of a series of requests for Periodicals-specific data and information. In post-record developments, the Service filed Docket No. R2005-1, an omnibus rate request, and submitted data collection reports in two ongoing Periodicals experiments. The omnibus request seeks an across-the-board average increase of 5.4 percent and, unlike most other omnibus cases, does not include any classification changes. It does,

however, project significant Periodicals costs reductions as a result of planned adjustments to sacking requirements.

[2008] The data requests reflect the Commission's assessment that the record could be substantially improved if it included more recent Periodicals data and a better indication of the impact of the proposal on a wide range of publications, including those with low circulation.⁵ In POIR No. 1, witness Mitchell was asked to construct postage for a publication under the proposed rate schedule and to describe and quantify how the proposed rate schedule might alter the mailing profiles of certain magazines mailed by the Complainants. In POIR No. 2, the Service was asked to provide a regression based on data from tables in Postal Service rebuttal witness Tang's testimony, to provide a larger sample of 250 observations, and to augment the list of variables with additional characteristics, such as percentage of the mailing that is zoned, palletized and presorted. In POIR No. 3, the Commission asked American Business Media to provide the percentage of editorial content for 144 publications. NOI No. 1 asked the Service to provide additional data on the 25,000 titles that witness Tang indicated have circulation of less than 15,000 per issue (and that account for 12 percent of Outside County volume). The requested data include, among other things, a breakdown of the 25,000 low circulation titles into four categories;⁶ identification of how many are nonprofit; the percentage published weekly or more frequently; the percentage that contain more than 10 percent advertising;⁷ and a distribution of pieces by weight, zone and container type.

⁵ Presiding Officer's Information Request No. 1, May 26, 2004 (POIR No. 1); Presiding Officer's Information Request No. 2, September 23, 2004 (POIR No. 2); Presiding Officer's Information Request No. 3, September 23, 2004 (POIR No. 3); Notice of Inquiry No. 1 Concerning Periodicals Data, November 19, 2004 (NOI No. 1).

⁶ The four categories are 1,000 copies or less; 1,001 to 5,000; 5,001 to 10,000; and 10,001 to 15,000. NOI No. 1 at 2.

⁷ Copies with 10 percent advertising or less are considered to be consisting of all nonadvertising content for rate purposes. See DMM § 707.10.

It also asked participants that had not already provided publication data to submit relevant information for the record.⁸

[2009] The Commission further notes that in discussing the availability of historical data on publications, Postal Service witness Tang testifies that the existing recordkeeping systems are limited. In particular, she notes: “The computer platforms upon which these systems rely were implemented many years ago and are not as flexible as might be the case were the systems being designed today.” Tr. 6/2202.

[2010] As much of the Service’s focus is on capturing data for purposes of assuring accurate payment of postage on current mailings, it is understandable that maintaining an extensive historical data base has not been a priority. At the same time, Periodicals is a relatively small class, and comprehensive data on this class have considerable value in terms of ratemaking and other policy decisions. The impact of the Internet, which cannot be fully discerned as of now, is also of importance as more publications consider electronic offerings. The Commission therefore urges the Postal Service, with the cooperation of mailers, to develop a profile of all Periodicals mail with information along the lines requested by Time Warner et al. in interrogatories directed to witness Tang. See, e.g., *id.* at 2199. This profile, along with the information used to develop Periodicals mail preparation characteristics (Docket No. R2005-1, USPS-LR-K-92) would be very useful in Periodicals rate design.

[2011] The jurisdiction issue centers on whether interested persons may pursue the questions raised in the complaint in the context of a section 3662 proceeding.

[2012] The Commission resolved initial objections to its acceptance of the Complaint by recognizing, among other things, that the filing raised a sophisticated claim: namely, that Outside County Periodicals rates are based on a structure that is so

⁸ See Response of Time Warner Inc. et al. to Notice of Inquiry No. 1, December 8, 2004 (Time Warner et al. NOI Response), in which witness Stralberg asserts that his analysis of Tang’s response leads him to conclude that the smallest Periodicals, with circulation of 1,000 or lower, would collectively benefit from zoning editorial pound rates, other factors being equal, and that many of the publications with circulations below 1,000 are likely to be the outside-county components of Periodicals that also mail under within-county rates. Time Warner et al. NOI Response at 1.

outmoded that, *ipso facto*, they violate controlling provisions of the Postal Reorganization Act. Order 1399 at 11. It was on this ground, in large part, that the Commission found that the Complaint sufficiently stated a claim that current Periodicals rates were unlawful.⁹ The Service renews its jurisdictional objections on brief. See *generally* Brief of the United States Postal Service at 3-8. Among other things, it revisits its earlier claim that the Complainants' filings "nowhere ... specifically allege that the existing rates, fees, or classifications for Periodicals mail do not conform to specific policies in the Act." *Id.* at 8. It also takes issue with the Commission's references to Docket No. C99-4 in Order 1399, claiming these statements "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." *Id.* at 5.

[2013] The Commission reiterates that it understood and accepted the Complaint as a challenge to the fundamental lawfulness of Outside County Periodicals rates, and has provided a forum in which this question could be explored. This proceeding has been focused on building a record on this question, not on acting without regard to the "lawfulness" issue or simply to provide a path to a pre-ordained recommendation. The Service's insistence that the Complainants did not present any allegation that the current rates are unlawful attempts to elevate form over substance, and misapprehends the force and effect of the Complainants' filing and the basis on which the Commission accepted it.

⁹ The Commission also determined that certain technical failings were either curable or not material. *Id.* at 11-12.

III. THE COMPLAINT

[3001] *Introduction.* The inordinately high rate of Periodicals cost increases over a period of years coupled with a perception of declining service has prompted a number of approaches to explaining and attempting to alleviate the problem.¹⁰ One way the Service has responded to these problems is by encouraging mailers to improve bundle preparation and by providing them with an incentive, in the form of dropshipping discounts, to enter publications as close as possible to their final destination.

[3002] Complainants propose a more comprehensive approach focusing on fundamental reform of the basic rate structure of Periodicals. This entails adding several elements that Complainants contend are significant cost drivers to the rate structure, and recognizing the linkages between these elements and certain related features, such as presort level and entry point. The following discussion addresses the Complainants' rationale for proposing these changes, the underlying cost model, the anticipated impact on rates and service, and the divergent viewpoints expressed on the record.

[3003] *Summary.* The Complainants sponsor five witnesses in support of their proposal. Witnesses Mitchell and Stralberg are expert witnesses who address complex costing and pricing issues. Witness James O'Brien, Vice President of Distribution and Postal Affairs for Time Incorporated, and witness Joseph E. Schick, Director of Postal Affairs for Quad/Graphics, Inc., provide an industry perspective on the need for rate structure reform.¹¹ Witness John Steele Gordon, an author and historian, addresses technological changes that affect the "nation binding" role of Periodicals, which has been a consideration associated with the flat EPC.

[3004] *Periodicals ratemaking dilemma.* The Periodicals class presents difficult and, in some respects, unique issues. In addition to containing editorial content, it encompasses a large variety of diverse publications, in terms of circulation size, frequency, and content. Outside County subclass rates apply to approximately 30,000

¹⁰ See, for example, PRC Op. Docket No. R97-1, para. 5768 and PRC Op. Docket No. R2000-1, paras. 5557-93.

¹¹ Time Incorporated is a division of Time Warner Inc.

diverse publications. This subclass contains Regular Rate, Science of Agriculture, Nonprofit, and Classroom publications. In addition, Within County publications — mostly newspapers — mail some issues at Outside County rates. Accommodating the service needs and other interests of mailers in the Postal Service processing and transportation networks is challenging enough when mail characteristics are fairly homogeneous — the difficulty is compounded by the diverse mailing practices within the industry which are influenced by circulation size, density, and geographic distribution among the users of Outside County subclass. In this subclass, only 3 percent of the titles generate 68 percent of the piece volume. The other 97 percent of the titles generate the remaining 32 percent of the volume. Publications with per-issue mailed circulation of less than 15,000 number 25,234. Tr. 6/2232. Moreover, the nature of Periodicals content poses important policy issues that must be weighed against the economic efficiency associated with a particular rate structure. The favored treatment of publications in the mailstream — especially the editorial content in these publications — has a long history beginning well before postal reorganization in 1970.¹² It is against this backdrop that Complainants have come forward with their proposal.

¹² See PRC-LR-1, A Policy History of Selected Preferred Mail Categories, and PRC-LR-2, A History of Mail Classification and its Underlying Policies and Purposes.

IV. PROPOSED RATE STRUCTURE AND RELATED COSTING SUPPORT

A. Introduction

[4001] The testimony of Complainants' witnesses, considered as a whole, makes clear that the proposal attempts to effect a comprehensive, fundamental reform of the Periodicals rate structure. Thus, relative to the current approach, the individual components of the proposed structure are intended to operate as part of a cohesive — and dynamic — whole. In the fullest realization of this new approach, Stralberg suggests that mailers be allowed to determine the optimum makeup of each of their mailings and not be tied to administrative limits, such as a pre-determined minimum weight for preparing a pallet or a required number of bundles per sack. Tr. 1/26. He notes: "The 'optimal' bundle minimum may depend on whether the pieces are machinable, whether they are pre-barcoded, presort level of the bundle, whether it is entered on a pallet or in a sack, and other factors." Id.

[4002] Supporters and opponents generally recognize the comprehensive nature of the Complainants' proposal and how the component parts of the proposed structure contribute to the overall objective. MPA and U.S. News, for example, applaud the efficiencies. Many opponents, however, focus almost exclusively on rate impact and service issues, or only on one or two individual elements, such as the new sack charges or the revised editorial discount. To provide a full assessment of the proposed structure, the following section addresses each of its main elements.

B. Bundle and Container (Sack and Pallet) Charges

[4003] *Background.* In the existing rate structure, rates for Outside County Periodicals are calculated with reference to two main elements — pieces and pounds.¹³ Based on observations about how mail is handled in today’s operating environment, witness Mitchell proposes adding three more elements — bundles, sacks and pallets — to the calculation. Under this approach, the fundamental components in pricing a mailing include the number of pieces in the mailing, the number of pounds, the number of bundles, and whether the bundles are placed in sacks or on pallets.¹⁴ In support of this change, Mitchell testifies that knowledge about cost drivers has improved in recent years, and contends that this:

... has brought the existing deficiencies into clearer focus and has suggested new paths that cost recognition should follow. For example, the makeup of bundles, sacks, and pallets, including their entry points and associated interactions, are now understood to be important cost drivers, but these factors are all but neglected in rates. As a consequence, mailers often have no way of knowing or reason for caring that their decisions about mail preparation and transportation are needlessly wasteful. If the factors that drive costs were reflected in rates, mailers would respond accordingly.

Tr. 3/800-1.

[4004] Witness Stralberg analyzes the costs associated with processing sacks and finds reasons for the inefficiencies that concern witness Mitchell. He concludes that sack-related costs depend on the number of sacks being handled, the presort level of the sack, and the sack’s point of entry into the mailstream relative to its destination.

Tr. 1/23-24. He therefore asserts: “A cost-based rate design should include per-sack

¹³ Various discounts are taken from these charges.

¹⁴ Mitchell’s proposal also links these elements to presort level and entry point.

charges that are consistent with the actual costs of handling sacks, which generally vary from \$1 to over \$3 each.”¹⁵ *Id.* at 24. Moreover, he says:

Such charges would, in my opinion, quickly reduce the fairly widespread practice among Periodicals mailers of sending sacks with only one or a few pieces in them through the postal system. A cost based sack charge may not seem unreasonable if the sack contains 40 pieces, but it would present a strong disincentive to mailing a sack with only one piece.

Ibid. (footnote omitted).

[4005] At the same time, Stralberg believes that if appropriate pricing is in place, there is no need to prohibit the practice of preparing skin sacks. He suggests that a mailer may have a good reason — such as service considerations — for mailing a single piece or a few pieces in a separate sack, but emphasizes: “If given correct price signals that require them to bear the costs of choosing such practices, however, chances are that mailers will avoid such practices in almost all cases.” *Ibid.* (n.4).

[4006] *Commission analysis.* This aspect of the Complainants’ proposal elicited comments on Stralberg’s model; on the implications of the sack charge relative to perceptions about delivery service and the absence of alternative containers; and the validity of the Complainants’ rationale for recognizing new cost drivers.

1. The Stralberg Model

[4007] Criticism of Stralberg’s model focuses on its suitability, accuracy and reliability.¹⁶ With respect to suitability, Postal Service witness Miller’s position is that a large number of cost drivers affect Periodicals costs, and that is not possible to reflect all of them directly in rates. Miller also generally believes that discounts should be based on

¹⁵ In this case, Mitchell’s proposed bundle and container rates are equal to Stralberg’s bundle and container costs; there are no additional markups.

¹⁶ Stralberg’s testimony addressing development of the supporting cost model is summarized in Appendix A.

comparisons of cost differences between a benchmark and the existing presort categories. Tr. 6/2157-59. The Commission notes that witness Miller acknowledges that Periodicals discounts are not currently calculated with reference to a benchmark. Id. at 2159-60.

[4008] With respect to accuracy and reliability, the main criticisms are that Stralberg uses somewhat dated mail flow assumptions and that the model is not comprehensive.¹⁷ Stralberg readily acknowledges the need for updated data and information, and fully explains the assumptions and adjustments he makes in the face of these problems. Moreover, he contends that while updated information would be helpful, its absence does not alter his main point, which is that the Periodicals rate schedule could be substantially improved by recognizing new cost drivers. Tr. 1/21.

[4009] Given the unavailability of current data and information, the Commission finds criticisms of Stralberg's model on this point somewhat misplaced. Stralberg obviously attempted to update existing analysis, although there are unquestionably several instances where more recent data would be a better starting point for the development of container charges. These include the productivity figures for flats operations and pallet cross-docking, and the cost for preparation of pallets for manual bundle sorting. For example, Stralberg uses FY 2001 Management Operating Data System (MODS) productivity data for flats operations. This is an improvement in the sense that these data are more recent than those used in the original version of USPS-LR-I-332.¹⁸ Base year MODS data provided in Docket No. R2001-1 show that 59 percent of Periodicals Outside County Regular Rate processing costs are generated by manual sorting operations. The mail processing environment for Periodicals is changing, however. The AFSM-100 inventory was expected to increase from 355 to 534 between

¹⁷ Stralberg does not model per-piece costs incurred in the delivery function, bundle costs, or forwarding and other handlings that "do not occur in the normal flow of most flats through the postal system." Tr. 1/28. Bundle costs are developed using USPS-LR-J-61, the Postal Service's flats model from Docket No. R2001-1.

¹⁸ Stralberg Workpapers, workbook FlatsR01Modified, worksheet 'PRODUCTIVITIES'.

fiscal years 2001 and 2002.¹⁹ These and other changes in the operating environment subsequent to Docket No. R2001-1 should be reflected in any rate design for Periodicals.

[4010] Stralberg also modifies pallet cross-docking productivities, based on a review of Postal Service witness Byrne's Docket No. R84-1 testimony. Byrne had studied an SCF and calculated a productivity of 9.5 pallets per hour for cross-docking. Stralberg reasons that cross-docking at a BMC would result in *lower* productivity because of the greater distances between inbound and outbound docks. At the same time, he says that the BMC annexes where Periodicals mail is cross-docked are smaller than main BMC facilities. Consequently, he uses 8.5 pallets per work hour as the cross-docking productivity at BMCs. This is lower than the SCF productivity Byrne calculated, but not as low as the BMC productivity used in the original model USPS-LR-I-332 (6.7 pallets per hour). Stralberg's reasoning seems sound; however, since the Byrne study is over 20 years old, the Postal Service should consider measuring current productivities for this operation.

[4011] Stralberg also adds costs not included in the original model, such as unloading costs for SCF, ADC and BMC entry facilities. This is based on the conclusion that the container flows in the original model start with the containers already on the platform of the entry facility. He adds a cost for preparation of pallets for manual bundle sorting. Tr. 1/47. Stralberg bases the latter cost on an industrial standard Postal Service witness Acheson used in Docket No. MC91-3. The Commission found Acheson's cross-docking transfer assumptions reasonable and used them.²⁰

[4012] Stralberg also believes that the USPS-LR-I-332 model did not include MODS operation 035, where non-carrier route flats bundles are prepared for the AFSM-100. Although these costs should be included, he did not have access to MODS 035 data, so he was unable to incorporate the information into his model. Stralberg

¹⁹ United States Postal Service, *Flats Automation Strategy*, May 2003, at 1.

²⁰ PRC Op. Docket No. MC91-3, para. 2113.

believes incorporation of this data would have increased the costs of non-carrier route flats relative to carrier route flats. Tr. 1/27.

2. The Problem of Sacks and Service

[4013] There was little direct or implied criticism of Stralberg's model. He appears to have accurately captured the cost causing characteristics of containers and provided the Postal Service with a sound framework for further study. Although changes in mail processing operations must be captured, and costs updated, his contribution can not be overstated. Armed with this tool, Postal Service managers can explore ways to improve operating efficiency as a prelude to pricing changes.

[4014] The use of sacks — especially sacks containing few pieces, known as skin sacks — emerges as a dominant theme in this proceeding. Many mailers of low-circulation Periodicals, particularly newspapers, apparently believe that service deteriorates if they do not engage in the practice of using skin sacks containing as few as one or two pieces. Moreover, according to Stralberg, the practice of sending skin sacks is not limited to small mailers, since he has “become aware that it occurs frequently among very large mailers, including Time Inc.” Id. at 24, n.4.

[4015] Stralberg generally discounts the perception that using skin sacks improves service, but acknowledges that service may sometimes be slowed when mailers use less finely presorted sacks with a greater number of pieces. He believes this is most likely to occur for outlying 5-digit ZIP Codes with low volume. He also regards these instances as relatively rare occurrences, and believes they result from Postal Service operational failures to meet critical dispatch times. Tr. 5/1564. Stralberg provides the following example of a potential service delay associated with a Periodicals ADC sack passing through a BMC/transfer hub:

The sacks may pass through a BMC/transfer hub where the Postal Service sorts sacks but normally not Periodicals bundles. When a Periodicals ADC sack (or pallet) comes to the BMC/transfer hub it is sent on to the ADC where it is opened and its bundles sorted. Some of those bundles may be to other SCF's served by the ADC. If those bundles were

in 3-digit/SCF sacks they would have gone directly from the BMC/transfer hub to the destinating SCF, bypassing the ADC, which could give a one-day delivery advantage in some cases. However, this is likely to occur only for sacks going to a small SCF that is not an ADC. ADC's are large SCF's that serve smaller surrounding SCF's. *Most of the mail in an ADC sack may be to the ADC's own service area and for that mail there is unlikely to be any service advantage in using 3-digit rather than ADC sacks.*

Id. at 1564-65 (emphasis supplied).

[4016] Postal Service witness Tang addresses the issues of cost and service quality in her response to an interrogatory from Time Warner et al. asking whether the cost of handling skin sacks was in many cases *higher* than the total postage for pieces contained in the sacks. She states:

... I generally do not focus on whether rates cover costs for a particular piece of mail, or portion of a mailing. However, as a general notion, there is a concern that fewer pieces per sack means that there is a greater cost per piece for each sack handling. With that in mind, efforts to address the 'skin sack' issue should take into account these additional costs and any impact on customers, along with other potential areas such as service quality — whether real or perceived.

Tr. 6/2178.

[4017] There is no current study squarely addressing whether the "skin sack" practice really enhances service, but it is clear that many mailers are convinced that it is necessary. This means that mailers are using small-volume sacks to meet their service expectations, even though this increases costs in a way that is not reflected in current rates, and imposes no direct consequences on an individual mailer. This makes the problem of reducing or eliminating low-volume sacks particularly difficult. Whether current processing conditions actually make it necessary to use low-volume sacks to receive established levels of service is an empirical question, and this question cannot be answered without more information on how sacking relates to service. Two things are

known, however: first, Stralberg's analysis highlights the high cost that skin sacks impose on the system; and second, the Domestic Mail Manual (DMM) contains the following provision that allows preparation of low-volume sacks based entirely on a publisher's perception of service:

Low-Volume Bundles and Sacks

As a general exception to 22.2, ...nonletter-size Periodicals may be prepared in low-volume 5-digit and 3-digit bundles containing fewer than six pieces *when the publisher determines* that such preparation improves service, if those bundles are placed in 5-digit, 3-digit, and SCF sacks. Low-volume bundles also may be placed on merged 5-digit scheme, 5-digit scheme, merged 5-digit, 5-digit, 5-digit metro, 3-digit, and SCF pallets.

DMM § 707.22.4, formerly M210.1.5 (Issue August 10, 2003). (Emphasis supplied.)

[4018] This language seems to indicate that the option was created as a response to service breakdowns. If this speculation is correct, and the cause of previous service breakdowns has been corrected, it would be advantageous for both the Service and Periodicals mailers to re-examine sack minimums.²¹ The Commission therefore strongly urges the Postal Service to investigate whether skin sack use by Periodicals mailers actually improves speed and consistency of service, and urges mailers to cooperate fully in this endeavor.

3. The Problem of "Sacks versus Pallets"

[4019] *The "sack versus pallet" debate.* A related area of great concern on this record is the extent to which publications can be moved out of sacks and onto pallets, even if an incentive to do so is built into the rate schedule. This problem is particularly thorny due to the absence of containers (other than pallets) that would provide an alternative to presenting mail in sacks; the longstanding 250-pound minimum for using a

²¹ The record is silent on whether there are systemic service delays.

pallet; and practical constraints on participation in co-palletization programs that otherwise might allow mailers to “escape” sack charges.

[4020] Testimony on this record makes clear that for many mailers, sack usage occurs by default, rather than by preference. Witness Heath, for example, points out that sacks and pallets are currently the only containers officially approved by the Postal Service.²² Tr. 6/2064. Witness McGarvey echoes Heath’s frustration, asserts that mailers do not like sacks, and says: “Give us a reasonable way to get out of them, or to reduce the sack count by increasing the sack size with assurance that service will not be compromised, and we will.” Id. at 1787.

[4021] It has long been suggested that pallets are not the only type of containerization that would lower Postal Service costs. As early as Docket No. MC91-3, for example, Dow Jones proposed a discount for using all-purpose containers (APCs).²³ In this case, witness Stralberg suggests that the use of tubs for small volumes of Periodicals appears to make sense. In addition, administrative exceptions may allow publishers with the typical NNA mailing profile to forgo containers altogether in certain well-defined situations. Tr. 6/2069-71. However, the Service is largely silent on the question of whether it is actively working on developing viable alternatives to sacks for the bulk of the Outside County Periodicals mailstream. Given mailers’ clear interest in an alternative and Stralberg’s analysis showing that sacks are a relatively costly container, the Postal Service is urged to devote resources to seeking viable alternatives to sacks.

[4022] The Periodicals class has had a well-documented history of rapidly rising costs despite coordinated mailer and Postal Service efforts to reduce those costs. Currently, Periodicals mail processing is undergoing numerous changes in an effort to improve efficiency while continuing to improve service performance. For Periodicals flats mail in particular, the Postal Service’s corporate flats strategy will result in a number of

²² Heath also reiterates that NNA members prepare small-volume sacks because of service frustrations, and reiterates that his testimony in Dockets No. R97-1 and R2000-1 addresses service problems experienced by newspapers mailing to subscribers outside their local area. Tr. 6/2065.

²³ See PRC Op. MC91-3, para. 4023.

operational modifications over the coming years. Witness Stralberg acknowledges that the data he uses are several years old and that processing and mailer practices are subject to change. Tr. 1/57-58. While this does not alter his fundamental point, it does compound the difficulty of recommending extensive changes to the Periodicals rate schedule at this time. The data used to develop rates should reflect the actual operating conditions rather than either an obsolete or a planned, ideal flats processing system.

[4023] The record indicates that private industry is making great strides in co-mailing and co-palletizing. However, on the terms now available, the record is mixed on whether these programs provide most Periodicals titles with a practical alternative to sacks. On the one hand, the answer appears to be “yes” for some publications, including some weeklies. Witness Armstrong, for example, states: “Contrary to commonly held belief, being a weekly magazine is not a significant hurdle for U.S. News entering into co-mail[ing] arrangements.” Tr. 6/2117. For other mailers, however, the ability to participate in co-mailing and co-palletization programs is constrained by several factors. Witness McGarvy, for example, contends that a threshold volume is necessary to make these programs successful and that there are many publishers who, because of their size, are “stuck with small sacks.” Id. at 1783. Witness Schick also acknowledges that “in most cases it is not practical to selectively bind or co-mail versions with less than 1500 copies.” Tr. 2/448. Production schedules, trim size, frequency of publication, and inability to use mail.dat files are other obstacles witness Bradfield cites. Tr. 6/1690, 1698.

[4024] The Commission notes that witness O'Brien maintains that mailers are more capable of changing mailing practices than they would have the Commission believe. Tr. 5/1426. It agrees that for some mailers, this may be the case. O'Brien, however, does not address impacts on the smallest circulation mailers in this proceeding, and none of the publications he uses as examples has per-issue circulation of less than 15,000. Id. at 1435. In this sense, the record does not contain sufficient information to determine the number of publishers that might be able to take advantage of

co-palletizing, even if such programs were widely available in all parts of the country. As discussed in Appendix D, witness Tang reports that there are over 25,000 publications with per-issue circulation of less than 15,000, and that over 15,000 of these publications have per-issue circulation of less than 1,000. As witnesses McGarvy and Tang have noted, the smallest publishers have not intervened in this proceeding. Tr. 6/1783. Consequently, information on the ability of these mailers to make changes is not part of the record.

4. Impact of Introduction of Proposed Container Charges on Postage

[4025] Witness McGarvy testifies that the Complainants would save, collectively, more than \$50 million annually without changing their mailing practices because they are already taking advantage of certain efficiencies, such as palletization. She also maintains that the Postal Service would not experience a reduction in costs and other Periodicals mailers would pay increased postage to fund the reductions for large mailers. Id. at 1786-87. As discussed below, the data in USPS-LR-1 show that the smallest publications witness Tang sampled could experience postage increases as high as 90 percent under the proposed rates.

[4026] The impact of the proposed container rates on smaller mailers is a major impediment to recommending that the Postal Service adopt them. Evidence presented by the Postal Service reveals that titles with per-issue circulation of less than 15,000 comprise 84 percent of the titles in Outside County subclass. The range of increases in postage for these mailers under the rates proposed by the Complainants is quite large and it appears that for some mailers, service issues prompted the use of these small-volume sacks in the first place.

[4027] MPA suggests that the impacts of container rates could be mitigated by “basing sack charges on less-than-100% passthroughs.” MPA Initial Brief at 8. However, the sack costs provided by witness Stralberg are the rates proposed by Mitchell. Thus, the mitigation MPA recommends would take the form of charging less than the full cost of processing each sack. Mitigating rate shock during structural changes is not uncommon in ratemaking. However, the Postal Service cautions that this

would require a much more complex process of determining which costs would be covered, accompanied by rationales to explain the different treatment that would be required. Postal Service Reply Brief at 8.

5. Impact on Revenue Generation

[4028] Under the existing rate design, pieces and pounds are the two fundamental elements. The proportion of revenue obtained from piece rates is 60 percent and the proportion obtained from pound rates is 40 percent. Under the proposed rate design, which adds bundles, sacks and pallets, these proportions necessarily change.²⁴ Under the new proportions, pieces would generate 49.2 percent of the revenue, pounds would generate 30 percent, and bundles, sacks and pallets, on a combined basis, would generate 20.8 percent. Tr. 1/54-6.

[4029] Witness Stralberg adds certain bundle and piece related costs he believes to be weight related to transportation costs to obtain 24.69 percent of total Outside County costs. Id. at 55. He reasons that if delivery costs are assumed to be 17 percent weight related, then total weight-related costs would equal 30 percent of total subclass costs. The validity of the 17 percent assumption requires empirical evidence. Witness Stralberg seems to have made a reasonable assumption, but further study could perhaps shed more light on the relationship of weight to delivery costs.

[4030] The 20.81 percent estimate for container costs includes bundle costs that witness Stralberg posits depend on the bulk of the bundles, which is an attribute he considers closely correlated with weight. He further explains:

In the AFSM-100 environment, non-carrier route flats bundles are taken to a 'prepping' operation where the bundles are broken and pieces placed on 'ergo carts' in a manner designed to facilitate subsequent loading into the AFSM-100. This operation is currently referred to as MODS operation 035. It tends to be performed also for flats that will not be sorted on the AFSM-100. In the pre-AFSM-100 environment,

²⁴ The proposal can be viewed as de-averaging the piece and pound elements by reassigning a portion of the costs traditionally associated with them to bundles, sacks and pallets.

the process of cutting flats bundles and preparing the pieces for sorting was often integrated into the piece sorting operations and indistinguishable from piece sorting.

Id. at 27.

[4031] The proportion of revenue to be obtained from the Periodicals pound rate has been of interest to the Commission for some time, as there has been supposition that it should be less than 40 percent. In the absence of hard evidence supporting a reduction, however, the Commission has maintained the 40 percent level.²⁵ Stralberg's analysis provides the first fresh look at this longstanding issue, and should stimulate further study to define relationships more clearly. The 40 percent proportion has been in use for some time and it seems clear that technology and cost ascertainment have advanced considerably during that period.

6. Conclusions

[4032] It appears from the costing evidence presented on the record of this docket that a portion of Periodicals costs is, in fact, bundle and container oriented, and that the linkages to presort level and entry point cited by witnesses Mitchell and Stralberg affect costs in a meaningful way. Moreover, Stralberg's model appears to be a sound theoretical starting point for developing rates based on heretofore unrecognized cost elements. Witness Mitchell makes a reasoned attempt to align rates for Periodicals mail more closely with costs incurred in the postal operating environment.

[4033] This effort represents a substantial step forward in the process of redesigning rates to keep pace with changing technology in the processing and transportation of Periodicals mail. There are practical and equitable limitations, however, to the wholesale implementation of the proposed bundle and container rates at this time. For example, the proposed sack charges are unlikely to increase the use of pallets among many of the publications with very low circulation. Co-palletization and co-mailing simply are not an option for some mailers at this time. Container rates would

²⁵ See, for example, PRC Op. R87-1, paras. 5359-62; PRC Op. R90-1, paras. 5259-65; PRC Op. PRC Op. R94-1, para. 5170; R97-1, paras. 5796-99; PRC Op. R2000-1, para. 5676.

have the greatest impact on the smallest publications and effectively punish these publications for their small size. This could be tantamount to making circulation size a prerequisite for mailing in the Periodicals class, something that appears directly contrary to the public policy of supporting periodical publications.

[4034] The Stralberg model relies in part on a library reference developed during the course of Docket No. R2000-1, with updated information from Docket No. R2001-1. The processing of Periodicals mail is changing as the Postal Service's automation plan for flats moves forward. While witness Stralberg has attempted to develop a model conforming to present practice, his model may not reflect the current processing environment realistically enough to be used for setting rates at this time. His methodology looks promising, however, and the Postal Service should update and examine the Stralberg model to determine its usefulness for future ratemaking efforts.

[4035] The bundle and container rates represent only one aspect of the total changes proposed in this docket. Others include zoning of editorial pound charges, recognizing machinability, and linking revised presort and entry elements to bundle and container charges. The impact of each of these factors alone would be difficult to assess if the package moves forward as currently proposed. The Postal Service should review each of the rate design features in the context of the current and planned processing and transportation network for Periodicals mail. The focus should be on quickly incorporating the most promising and least disruptive components. In addition, efforts to develop a less costly container than the sack should be emphasized as a better way to reduce the number of sacks in the postal system than imposing rate penalties on captive users.

[4036] The record in this proceeding contains testimony indicating that the impact of the proposed rates could not only be significant, but also potentially devastating to some mailers, particularly small publications that have no alternatives to the use of expensive, low-volume sacks. Some mailers also believe that without the use of such sacks, service will be compromised. The record lacks sufficient evidence to determine whether changes in the makeup of low-volume mailings will exacerbate existing service problems or create new ones. Thus, before the proposed container rates can move

forward, an appropriate investigation of the impacts on service and costs should be conducted. The Commission urges the Periodicals mailing community, especially those who have raised service concerns on this record, to fully cooperate with the Service in this endeavor.

C. Machinability

[4037] *Background.* Witness Mitchell's proposed piece rates retain the existing structure's recognition for pieces bearing a barcode, and adds recognition for pieces that are machinable. These rates apply to qualifying pieces at all sortation levels except carrier route.²⁶ Tr. 3/824. Under the Complainants' proposed schedule, for example, a bundle containing nonmachinable mixed ADC pieces would be charged \$0.44 per piece, while a bundle with machinable mixed ADC pieces would incur a charge of \$0.31 per piece. The difference (of \$0.13 per piece) reflects the more costly processing required for nonmachinable pieces.

[4038] *Commission analysis.* This aspect of the Complainants' proposal drew limited comment. NNA argues that recognition of machinability will heavily impact newspapers because they "are not permitted to use the sorting machines that complainants have in mind[.]" NNA Initial Brief at 11-12. Witness Heath estimates that "about 50% of newspapers are bar-coded and UFSM 1000 eligible." Response of National Newspaper Association to Notice of Inquiry No. 1 Concerning Periodicals Data, December 1, 2004, at 2.

[4039] ABM directed a question to Mitchell about his observation (at Tr. 3/803-4) that small publications will be helped by the proposed recognition of machinability, asking whether "all small publications" will be helped. Mitchell responded:

One cannot say that all small mailers will be helped by the recognition of machinability. I believe, however, that the publications of many small mailers are machinable. Also, I believe all mailers should be provided information relating to the cost differences associated with machinability. . . . Pieces seeing an increase due to this recognition are those

²⁶ Witness Mitchell defines machinability as pieces that can be processed on the AFSM-100. *Id.* at 826.

that are now being provided below-cost rates, corrected for ECSI value.

Id. at 925.

[4040] The Commission has long recognized the operational difficulties the Service faces in processing nonmachinable mail. These difficulties and their attendant costs come into sharper focus in an increasingly automated environment. The rate structures for First-Class Mail, Standard Mail, and Package Services mail already contain rate elements for mail that is more costly to process because of physical or other characteristics that prevent machine processing. Periodicals mail is the only traditional class in which machinability is not explicitly recognized in the current rate schedule.

[4041] The Postal Service has embarked on an ambitious corporate flats strategy modeled after its successful Corporate Automation Plan for letters. The ultimate goal of the strategy is to automate all flats processing, including delivery point sequencing (DPS) of flats mail. Machinability of flats will play a significant role in a fully automated flats environment.

[4042] Until fairly recently, it appears that a significant volume of flats has remained in the manual processing stream regardless of machinability. In Docket No. R2001-1, witness Kingsley testified that the “vast majority of the incoming secondary processing at the delivery units is manual.” Docket No. R2001-1, USPS-T-39 at 17. In larger facilities a significant portion of all flats were processed manually.²⁷ Section C820 of the current DMM specifies size, weight, and other criteria for flats processed on the AFSM-100. Periodicals mail processed on the AFSM-100 cannot exceed 20 ounces, for example, and the thickness must fall between 0.009 inches and 0.75 inches.²⁸ Witness Stralberg testifies, however, that he has observed copies of *In Style* weighing close to 2.5 pounds being sorted on an AFSM-100 without apparent difficulty. He also has observed polywrapped flats being sorted on an AFSM-100 without apparent problems. Tr. 1/85.

²⁷ One indication was 15 percent in response to Docket No. 2001-1, Tr. 9/2216.

²⁸ DMM § 301.3.3, formerly § C820.2.0 (Issue August 10, 2003).

Witness O'Brien also testifies that he believes the AFSM-100 is capable of processing a wider range of publications. Tr. 5/1516.

[4043] Deployment of additional AFSM-100 equipment is expected to move more incoming secondary flat distribution from manual to automated operations. In this regard, the fiscal year 2004 unit attributable cost increase for Periodicals Outside County subclass is not encouraging. Total attributable costs show a 7.7 percent increase and mail processing costs show a 15.4 percent increase.²⁹

[4044] The movement from manual to automated processing is the first phase of the Postal Service's corporate flats strategy. A major goal of the flats strategy is to foster Delivery Point Packaging (DPP), a one-pass system for sorting letters and flats together, or a Flats Sequencing System (FSS), a two-pass system for sorting flats in delivery sequence order.³⁰ In identifying possible rate structure changes, the Postal Service lists "examining the effects of weight and shape on costs and machinability." USPS Corporate Flats Strategy, May 2003, at 19. Witness Miller describes several enhancements to AFSM-100 operations including the replacement of in-plant keying operations with Remote Encoding Center (REC) operations. He testifies that the Postal Service continues to look for ways to enhance flats processing. Tr. 6/2143-44.

[4045] In a fully mechanized/automated processing environment the higher cost of manual processing is readily apparent. In the absence of automated flat sorting equipment, the Postal Service has of necessity processed a significant amount of Periodicals mail manually. As technology improves, however, mail remaining in the manual mailstream will continue to incur higher costs than automated mail. Tr. 3/935. Mailers should expect the Postal Service to develop additional machinability standards as technology evolves and additional automated equipment is deployed. The Postal Service therefore should look toward a rate structure that recognizes the machinability of Periodicals mail, along the lines suggested by Complainants. However, prior to

²⁹ Draft Cost and Revenue Analysis, Fiscal Year 2004, PRC Version; Draft Cost and Revenue Analysis, Fiscal Year 2003, PRC Version.

³⁰ USPS Corporate Flats Strategy, May 2003, at 1.

implementation of such rate distinctions, the Service should update any weight limits and other physical restrictions applicable to its machinery. As more Periodicals mail becomes automated, savings should accrue and a rate structure for recognizing cost distinctions should be available to provide appropriate incentives for mailers.

[4046] To minimize disruption, the Postal Service should provide Periodicals mailers with notice that pieces that are nonmachinable will become subject to rates that reflect higher processing costs. Mailers can then explore the pros and cons of adjusting the size of their mailpieces prior to implementation of such rates.

D. Presort Levels

[4047] *Background.* The existing Periodicals rate structure has four presort levels or tiers: basic, 3-digit, 5-digit and carrier route.³¹ Witness Mitchell proposes continued recognition for presorting to 5-digit and carrier route, and suggests several refinements to the other tiers. The refinements are based on his conclusion that the mail flow models that underlie current rates identify distinct cost characteristics for pieces sorted into mixed Area Distribution Center (ADC) bundles, ADC bundles, and 3-digit/Sectional Center Facility (SCF) bundles. He therefore proposes separating the basic tier into two distinct tiers — referred to as mixed ADC and ADC — and reconfiguring the 3-digit tier to include pieces sorted to SCF bundles. *Id.* at 824, 826.

[4048] *Commission analysis.* This aspect of the Complainants' proposal drew limited comment. Mitchell asserts that there was no record evidence on this issue in Docket No. R2001-1, and no indication that anyone focused on it. However, he contends that since the mail flows are now clear, there is no reason not to recognize the apparent distinctions in rates. *Id.* at 824, n.25. He also states that ADC and mixed ADC categories already have been introduced in both Standard Mail and First-Class Mail for letter-shaped pieces. *Id.* at 1101. The Commission agrees that the proposed adjustments appear to reflect the mail flows, and that these refinements would be an improvement for that reason.

³¹ High density and saturation distinctions are recognized within the carrier route tier in the existing rate structure, and Complainants' proposal carries over this treatment.

E. Dropshipping

[4049] *Background.* The existing Periodicals rate structure recognizes ADC, SCF and Destination Delivery Unit (DDU) entry. Witness Mitchell proposes retaining these elements, and adding a new incentive for destination bulk mail center (BMC) entry of pallets and sacks. In support of this approach, he asserts that BMCs are logical entry facilities for Periodicals mail, noting that “[a] BMC is positioned and connected to serve a broad territory efficiently, a territory that would generally receive substantial volumes of mail. Even a relatively small mailer could have a great deal of volume for such a large area.” *Id.* at 973.

[4050] *Commission analysis.* Several considerations identified on this record lend support to the validity of recognizing destination BMC entry in the Periodicals rate structure. These include consistency with current practice; mailer interest and benefit; consistency with the entry options available in Standard Mail; and the apparent absence of administrative or service complications.

[4051] With respect to current practice, witness Tang states:

DMM section M045.3.1 describes the preparation of Mixed ADC pallets of sacks and trays of Periodicals mail. Although the BMC presort level is not specifically mentioned as a required presort level, to my knowledge nothing in this section precludes mailers from preparing Mixed ADC pallets of sacks where all sacks on the pallet destinate in the service territory of one BMC, therefore have an implicit presort level of BMC, and are documented in the mail.dat as BMC ‘parent’ pallets.

Tr. 6/2219.

[4052] Tang also testifies that 19 of the publications in her sample of 251 prepared pallets in the manner described above. *Ibid.* This appears to comport with witness Stralberg’s contention that although DBMC presortation is not currently recognized in the Periodicals rate structure, mailers nevertheless enter pallets (presorted to ADC) at

destination BMC facilities, where they are routed to the appropriate ADC, broken open, and undergo further processing. Tr. 1/181.

[4053] As for mailer interest and benefit, witness Armstrong characterizes the absence of the BMC entry option as “another opportunity to increase the Postal Service’s efficiency that is blocked by current Periodicals rates.” Tr. 6/2116. He testifies that one way U.S. News would respond to the Complainants’ proposed rate structure is by switching entry points for approximately 250,000 copies.

[4054] There is no direct evidence on why BMC entry is not recognized in the current structure, but concern about meeting Periodicals mailers’ service needs may be a main reason. Given that the Periodicals mailers who are currently using BMC entry would likely be doing so only if they were largely satisfied with the service they are receiving, it may be that network and administrative improvements have alleviated service problems. BMCs currently serve as transfer hubs for Periodicals mail and, if BMC entry moves Periodicals mailings closer to their destination, encouraging such entry may lower costs. At the same time, the volume of Periodicals mail entered at destination BMCs would be expected to increase if the rate structure were revised to recognize this option. The Commission therefore encourages the Service to investigate the feasibility of incentives for entering Periodicals mail at destination BMC facilities in terms of both internal operations and service considerations.

F. Editorial Pound Charges

[4055] A flat editorial charge has been a fixture in the Periodicals rate structure since the 19th century.³² This has created a significant distinction in the treatment of pound charges: editorial pounds are “flat” or unzoned, while advertising pounds are zoned. Witness Mitchell asserts that this bifurcated approach has its origin in a legislative compromise that was reached after publishers argued that applying zone rates to the entire weight of a publication would have a negative impact on distribution. He claims that the anti-zoning arguments “focused on the high costs of transportation and raised the specter of a nation divided into separate regional publishing zones because of cost prohibitive rates for mailing to subscribers in remote parts of the country.” Tr. 3/817.

[4056] However, both Mitchell and witness Gordon assert that “dividing the nation” is not a realistic policy concern in today’s world. Id. at 627 and 818. Mitchell emphasizes two additional points. One is that, contrary to a concern expressed in a previous rate case, zoning editorial content is not likely to cause publishers to drop subscribers in distant zones.³³ The other is that because editorial pound charges are not zoned, postage does not reflect the higher transportation and non-transportation costs associated with mailing to more distant zones. Thus, Mitchell asserts that local and regional publications printed in locations distant from their delivery area are imposing extra costs on other publications. Current rates, he argues, do not adequately reflect the increase in postal costs to transport such mail to its destination because the editorial portion is carried for long distances at the flat rate. He believes this is most pronounced

³² The flat editorial pound charge is one way the Commission recognizes the ECSI value of editorial matter in Periodicals. Another way is through the editorial benefit, provided on a per-piece basis. This benefit was added in 1985.

³³ This concern was expressed by Dr. Kielbowicz in Docket No. R90-1. His testimony in that case included “Public information found on the pages of periodicals should be just as accessible to the residents of Washington State as to the residents of Washington, D.C. The various proposals to substitute editorial pound and piece discounts for the flat rate would vitiate this policy. Continuing the editorial flat rate is the best way to facilitate the widespread circulation of public information nationally. With migrations of people more pronounced in 1990 than in 1917, the need for continuation of the editorial flat rate system is as great in binding the nation together in 1990 than in 1879 or 1917.” Docket No. R90-1, ABP-RT-3 at 23-24.

for publications with a high percentage of editorial material. He reasons that if the entire weight of the publication were zoned, publishers would make decisions about entry based on the rate schedule, as the full costs of transporting the mail would be reflected in the rates. *Id.* at 828-31. Based on these arguments, the Complainants, through witness Mitchell, propose altering the way editorial content is recognized in the rate schedule. This entails zoning both editorial and advertising pounds, and providing an editorial benefit of 10.1 cents per pound.

[4057] *Participants' reaction.* This aspect of Complainants' proposals engendered the strongest reaction from other Periodicals mailers. The flat EPC has long been viewed by many as an essential aspect of providing favored rate treatment to periodicals in general, and the editorial portion of periodicals in particular. American Business Media and McGraw-Hill argue that the flat editorial pound charge promotes "widespread dissemination of diverse Periodicals." Joint Initial Brief of American Business Media and McGraw-Hill Companies, Inc., (ABM and MH Joint Initial Brief), at 45-46. They emphasize that the Commission has supported the flat editorial pound charge in previous cases. They also cite the Commission's concerns in Docket No. R87-1 about the impacts of "dramatic structural change" on certain publications. *Id.* at 36.

[4058] Complainants challenge this position directly. They suggest that the flat EPC is no longer an effective means for binding the nation together by promoting widespread dissemination of information, if in fact it ever was. See 39 U.S.C. § 101(d). In support of testimony related to this issue submitted by witnesses Mitchell and Gordon, Complainants offer an extensive legal memorandum directly challenging previous analysis that justified the flat EPC on public policy grounds.³⁴

[4059] *Commission analysis.* The Commission has carefully considered this material and the question of whether the flat EPC continues to further the policy goals established in the Postal Reorganization Act of 1970. This analysis is provided as Appendix B to this decision. The Commission concludes that the flat EPC in periodicals

³⁴ Complainants' Memorandum of Law and Policy Relating to the Editorial Pound Change for Periodicals, Docket No. C2004-1, December 1, 2004.

effectively fosters the public policies of the Act. While the passage of time has made this rate design feature less important than it was in 1970, it still serves important functions that are not outweighed by the potential for encouraging dropshipping and more precise cost tracing in rates.

[4060] The issue of the appropriate design of editorial pound rates is not new. The Commission has addressed this issue in a number of cases, including Docket Nos. R87-1, R90-1, and MC95-1. More recently, in Docket No. R2001-1, Postal Service witness Taufique proposed applying a flat editorial pound charge for zones 1 and 2 through 8 and varying the rates for mail entered at DDU, DSCF, and ADC. The purpose of this proposal was to provide further incentives to mailers to dropship more Periodicals mail. Docket No. R2001-1, USPS-T-34 at 5-7.

[4061] The impact of structural changes on publications is a major concern. Small publications are particularly vulnerable to significant changes. The Commission also continues to support the goal of encouraging dropshipping. The goal is to give some measure of recognition to cost differences while maintaining an appropriate recognition of editorial content.

[4062] It is clear that the local and regional delivery patterns of some publications are not an indication of how far the Postal Service transports them. As witness Mitchell points out, the location of a printer may be quite far from the delivery area. Certainly it is much easier today to transmit material electronically for printing at a distant location than it was some years ago. The rate schedule has been changing in an effort to accommodate worksharing and dropshipping and it appears that while more co-mailing and co-palletization should be encouraged, a large portion of the Periodicals Outside County subclass volume currently benefits from these incentives.

[4063] While the flat editorial pound charge probably discourages dropshipping somewhat, the record indicates that many mailers dropship in response to current pallet and dropship discounts. This takes place despite the existence of the flat editorial pound charge. Witness Schick testifies that 10 years ago, Quad/Graphics would not have dropshipped a periodical with less than 35 percent advertising. Today, however, partly

because of changes to the rate schedule, he states that Quad/Graphics would consider any periodical with more than 15 percent advertising.³⁵ Service considerations can also motivate publishers to dropship. Witness Schick states that dropshipment “helps to ensure more consistent delivery for our clients.” Tr. 2/436.

[4064] Witness Taufique’s R2001-1 proposal represented something between the current flat editorial rate and the full zoning of editorial pounds. There are other approaches as well, including implementing certain components and not others. As discussed elsewhere, the Commission continues to search for a balance between recognizing the importance of editorial material in the rate structure on the one hand and encouraging efficiency on the other hand.

[4065] Witness Stralberg further analyzes the editorial pound charge in his surrebuttal testimony. He offers a modification of witness Mitchell’s proposed rates to incorporate a flat editorial pound charge of 12.95 cents per pound.³⁶ His analysis of the ABM publications shows that most would receive smaller percentage postage increases if the flat editorial pound charge is substituted for the zoned charges. The percentage increase is halved for some publications when the flat editorial pound charge is used. Id. at 1579-81. The results are similar for publications in witness Tang’s sample. Id. at 1573-74.

[4066] Witness Stralberg concludes from his analysis that the “use of low-volume sacks (skin sacks), often containing just a single bundle, is by far the predominant reason why some publications would see very high postage increases under the proposed rates.” Id. at 1541. He finds the number of bundles per sack to be a more accurate predictor of a large percentage increase under the proposed rates. The exception to this pattern appears to be a combination of factors such as being nonmachinable and lightweight with low circulation and low density. Id. at 1548, n.6.

³⁵ Note that for administrative purposes, publications with less than 10 percent advertising are considered 100 percent editorial.

³⁶ Tr. 5/1544; see also TW et al. LR-5, file FlatEdOption, worksheet LbRts.

[4067] This exception illustrates one difficulty with isolating the impacts of individual components of the Mitchell proposal. It is the entire set of components that interacts to create the impacts. These impacts cover a very wide range of percentage increases. The potential for subjecting substantial numbers of periodicals to significant percentage increases creates concern, particularly since they may be unavoidable to many mailers.

V. SUGGESTIONS FOR MOVING FORWARD

A. Potential Options

[5001] The Postal Rate Commission is charged with recommending rates that are consistent with the goals of the Postal Reorganization Act. These goals are enumerated in the policy sections of the Act, such as 101 and 403, and in the specific factors in sections 3622(b) and 3623(c). Cost-based rates and encouraging efficiency in postal operations have been two frequent hallmarks of Commission rate recommendations. The Commission has recommended — and the Postal Service has adopted — rates that move all classes and subclasses of mail toward more efficient preparation through discounts for presorting, dropshipping, palletizing, and other cost-efficient measures. The Commission continues to support an economically efficient approach that encourages the optimal use of society’s resources to process and deliver mail to its ultimate consumers.

[5002] The existing Periodicals rate schedule has evolved over an extended period, as technological innovations and industry developments such as presorting, barcoding, dropshipping, and palletizing have been given formal recognition. This has moved Periodicals in the direction of efficiency while continuing to recognize the special editorial attributes of the mail in this class. The components that form the foundation of the Complainants’ proposed restructuring entail major changes for mailers of Outside County flats. The Commission does not view these changes as radical, as some participants contend, because they reflect existing mail preparation practices and mail flows and constitute only partial de-averaging. At the same time, the record shows that full implementation of the proposed changes at this time would cause significant financial impacts, and might have effects on service. In the instant filing, the Complainants have nonetheless made major progress in identifying and quantifying cost drivers associated with bundles, sacks and pallets.

[5003] It is clear that there is room for improvement in the Periodicals rate structure, especially in light of the new insights that the Complainants provide into the costs of bundles, sacks and pallets. At a minimum, the Time Warner et al. proposal is a more

cost-based rate structure than the current structure. If it were fully implemented, it would provide financial incentives to mailers to engage in lower cost mailing practices by encouraging mailers to use more efficient bundling, containerize more efficiently, change to a more efficient zone distribution, and increase the proportion of machinable pieces.

[5004] Altering rate design is not the only way to improve efficiency, however. The Postal Service has an obligation to develop processing practices that eliminate, to the extent possible, inefficient practices such as the use of skin sacks. It also should update machinability standards to reflect the capabilities of its equipment, and keep mailers informed as new equipment is developed. The Commission is encouraged by Postal Service statements indicating increased attention to meeting these responsibilities. Efforts to increase efficiency by changing rate designs should be coordinated with planned processing change initiatives so that unnecessary disruptions can be avoided.

B. Alternative Approaches for Improving the Rate Structure

[5005] The Commission sees at least three general alternatives to full implementation of the Time Warner et al. proposal: (1) implementation of the proposed rate structure, but with only partial recognition of cost differences and/or costs; (2) a “piecemeal” approach of gradually making changes over time; and (3) an “opt-in” approach.

[5006] Under the first alternative, the change to the more cost-based type of rate structure would be phased in over two or more proceedings by starting with low bundle/container charges and gradually increasing them case-by-case as experience with impact on mail users is evaluated and taken into consideration. While this might moderate the initial impact, if many mailers are unable to adjust mailing practices to avoid the resulting devastating rate increases, this approach seems unlikely to garner widespread support in the Periodicals community.

[5007] The piecemeal approach would introduce reform to the rate structure incrementally by first proposing one or more changes per rate case or classification case. For example, the Postal Service could begin by announcing its intention to impose surcharges for nonmachinable periodicals at some future date while taking immediate action to deaverage the basic presort rate into its component parts. This approach would allow mailers time to adjust practices, and could lead to additional cooperative efforts to develop efficient mail processing practices.

[5008] Measured introduction of changes also would allow the Postal Service and the Commission to evaluate the extent to which small circulation mailers with additional time to change their mailing practices could reduce the costs imposed on the Postal Service. At this time, it appears that there are some small circulation mailers who will never be able to modify their mailing practices because their volume is too small. These mailers would be seriously disadvantaged by some aspects of the proposed rate structure. Gradual introduction of changes would allow focused evaluation of the benefit of specific changes as against their impact on Periodicals mailers.

[5009] A third alternative might be an opt-in approach. Under this approach, one subclass would be retained, but there would be two rate schedules. One rate schedule would incorporate the full Time Warner et al. proposal or something similar, and the other rate schedule would retain the current rate structure. A circulation threshold (proposed by the Postal Service) would be established. Publications with circulations above this threshold would be required to use the proposed rate schedule. The remainder of the class could choose whichever schedule it preferred. The threshold would represent a line of demarcation between mailers that are assumed to be able to utilize efficient mailing practices and those that (primarily because of low circulation) cannot reasonably be expected to palletize or otherwise avoid significant postage increases under the proposed rate schedule. Over time, the Postal Service might propose to incrementally adjust the threshold as mailing practices and technology evolve.

[5010] As noted elsewhere, the Postal Service has determined that there are 929 publications with a circulation greater than 100,000 and 29,050 publications with lesser circulations. Witness Tang's study of 251 sampled publications shows that with no changes in mailing practices, 90 percent of the large circulation mailers in the sample would receive postage decreases under the Time Warner et al. proposal, while 10 percent of these mailers would receive higher postage bills. Time Warner et al. suggest that most, if not all, of these publications would be able to react to the price signals inherent in the proposed rate design and modify their mailing practices to obtain lower rates.

[5011] According to witness Tang's calculations, 71 percent of publications with circulation below 100,000 would experience higher postage bills under the full implementation approach, with one increasing by 90 percent.³⁷ While some of these publications may be able to take steps to ameliorate the impact of the proposed rate design, it does not appear that some of the smaller circulation mailers would be able to use more efficient bundles and containerization. The opt-in approach would not penalize

³⁷ Small publications in this context refer to the sum of witness Tang's small and medium publications.

them by forcing them into a rate structure better suited to larger mailers. However, there are some publications with circulation below 100,000 that appear to already use efficient bundling and containerization as evidenced by the reduced postage bill they would experience under full implementation of the Time Warner et al. proposal. Under the opt-in approach, these mailers would be allowed to opt in to the new restructured rate schedule. Mailers able to change their mailing practices to obtain reduced postage charges under the proposed rate design would also be allowed to opt in to the new restructured rate schedule.

[5012] The opt-in approach has the advantage of allowing mailers and the Postal Service to benefit immediately from the full implementation of the Time Warner et al. proposal for large mailers and smaller mailers who opt in.³⁸ At the same time, no small publication would be adversely affected by large rate increases because they would continue to use the current structure. This creates a situation for small publications whereby there would be no losers. Allowing mailers to opt in to the restructured rate schedule adds complexity, and presents complications in terms of rate design, but these can be overcome as explained in Appendix C to this decision, which contains a detailed explanation of the opt-in approach. The Commission recommends that the Postal Service consider the opt-in approach for Outside County Periodicals.

³⁸ When it is determined that a publication is subject to the restructured rates, either by its circulation or by volunteering, all mailings of the publication should be subject to the restructured rates including supplemental mailings, i.e., nonrequester and nonsubscriber mailings.

C. Supplemental Mailings

[5013] *Background.* Another issue that has generated comment is the impact of the proposal on supplemental mailings. Time Warner et al. witness Schick defines supplemental mailings as “new startups of a publication or a back issue of a publication.” Tr. 2/567. Supplemental mailings by large and medium publications may share some of the same characteristics as main file mailings of smaller publications. They are smaller and less dense than main file mailings, and thus frequently less workshared than main file mailings. Time Inc.’s main file mailing of *Money*, for example, is palletized and averages 10.74 pieces per bundle while its supplemental mailing is not palletized and averages 8.85 pieces per bundle. Under the Complainants’ proposed rates, *Money*’s main file would see a reduction in per-piece postage of 13.7 percent. *Money*’s supplemental mailing, however, would experience a 43 percent *increase* in postage. Tr. 1/118, 121. Because supplemental mailings mailed as Outside County subclass mail cannot exceed 10 percent of a publication’s copies mailed to subscribers, the overall impact for *Money* is a net reduction of 8 percent in its combined postage.³⁹

[5014] Schick states that the co-mailing program of Quad/Graphics includes supplemental mailings. Tr. 2/344. He believes co-mailing is a cost-effective method of preparing small mailings. When asked why supplemental mailings in sacks were not co-mailed or co-palletized he replied that if the proposed rates were adopted, he would expect mailers and printers to try to co-mail more supplemental mailings. Tr. 1/210. Witness Tang also testifies that her analysis includes back issues and supplemental mailings in order to capture the impacts of the proposed rates on these mailings. Tr. 6/2180. Witness Mitchell testifies that he believes supplemental mailings are charged postage below their costs to the Postal Service:

The classic situation might be a supplemental mailing of 24 pieces going to widely dispersed addresses. The pieces

³⁹ DMM § 707.7, formerly § E215 (Issue August 10, 2003), contains rules relating to copies not paid for or requested by addressee.

could be prepared in a 24-piece mixed ADC bundle and placed in a mixed ADC sack, or they could be placed in 24 5-digit sacks that would travel unopened to the respective DDU's. Supplemental mailings (including special-edition mailings) tend to be frequent and expensive. It seems likely that they all pay rates that are substantially below costs. Mailers should consider whether alternatives are available, including the possibility of integrating such mailings with a main file. Without appropriate signals, they will not do so.

Tr. 3/951.

[5015] Witness Bradfield asserts that the rates for the supplemental mailings are higher because the Postal Service's costs for these smaller, less workshared mailings are higher, and the cost-based rates in effect today reflect those cost differences.

Tr. 6/1693-94. In their joint initial brief, ABM and McGraw-Hill point to witness Bradfield's testimony, stating it shows that:

[S]mall supplemental mailings of Complainant publications have a per piece postage more than double that of the main file mailings of those publications. Since the pieces in the main file and supplemental mailings were identical, the large per-piece rate differential must reflect the higher postal costs of handling smaller, less dense mailings.

ABM and MH Joint Initial Brief at 3-4. They also point to witness McGarvy's comparison of the per-piece postage paid by the ABM publication *Creativity* with the per-piece postage paid by *Time*, *Newsweek*, *TV Guide*, and *Reader's Digest*. Witness McGarvy asserts that the only difference between *Creativity* and the Complainants' publications is the size and density of the mailing. *Ibid*.

[5016] In response to Presiding Officer's Information Request No. 1, Question 2, Complainants acknowledge that changes to supplemental mailings would be made in response to the proposed rates.⁴⁰ The response of Condé Nast is typical:

It is our belief that the proposed rate schedule would allow us to initiate comailing of Vogue's supplemental copy mailings. These mailings are currently mailed by themselves (no comailing currently performed as we do for Vogue's mainfile copies) and are all entered at the printers mailing facility in Flora IL.

Our supplemental mailings are our least sophisticated mail as they are not drop shipped, not carrier routed and much of the mail is prepared in sacks.

The rate incentives offered by the proposed rates would allow us to convert these smaller mailings into something more comparable to the characteristics of our large monthly mailing of Vogue's mainfile copies.

This would result in more pallets, fewer sacks, mail entered much closer to destination at lower cost. This would also result in better service to our newest subscribers.

Though the question asked pertained to only Vogue the same response could be given for almost all of our consumer magazine titles.

Tr. 6/2090.

[5017] *Commission analysis.* There is ample evidence that supplemental mailings are more costly to process than main file mailings. It is also the case that supplemental mailings exhibit characteristics similar to those of low-circulation publications. The

⁴⁰ POIR No. 1, Question 2 states: TW et al.-T-I, at page 17, in discussing various mailing-related practices states: "It is not reasonable to expect publishers, or printers, or anyone else to consider costs that do not affect their bank accounts." Please describe, and quantify to the extent possible, how the proposed rate schedule might alter the mailing profiles of (a) Sports Illustrated for Kids; (b) Reader's Digest (the magazine); (c) Vogue; (d) TV Guide; and (e) Newsweek. Please fully explain any assumptions underlying your descriptions.

Postal Service should examine these mailings to determine the extent to which witness Mitchell's allegation that they are below cost is true. The Postal Service may find it feasible to develop classification language or a partial restructuring of Periodicals rate design to treat these mailings in a different manner than main file mailings.

IT IS ORDERED:

1. The Commission finds that after consideration of the record made in this case, the existing rate structure for Periodicals mail is not violative of the policies of the Postal Reorganization Act.
2. Except to the extent granted or otherwise disposed of herein, all motions, exceptions and other outstanding requests filed in Docket No. C2004-1 hereby are denied.

By the Commission

(S E A L)

Steven W. Williams
Secretary

APPENDIX A

PARTICIPANT PRESENTATIONS

I. COMPLAINANTS' DIRECT CASE

A. Witness Stralberg (TW et al.-T-2)

[1] Witness Stralberg provides detailed technical and theoretical support for the Complainants' proposal, primarily in the form of a set of unit cost and volume estimates witness Mitchell uses for rate design purposes. His starting point is an assessment of the cost-causing characteristics of a typical Periodicals flats mailing. This leads him to the conclusion that bundles, sacks and pallets have emerged as significant cost drivers in today's processing environment, and therefore should be recognized as separate elements in the rate structure. In fact, Stralberg asserts that the existing structure's implicit assumption that costs are incurred on either a per-piece or per-pound basis is flawed. Tr. 1/22.

[2] Having identified bundles, sacks and pallets as cost drivers, Stralberg analyzes the costs associated with each of these elements, as well as with individual pieces. This entails some reclassification of costs, relative to the existing approach. Stralberg then evaluates the existing cost model's ability to support the Complainants' proposed structure. He finds that while some aspects of the model have continuing utility, its piece-pound focus precludes the calculation of a full set of cost and volume estimates. He therefore develops and documents a comprehensive new cost model, and presents the resulting cost and volume estimates.

[3] Stralberg's discussion of these topics also addresses a wide variety of related issues such as complexity, anticipated reaction, and impact.

[4] Under the Complainants' approach to costs and rates, which introduces new elements to the rate structure, the proportion of revenue generated from pieces and pound rates necessarily changes. Thus, instead of obtaining 60% of revenue from pieces and 40% from pounds, as now occurs, the proposal anticipates that bundles, sacks and pallets (on a combined basis) will contribute 20.8%, pieces will contribute 49.2%, and pounds will contribute 30%. The following table shows this effect.

Impact of Complainants' Proposal on Revenue-Generated Responsibility of Rate Elements

Existing Rate Design		Proposed Rate Design		Change
Basic Elements	Percentage Revenue Contribution	Basic Elements	Percentage Revenue Contribution	
Piece	60%	Piece	49.2%	-10.8%
Pound	40%	Pound	30.0%	-10.0%
		Sack Pallet Bundle	20.8% (combined)	n/a

Source: Adapted from Tr. 1/54-56.

[5] Stralberg contends that the set of unit costs and corresponding volumes for Outside County Periodicals flats, bundles of flats, sacks and pallets he has developed “will make possible a more cost based rate design than the one in effect today.” Id. at 21. He further maintains that the proposed design will give both large and small mailers incentives to improve their mail preparation and entry practices, thus reducing Periodicals costs. Ibid. He acknowledges that using more recent cost and volume data may change his unit cost estimates somewhat, but does not believe this would substantially alter the major conclusion that both he and Mitchell reach, “namely that a cost based restructuring of Periodicals rates today is both feasible and highly desirable.” Ibid.

1. Stralberg's criticisms of the existing rate design

[6] Stralberg observes that the implicit assumption in the existing Outside Periodicals rate structure is that costs are incurred on either a per-piece or a per-pound basis. However, based on his observation of how a typical Periodicals flats mailing is handled in today's environment, he believes some costs are neither piece nor pound oriented, but are instead more closely associated with bundle, sack and pallet usage.

[7] In support of this position, he asserts that the costs are driven by the manner in which Periodicals are prepared, which he describes generally as follows:

Periodicals flats are prepared by mailers in presorted bundles and usually placed either in sacks or on pallets provided by the Postal Service. The Postal Service must perform various handlings on these sacks/pallets, often including transfers through multiple facilities, until they are emptied of their contents and can be recycled for further use. The Postal Service then must handle the bundles that were emptied out of the sacks and pallets, until the bundles have been opened — after which it must handle the individual pieces that were inside the bundles through additional sorting and delivery operations.

Id. at 23.

[8] Given the role bundles, sacks and pallets play in Periodicals processing, Stralberg contends that the assumption underlying the existing structure is fatally flawed. Ibid. He therefore urges that costs incurred in handling sacks and pallets be viewed as per-sack and per-pallet costs, rather than as strictly per-piece or per-pound costs (as they are now), and that costs incurred in sorting bundles be viewed as per-bundle costs. Ibid. He contends that recognizing the cost-causing characteristics of these three elements and of individual pieces, and pricing them in accordance with costs “will remove anomalies in the current rate structure and provide mailers with much better pricing signals.” Ibid. He also supports recognizing machinability and eliminating the flat (or unzoned) editorial pound charge.

2. Stralberg's assessment of the cost-causing characteristics associated with the use of sacks, pallets and bundles

a. Sacks and Pallets

[9] *Sacks*. Stralberg defines sack-related costs as those incurred in sorting sacks (either manually or on mechanized sack sorters); loading and unloading sacks from trucks; moving sacks across postal platforms and workroom floors; opening sacks; shaking out the contents of each sack; putting aside empty sacks; and recycling sacks for later use.¹ He asserts that these costs generally depend on the number of sacks being handled, on the presort level of each sack, and on a sack's point of entry into the postal system relative to its final destination; however, he believes these costs have little to do with the number of pieces *inside* a sack. *Id.* at 23-24 (emphasis supplied).

[10] Stralberg's position is that a cost-based rate design "should include per-sack charges that are consistent with the actual costs of handling sacks, which generally vary [under the new cost model] from \$1 to over \$3 each." *Id.* at 24. Stralberg believes that assessing this type of charge would quickly reduce "the fairly widespread practice among Periodicals mailers of sending sacks with only one or a few pieces in them through the postal system." *Ibid.* At the same time, he generally opposes imposing minimum sack quantities and, assuming appropriate pricing is in place, sees no need to prohibit the practice of sending low-volume "skin sacks." *Id.* (n.4).

[11] *Pallets*. Stralberg states that pallets incur costs as they are moved on or off trucks; across platforms; across the workroom floor to a bundle-sorting area where the contents are distributed (sometimes by using a mechanized pallet dumper); and while being recycled. *Ibid.* Based on his model, Stralberg concludes that pallet usage generally causes *fewer* costs relative to flats entered in sacks, and that more finely presorted pallets (such as 5-digit pallets) cause fewer *bundle* handling costs relative to less finely presorted pallets. *Ibid.*

[12] Stralberg acknowledges that pallets with finer presort may have less volume, and notes that the Service imposes a 250-pound minimum weight for destination-entered

¹ His detailed discussion appears at Tr. 1/23-29.

pallets to avoid handling too many small pallets. However, he believes some facility managers “would be happy to receive 5-digit pallets containing considerably fewer than 250 pounds” because these pallets can be transferred directly to the destination delivery unit and require much less bundle sorting than 3-digit or ADC pallets. *Id.* at 24-25.

b. Bundles

[13] Stralberg addresses four main points in connection with identifying and classifying bundle-sorting costs: bundle’s bulk; premature bundle breakage; and two cost model issues: an assumption associated with the bundle-sorting conversion factor and the omission of a “prepping” operation associated with bundle sorting.

[14] *Stralberg reclassifies some bundle costs based on the conclusion that bundle bulk is a cost driver.* Stralberg’s review of his cost model leads him to conclude that many of the costs it identifies as “bundle related” depend on the bulk of the bundles, rather than on the number of bundles. He therefore believes it is more appropriate to consider these costs weight related, given bulk’s closer correlation with weight. *Id.* at 25-26.

[15] In support of this treatment, Stralberg cites “hamper moving” operations. He says “weight related” bundle costs occur when a hamper or other postal container, after being filled with bundles in a bundle-sorting operation, is moved to another bundle sort or to a piece-sorting operation, in the same facility or in another one. Stralberg says his model, like the existing one, assumes that these hampers hold an average of 52.45 bundles each, and this number is used to translate the costs of moving the containers into “per bundle” costs. *Id.* at 26. However, he contends that hampers are generally moved when full, and observes that they will fill up faster if the flats are thick or if there are many flats per bundle. He therefore considers these costs to be determined primarily by cube, which tends to vary in closer proportion with *weight* than with the number of pieces or bundles and, in turn, asserts that it is more appropriate to classify them as per-pound costs. *Id.* at 26-27.

[16] This conclusion leads Stralberg to exclude these costs from his total estimated bundle costs; however, because the variations are small, Stralberg says witness Mitchell uses only the weighted averages across each row in Table B3a, effectively assuming the piece-sorting costs vary only with bundle presort level and piece characteristics. *Id.* at 189.

[17] *Drawbacks associated with the bundle sorting “conversion factor.”* Stralberg says the Service’s existing mail flow models² identify certain costs associated with bundle sorting but, consistent with the prevailing rate design, translate them into per-piece costs by dividing these costs by the average number of pieces per bundle. He sees several drawbacks to this approach. One is that the resulting presort savings are accurate only for bundles with the average number of pieces. Another is that the actual savings associated with preparing a presorted bundle of pieces depends on whether the individual pieces would have been sorted on AFSM-100 equipment or manually had they not been in a bundle. A third concern is that the existing approach does not account for other characteristics, such as prebarcoding. *Id.* at 23.

[18] Stralberg notes that the Service currently imposes a six-piece bundle minimum for Periodicals flats to avoid the additional costs that might be incurred if mailers prepare bundles with too few pieces, and points to apparent interest, on the part of the Service, in increasing the minimum. *Id.* at 25-26. However, he cautions that a new bundle minimum would not be optimal in all circumstances. Instead, he says the “optimal” bundle minimum may depend on whether the pieces are machinable, whether they are prebarcoded, presort level of the bundle, whether the bundle is entered on a pallet or in a sack, and other factors. *Id.* at 26 (footnote omitted). He concludes:

I believe therefore that the Postal Service would be better off simplifying its ever more complicated mail preparation regulations, abandoning current minimums and simply letting mailers figure out how many bundles to make by pricing both bundles and pieces in accordance with actual costs. To

² These models are now used to estimate cost savings from presorting and prebarcoding.

assist in the development of such a pricing structure, I have estimated the per-bundle costs for each combination of bundle and container presort level, as well as the piece handling costs for different presort levels and piece characteristics.

Ibid.

[19] *Stralberg identifies a discrete “prepping” operation, but omits it from his cost model.* Stralberg says that in the pre-AFSM-100 environment, the process of cutting flats bundles and preparing the pieces for sorting was often integrated into piece-sorting operations and indistinguishable from piece sorting. In the new environment, however, he says that non-carrier route flats bundles are taken to a prepping operation where the bundles are broken and pieces placed on carts to facilitate subsequent loading into the AFSM-100. He believes this operation (referred to as MODS operation 035) also tends to be performed for flats that will *not* be sorted on the AFSM-100. *Id.* at 27.

[20] Stralberg notes that his modeled unit costs for bundles (in Exhibit B) do not include costs for the MODS 035 operation, despite his belief that this operation occurs. This omission is based on Stralberg’s lack of access to any productivity estimates for this operation. Stralberg further notes that this operation (or its equivalent) is not included in the existing model, and says he finds no reference to it in the flats mail flow model which was used in Docket No. R2001-1 to set flats presort and automation discounts.³ He says that had he been able to include the MODS 035 costs, the costs of non-carrier route flats categories in his Exhibit B would have been *higher* relative to the carrier route categories. *Ibid.*

[21] *Bundle breakage costs.* Stralberg believes that the most important factor affecting bundle breakage costs is the type of container used to carry them, and contends that an analysis shows that pallets provide “far better protection” than sacks. He maintains that the second most important factor is the presort level of the *container*,

³ This model appears in USPS-LR-J-61.

rather than the presort level of the bundle. In fact, he contends that for a 5-digit pallet with carrier route bundles, bundle breakage simply is not an issue. *Id.* at 184.

[22] *Stralberg's set of estimated bundle costs.* Stralberg's Exhibit B, Table B2a, contains the per-bundle costs that witness Mitchell uses to develop per-bundle rates. *Id.* at 44. Mitchell excludes Stralberg's weight-related costs. Stralberg's Table B2b contains weight-related bundle costs; Table B2c contains the sum of the two sets of costs. *Ibid.*

3. Stralberg's assessment of cost-causing characteristics associated with individual flats pieces and weight (cube and pounds)

[23] *Individual flats pieces.* Stralberg prefaces his discussion of piece costs with several criticisms of the existing design. For example, he says that while it recognizes prebarcoding of non-carrier route flats and four presort levels, it does not recognize machinability, despite this feature's growing importance with the advent of the AFSM-100. *Id.* at 27. He also characterizes the current presort levels as a "confusing mix," provides several examples, and asserts that inconsistent definitions have led to "some striking rate anomalies."⁴ *Id.* at 27-28 (including footnote 7).

[24] Stralberg contends that recognizing all meaningful combinations of bundle and container presort level, container type, machinability and prebarcoding not only leads to much more cost-based rates, but is conceptually simpler than the current approach. His Tables A3 and B3 illustrate all the categories of piece characteristics for which he presents estimates of volumes and unit costs. *Id.* at 28.

[25] *Weight-related costs.* Stralberg asserts that for Periodicals, bulk (measured in cubic feet) is probably much more of a cost driver than weight, pointing out:

It is the bulk that consumes space on trucks and in trays, hampers and other containers used to transport these flats. The faster that trays, hampers and other containers are filled up, the sooner they must be removed and replaced.

Id. at 29-30.

⁴ The current levels are carrier route, 5-digit, 3-digit and basic. *Id.* at 27.

[26] He nevertheless concludes that since density (weight/cube) is fairly uniform, at least among magazines, it is reasonable to continue to treat pounds, rather than cubic feet, as a major cost driver in Periodicals. *Id.* at 30.

[27] Stralberg makes two main assertions with respect to mail processing costs. One is that more than half of the costs the mail flow model identifies as per-bundle costs would more appropriately be considered weight related. The other is that a portion of the model's per-piece costs are also, strictly speaking, more weight than piece related. *Ibid.* He performs an analysis showing that approximately 30% of Outside County revenues should be derived from pound rates when the rates include cost-based charges for sacks, pallets and bundles. *Ibid.*

4. Stralberg's estimate of the pound-related proportion of Periodicals costs

[28] Stralberg finds that total test year 2003 after rates costs attributable to Outside County Periodicals are \$2,404.808 million. *Id.* at 54. Of this amount, he finds that total costs related to user-prepared sacks and pallets and to non-weight related bundle costs, after a CRA adjustment, are \$500.44 million, or 20.81% of the total costs. He notes that witness Mitchell develops separate charges for these elements that represent roughly the same percentage. *Ibid.*

[29] Stralberg says that since postal operations are affected to some degree by both the number of pieces handled and the weight of those pieces, it may never be possible to determine with "absolute precision" which portion of overall costs are primarily weight related. However, he concludes that it would be "reasonable and consistent" with the concept of cost-based rates if 30% of Outside County revenues are derived from pound rates, when slightly more than 20% of revenues are derived from sack, pallet and bundle charges. *Id.* at 55.

[30] Stralberg's reasoning is that transportation costs are generally incurred on a cube or weight-related basis, and therefore are pound rather than piece oriented. He provides a supporting analysis which he claims shows that about 25% of costs are clearly weight related, and asserts that there must be additional weight-related costs

in delivery and in mail processing. *Ibid.* However, he claims that total weight-related costs must be higher than \$593.830 million because delivery costs “clearly must have some weight related component,” and piece sorting costs are affected, to some extent, by the weight of the pieces sorted. *Id.* at 55-56. Pursuing this line of reasoning, Stralberg states that total delivery costs attributed to Outside County Periodicals, including piggyback costs, are \$743.054 million. He does not know the percentage of these costs that is weight/cube related, but says that “clearly the percentage is greater than zero.” *Id.* at 56. He proposes adopting the assumption that 17% of overall delivery costs are weight related. This adds \$126.32 million to weight-related costs, making them almost exactly 30%. *Ibid.* The following table summarizes Stralberg’s analysis:

**Stralberg’s Analysis of Pound Rate
Revenue—Generating Responsibility**

Transportation Costs —	(in millions)
Cost Segment 14	\$342.758
Cost Segment 8	45.144
Cost Segment 8 Piggyback Costs	factor of 1.589%
Subtotal	\$414.498
Bundle costs	\$128.185
Piece costs	\$ 50.987
Subtotal:	\$593.830 (24.69%)
Other costs (delivery)	126.32
Total:	\$720.150 (30%)

Source: *Id.* at 54-55.

5. Stralberg's volume estimates

[31] *General approach.* Stralberg develops estimates of test year FY 2003 after rates volumes of Outside County sacks, pallets, bundles and nonletter pieces by entry point. Exhibit A contains a summary of his estimates. *Id.* at 30. Stralberg identifies his primary data sources as the mail characteristics study in USPS LR-I-87 and USPS LR-J-114. He also normalizes the LR-I-87 survey results for consistency with the test year 2003 after rates billing determinants the Commission used in its R2001-1 rate design. *Id.* at 30-31.

[32] Stralberg says that after letter-shaped pieces are excluded, his process is essentially the same as that applied by witness Miller (USPS-T-24, LR-J-61) in Docket No. R2001-1. It entails using a set of multipliers that relate billing determinant volumes of the existing presort/automation rate categories to the corresponding volumes computed from unadjusted survey results. Stralberg says he was able to extend the use of multipliers to bundle and container counts from the mail characteristics study. A spreadsheet calculates the volume estimates. *Ibid.*

[33] Stralberg notes that this process was performed separately for regular rate and nonprofit Periodicals, and the results were then extrapolated to include Classroom publications. Then, to produce the container volumes in Table A1, estimates of sacks and pallets by presort level were used to normalize the container counts by entry point obtained from LR-J-114. *Id.* at 31.

[34] Stralberg provides considerable additional detail about the development of billing determinants for non-letters, for non-letter piece volumes, bundle volumes and container volumes by entry point. *Id.* at 31-35.

6. Stralberg's new cost model

a. Introduction

[35] Stralberg notes that the cost model that underlies existing rates is based on the piece/pound assumption, so he cannot use it to calculate a set of unit cost estimates that will fully support the Complainants' expanded proposal. He therefore develops a comprehensive new model.

[36] Stralberg characterizes the new model as similar to the LR-I-332 model developed by the Postal Service and Christensen Associates during Docket No. R2000-1. He notes the model's origins as part of a cooperative industry/Postal Service effort to try to limit the Periodicals rate increase, acknowledges his involvement in that effort, and states that he reviewed the model in preparing testimony for this case. He says:

. . . I concluded that the modeling approach used in LR-I-332 is well suited for developing the types of cost based rates that are being proposed in this case, but that a number of substantial changes to the model were needed, including the following:

- wage rates and piggyback costs from TY01 of R2000-1 were changed to TY03 of R2001-1;
- the model was changed to use PRC costing methodology;
- the R2000-1 modeling assumptions for flats piece sorting were changed to the R2001-1 assumptions, which include a more dominant role for the AFSM-100 machines;
- mail flow assumptions for containers entered at origin facilities were modified in accordance with the LR-J-114 entry point data;
- some costs categorized in the original model as per-bundle were recategorized as per piece, and other costs originally categorized as per-bundle or per-piece were re-categorized as primarily weight related.
- a CRA adjustment was applied to the modeled costs to make them correspond to TY03 after rates mail processing costs for non-letter Periodicals.

Id. at 36.

[37] Stralberg's testimony provides a detailed overview of the model (id. at 36-38); it discusses estimated piece costs (id. at 38-40); estimated per-bundle costs (id. at 40-44); estimated per-sack and per-pallet costs (id. at 44-50); and explains a CRA adjustment (id. at 51-54). It also provides an analysis addressing the estimated proportion of Periodicals costs that are pound related. Id. at 54-56.

[38] The new model's main analytical focus is on identifying and isolating Periodicals mail processing costs that vary with five, rather than just two, elements: the number of pieces and number of pounds (as occurs now), *plus* the number of bundles, sacks and pallets. *Id.* at 39, 166.

[39] *Limitations.* Stralberg acknowledges that factors such as ongoing changes in processing methods and mailers' practices, and older (or unavailable) data limit his results in several respects, but he nevertheless considers the new model "a suitable and accurate tool for the determination of unit costs and the development of truly cost based Periodicals rates." *Id.* at 57-58.

b. Stralberg's estimates of per-piece costs

[40] Stralberg explains that his estimated per-piece costs are comprised of two main components. One component consists of the costs incurred at various manual, mechanized and automated piece sorting operations. The other consists of certain other costs incurred in transporting pieces that have already passed through at least one piece sort to subsequent piece sorts (if necessary) and to the destination delivery unit (DDU), until the pieces have been given to the carriers. *Id.* at 38.

[41] Stralberg further claims that the "pure" piece sorting costs (in the first component of costs he has identified) include two distinct types of costs: those incurred in the absence of premature bundle breakage and the *additional* costs incurred when premature breakage occurs, which "typically leads to additional piece sorting costs." *Ibid.* (Emphasis supplied.) He notes that piece-sorting costs related to premature bundle breakage are defined as "per bundle" costs in the existing model; however, he considers them to be per-piece costs because he concludes that they are determined not by the number of bundles that are broken, but by the number of pieces in the bundles that are broken.⁵ *Ibid.* Stralberg's estimates of "pure" piece sorting costs appear in Exhibit B/Table B3a. These are the costs Mitchell uses in his rate design. *Ibid.*

⁵ Stralberg notes, with respect to his bundle breakage methodology, that he uses the original LR-I-332 method to calculate costs. This is based on his conclusion that although the R2001-1 flats model remedied some of the problems associated with an earlier model, it is also severely flawed in some of its assumptions. *Id.* at 40.

[42] Stralberg says the second main component — costs incurred in transporting pieces to subsequent piece sorts and to the DDU, until they reach carriers — can be viewed as more weight related than piece related because the costs are determined more by physical bulk than by the number of pieces. These costs appear in Table B3b. *Ibid.* Stralberg notes that he computed these costs on a per-piece basis, but that witness Mitchell did not use them in designing piece rates. *Id.* at 38-39. Table B3c contains the sum of these two piece-related categories. *Id.* at 39.

c. Stralberg's estimates of per-bundle costs

[43] Stralberg states that bundle sorting is either mechanized or manual. He notes that overall productivity figures are generally available, but says he does not consider these sufficient. This is because the overall figures represent work other than actual bundle sorting, such as opening sacks and shaking out their contents onto a moving belt, and other activities. *Id.* at 40. Thus, since Stralberg's objective is to separate sack, pallet and bundle costs, he needs to isolate "pure" mechanized and manual bundle sorting productivity by excluding the component that consists of sack and pallet handling. *Id.* at 40-41. He identifies other factors as well, which he defines as the part of bundle sorting costs that vary *only* with the number of bundles, rather than with the number of sacks and pallets or with bundle bulk. *Id.* at 41.

[44] Stralberg finds that this issue was addressed in the development of the original LR-I-332 model for mechanized bundle sorting, so he uses that result in his new model. However, he says it does not appear that this was addressed for manual bundle sorting, so he develops his own analysis.⁶ The following table shows the productivities he adopts or develops for both types of bundle sorting:

⁶ This analysis is described in detail at Tr. 1/41-43.

Stralberg Bundle Productivities

Activity	Bundles per workhour
“Pure” mechanized bundle sorting productivity:	560.75
“Pure” manual bundle sorting productivities:	
Mixed Area Distribution Center:	121
Area Distribution Center:	369
3-digit/SCF:	455
5-digit:	505

Source: Tr. 1/41-43.

[45] *The impact of bundle breakage.* Stralberg notes that although he treats the costs associated with bundle breakage as per-piece cost, he nevertheless believes that breakage has an impact on estimated per-bundle costs. He points to the following trade-off: “[w]hen a bundle breaks prematurely, it spends less time in the system as a bundle, leading to lower per-bundle costs, as well as higher per-piece costs.” *Id.* at 43. Moreover, Stralberg says that because bundles in sacks have a much higher probability of breaking, the result is that for corresponding combinations of container and bundle presort, the per-bundle costs are slightly *lower* for sacked bundles. *Ibid.* However, he maintains: “This should not be interpreted as meaning that putting bundles in sacks is less costly; the reverse is true when piece handling and container handling costs are also taken into account.” *Ibid.*

[46] *Treatment of weight-related bundle costs.* Stralberg also says that substantial portions of the costs the model identifies as “per bundle” are related to activities such as placing empty containers at a bundle-sorting operation to receive sorted bundles, removing those containers when they are full and taking them to a subsequent operation

or to the platform and onto a truck to another facility. *Id.* at 44. Stralberg reiterates his earlier point — that these are converted to per-bundle costs by assuming the containers contain 52.45 bundles. However, he notes: “In reality, of course, the number of bundles in a full container depends on the number of pieces per bundle and on the size of those pieces.” *Ibid.* He refers to these costs as weight-related bundle costs, and identifies them separately. He notes that witness Mitchell also excludes the weight-related bundle costs in designing rates. *Ibid.*

d. Stralberg's estimates of per-sack and per-pallet costs

[47] Stralberg asserts that the cost of handling sacks and pallets depends on entry point and the container presort level. His model determines sack and pallet unit costs through three main steps. The first involves identifying the types of postal facilities that handle Periodicals sacks and pallets. The second involves identifying the various processing operations performed on sacks and pallets in each type of facility and determining the unit cost of each operation. The third entails determining the probability that a sack or pallet with a given presort level and entry point will pass through each type of facility and each type of operation. *Ibid.*

[48] *Step 1: facility types.* Stralberg says Periodicals sacks and pallets may be handled in one or more of eight types of facilities.⁷ Stralberg assumes that Periodicals handling at BMCs consists only of cross-docking pallets and sorting and dispatching sacks; therefore he assumes that no Periodicals sacks or pallets are opened at BMCs. *Id.* at 45. With one exception, he assumes, as does the existing model, that all sorting of Periodicals bundles and flats occurs at the DADC, the DSCF or the DDU. The exception relates to mixed ADC sacks, whose contents Stralberg says are typically distributed at the origin ADC. *Ibid.*

⁷ These include four destinating facilities and four originating facilities: the destinating delivery unit, the destinating sectional center facility, the destinating area distribution center and the destinating bulk mail center (BMC). The originating facilities include the originating BMC, the originating ADC, the originating SCF and the originating associate office, when these are different from the destination facility. *Ibid.*

[49] *Impact on Mitchell's rate design.* Stralberg notes that Mitchell proposes separate rates for sacks and pallets entered at the DMBC, and that these rates are lower than those proposed for sacks and pallets entered at origin facilities. He says these rates are based on the unit cost estimates in Table B1. *Ibid.*

[50] *Step 2: costing the container operations.* Stralberg provides an extensive discussion of his development of the costs of container operations. *Id.* at 45-48. He notes that the operations cost spreadsheets list a series of operations that may be performed on sacks or pallets in each type of facility. He says the per-sack or per-pallet unit cost is computed for each operation using the estimated productivity rate (units/workhour); conversion factor (if the unit handled is something other than a sack or pallet); and test year 2003 wage rates, piggyback factors and premium pay factors. *Id.* at 46.

[51] Stralberg notes that the existing model uses container productivity rates from several sources, says he uses most of these, but modifies them for PRC volume variability assumptions. *Ibid.* Some of the changes he makes in assumptions about productivity rates and container operations, other than those related to wages, piggyback factors and volume variability pertain to the following: unloading at entry facilities; pallet cross-docking; manually-sorted pallets; operations at AOs, stations and branches; and containers entered at AOs. *Id.* at 46-48. Stralberg recognizes that even with these changes, it is possible that his productivity rates tend to underestimate the cost of some operations and overestimate the cost of others. *Id.* at 48.

[52] *Step 3: container downflows.* The container downflows in Stralberg's model are based on the flows in the existing model, but reflect several modifications.⁸ One entails replacing assumptions Stralberg does not believe were empirically based with assumptions based on new information (primarily in the form of an entry point study in USPS-LR-J-114). Stralberg finds that determining container downflow is reasonably straightforward once a container reaches a destinating facility, but that entry at more

⁸ Container downflows define the flow of containers between the eight types of facilities.

remote points means there are more possible paths that a container can follow. *Id.* at 49. His review of the existing model leads him to conclude that its developers must have made “some fairly arbitrary assumptions” about the flow of containers from origin entry points. *Ibid.* He notes, for example, that entering a 5-digit container at the OAO generates seven possibilities as to the next facility, and that OAO-entered 3-digit containers have six possible flows. He says that LR-I-332 assumes that the probability is exactly one-seventh (14.286%) for the 5-digit container and exactly one-sixth (16.667%) for 3-digit containers. Thus, he states that these assumptions do not appear to be empirically based. *Ibid.*

[53] Stralberg says that more information is now available from a new source — the entry point data described in LR-J-114 — and that this makes it possible to determine the probability of each alternative facility for each sack or pallet presort level. His Exhibit C shows the distributions of originating entry point types among types of service area. *Id.* at 50.

[54] By combining a table that contains assumptions of downflows regarding the service area in which these facilities are located with data from LR-J-114, Stralberg computes the combined downflow from OAO, OSCF and OADC entry facilities for each combination of container type and container presort level.⁹ He relies on LR-I-332 assumptions regarding the downflows from OBMC, DBMC, DADC and DSCF. *Ibid.*¹⁰

7. Summary of the new cost model's results

[55] Stralberg’s new model calculates unit mail processing cost estimates and volume estimates that support the elements in the Complainants’ proposed new rate structure. Stralberg summarizes these results in two exhibits included with his testimony. Exhibit A, which consists of three tables, presents an expanded set of test year 2003 after-rates billing determinants for Outside County Periodicals corresponding to the mail

⁹ This table is labeled "Container Flows Between Facility Types" and is in spreadsheet "VolumesTY03AR.xls." *Id.* at 50.

¹⁰ Stralberg also makes a CRA adjustment because applying projected test year 2003 after-rates volumes to the unit costs indicated by his model results in total costs that are somewhat *higher* than indicated by corresponding CRA-based projections. *See generally id.* at 51-54.

categories for which he estimates unit costs.¹¹ Stralberg's Exhibit B, which consists of five tables, presents the estimated test year 2003 unit costs for each category of sacks and pallets.¹² Id. at 22. The unit costs shown in Exhibit B are the adjusted costs that form the basis for Mitchell's rate design. Id. at 52. The results include an expanded set of test year 2003 after rates billing determinants and corresponding mail processing unit costs. Id. at 22. Revised Exhibit B reflects Stralberg's corrections, and the new estimated mail processing unit costs. Id. at 17.

¹¹ Table A1 is captioned "Outside County Sack & Pallet Counts by Entry Point & Container Presort." Table A2 is captioned "Estimated Counts of Bundles by Bundle & Container Presort Level." Table A3 is captioned "Piece Counts by Bundle & Container Presort Level and Piece Characteristics." See Tr. 1/59-60.

¹² Exhibit B consists of five tables. Table B1 is captioned "Unit Costs of Sack/Pallet Handling By Entry Point & Container Presort." Table B2a is captioned "Per-Bundle Unit Costs By Bundle & Container Presort Level - Excludes Weight Related Bundle Costs - Used in Mitchell's Rate Design." Table B2b is captioned "Weight Related Per-Bundle Unit Costs By Bundle & Container Presort Level." Table B2c is captioned "Total Per-Bundle Unit Costs, By Bundle & Container Presort Level, Including Weight Related Costs." Table B3a is captioned "Unit Piece Processing Costs By Bundle & Container Presort Level & Piece Characteristics Excludes Weight Related Costs - Used in Mitchell's Rate Design." See id. at 61-63. A third exhibit identifies, by percentage, the service territory of originating facilities for origin-entered containers (Exhibit C). TW et al.-LR-1 contains related spreadsheets.

B. Witness Mitchell (TW et al.-T-1)

[56] Witness Mitchell's testimony analyzes alleged deficiencies in existing Periodicals rates; develops and documents a proposed alternative rate design for Outside County flats; and addresses the desirability and superiority of the proposed alternative in terms of the statutory ratemaking and classification criteria. Appendix A to his testimony presents a model that addresses options and decisions a publisher might face, in the context of the Complainants' proposed zoned editorial pound rate, with respect to reducing or eliminating subscribers who live in more distant postal zones. A library reference contains the three spreadsheets that constitute Mitchell's workpapers. Tr. 3/798.

[57] Mitchell's alternative rate design, in brief, retains some of the elements in the existing design with little or no change, but significantly alters others and adds several new features. In particular, it adds the three new elements (sacks, pallets and bundles) that witness Stralberg has identified as cost drivers to the basic piece-pound structure. It continues to recognize prebarcoding, but adds recognition of machinability. It also continues to recognize palletizing, but alters the way it is recognized.

**Time Warner et al. Proposed Rate Schedule — Outside County Periodicals —
Non-Letters
PERIODICALS RATES**

Per Piece		Per Bundle		Per Sack		Per Pallet		Per Pound	
Bundle Level Piece Description		Container Level Bundle Level		Sack Level Entry Point		Pallet Level Entry Point		Distance (Zone) From Entry Point	
Bundle/ Piece	\$/Pc	Container/ Bundle	\$/Bundle	Sack/ Entry Pt.	\$/Sack	Pallet/ Entry Pt.	\$/Pallet	Entry Zone	\$/Pound
Mx. ADC		Mx. ADC							
Non	0.440	MADC	0.260	Mx. ADC		ADC			
Mach	0.310	ADC	0.320	Origin	1.53	Origin	40.44	DDU	0.145
Bar-Non	0.386	3-D/SCF	0.340			DBMC	26.90	DSCF	0.166
Bar-Mach	0.264	5-D	0.370	ADC		DADC	13.67	DADC	0.174
ADC				Origin	3.25			Zones 1 & 2	0.191
Non	0.321			DBMC	2.37			Zone 3	0.206
Mach	0.275	ADC		DADC	1.29	3-D/SCF		Zone 4	0.244
Bar-Non	0.290	ADC	0.100			Origin	40.02	Zone 5	0.301
Bar-Mach	0.241	3-D/SCF	0.170	3-D/SCF		DBMC	26.90	Zone 6	0.362
SCF/3-D		5-D	0.200	Origin	3.22	DADC	25.72	Zone 7	0.436
Non	0.307	CR	0.210	DBMC	2.37	DSCF	13.67	Zone 8	0.498
Mach	0.260			DADC	2.02				
Bar-Non	0.280			DSCF	1.29				
Bar-Mach	0.230	3-D/SCF				5-D			
5-D		3-D/SCF	0.110	5-D/CR		Origin	42.39		
Non	0.233	5-D	0.180	Origin	3.30	DBMC	30.46		
Mach	0.210	CR	0.190	DBMC	2.78	DADC	24.58		
Bar-Non	0.225			DADC	2.10	DSCF	17.05		
Bar-Mach	0.194			DSCF	1.73	DDU	1.57		
CR Basic	0.121	5-D/CR		DDU	0.93				
CR HD	0.089	5-D	0.000						
SAT	0.081	CR	0.080						
Piece Sorting Delivery		Bundle Sorting		Sack Handling/Sorting Sack Opening Sack Return		Pallet Handling Pallet Opening Pallet Return		Transportation Bulk Handling Some Piece Sorting Delivery	
Per-pound Editorial Discount, cents per editorial pound					10.1				
Per-piece Editorial Discount, cents times editorial percent					7.4				
Per-piece charge for qualified Ride-Along pieces, cents					12.4				
Source: Witness Mitchell Proposed Rate Schedule, Tr. 3/840.									

1. Deficiencies in current rates

[58] Mitchell casts the threshold question in this case as an inquiry into what is “so wrong with current Periodicals rates” that a complaint proceeding seeking to effect reform has been filed. His answer cites the following reasons:

- a history of Periodicals rate increases, dating to the 1980s, that have been greater than the Consumer Price Index (CPI);
- recent improvements in our understanding of costs that have brought existing deficiencies into clearer focus and have suggested new paths that cost recognition should follow;
- a pound rate he characterizes as highly inefficient;
- the impact of the unzoned editorial pound rate, which means that many local and regional publications that choose to print near their home base are unfairly charged elevated rates to support reduced rates for publications going longer distances.

Id. at 800-02.

[59] Mitchell briefly reviews the origin and development of Periodicals (formerly referred to as second-class mail), and says this history might lead one to expect that Periodicals rates are low and attractive. Id. at 805. However, he claims Periodicals rates are not low, have been rising inordinately, and that their attractiveness is dwindling. Ibid. Moreover, he contends that one would be hard pressed to argue that this outcome is consistent with Congressional expectations, and claims that “[s]omething went wrong.” Ibid. In fact, he contends that the current rates are “inefficient to such a degree that they do not conform to the policies of the Act and that improved rates that enhance efficiency will improve the lot of publishers.” Id. at 805-06.

[60] *Mitchell’s perspective on Periodicals rate increases.* Mitchell asserts that since the late 1980s, there has been inordinate concern that, due to rising costs, rates for Periodicals have been rising too rapidly. Id. at 806. He notes that the Commission has commented on this development and has recognized that mailers and the Postal Service must aggressively pursue cost reduction opportunities and explore other aspects of the “operational realities” they face. Ibid., citing PRC Op. R2000-1, para. 5593.

[61] Mitchell illustrates his point about the cost-rate relationship with a graph showing an index of Periodical rates, at a constant markup index, and the Consumer Price Index, Urban (CPIU). *Id.* at 806-07 (Graph 1). He characterizes the resulting picture as disturbing. *Id.* at 806. He notes that the index would have been expected to increase with the CPIU if no technological changes occurred and no scale economies were realized; however, he says the graph shows that the Periodicals index has outstripped the CPIU by a wide margin. *Id.* at 806-07. In fact, using the 1984 rate case as a base, he asserts that the Periodicals index increased to 275, while the CPIU increased to 170, and asserts that this is substantial difference. *Id.* at 807.

[62] Mitchell further contends that “the actual situation is worse than the picture.” *Ibid.* He notes that the Service claims there have been important technological advances during this period, that its total factor productivity index has increased 9.8 percent, and that it is realizing increasing returns to scale. *Ibid.* He also says that some shifting to pallets has occurred, although there has not been a separate rate for this practice. *Ibid.* (footnote omitted). Thus, he claims:

This means that the most supportable expectation would actually be for the price index to be *below* the CPIU. Alternatively, if increases in real wages absorbed the gains from mechanization, palletization, scale, and other improvements, the rate index still should not exceed the CPIU. It is clear no such expectations have been borne out.

Ibid. (emphasis in original).

[63] Mitchell asserts that this outcome is consistent with a phenomenon he refers to as “negative technological change,” or the situation where mailers make cost-reducing adjustments (such as using pallets), the Service invests in technology (such as flat sorting machines and barcode readers), economies of scale are realized (consistent with the Service’s analysis of mail processing costs), but costs, corrected for inflation, do not decline but *increase*. *Id.* at 808 (emphasis in original).

[64] *Despite some improvements, Mitchell contends that Periodicals rates are not as cost based as they could be.* Mitchell acknowledges that there have been several cost-based improvements in the rate structure that have improved signals, and identifies these changes and the date of their introduction. He nevertheless finds that both the quality of the current signals and the extent to which they recognize costs are deficient.¹³ *Id.* at 809.

[65] Based on this conclusion and the related contention that both our understanding of cost incurrence and mailers' ability to respond to such incurrence have improved in recent years, Mitchell asserts that it is time to improve the signals and to take further steps in the direction of recognizing costs in rates. Moreover, citing several cost-based innovations in parcel post and closer alignment of Standard rates with costs, he claims that Periodicals appears to be lagging other subclasses in this respect. *Ibid.*

[66] Mitchell asserts that most mailers now have both the capability and willingness to analyze their operations and to respond to signals in rates, and that says that when such capabilities are neglected, the entire subclass suffers. In particular, he believes the following disparities between costs and rates need attention:

- the *differences* among zones in the advertising pound rates are based on transportation costs only, and do not recognize that non-transportation costs also vary with distance;
- the non-transportation portion of the dropship discounts (relative to zones 1 & 2), which is largely pound oriented, is given 50 percent on a per-piece basis;
- many of the costs depend on the quantities and sizes of the bundles, sacks, and pallets in a mailing, but this fact goes largely unrecognized in rates;
- the costs of handling bundles depend on the makeup (*e.g.*, ADC, SCF, 3-digit, or 5-digit) of their containers and where they are entered, but neither of these factors are recognized in rates;
- the one-half-cent per-piece pallet discount is based on a pound-oriented savings; and

¹³ These improvements include the introduction of piece rates; presort discounts; dropship discounts; saturation and high-density sequence discounts; barcode discounts; and pallet discounts. *Id.* at 808-09.

— the one-cent per-piece pallet discount is also based on pound-oriented savings and applies only to dropshipped pallets, although the savings exist for *all* pallets.

Id. at 810 (emphasis in original).

[67] Mitchell contends that many of these factors can be recognized in rates, and that doing so would be in line with Commission emphasis in recent years on cost recognition, efficient component pricing, worksharing and notions of lowest combined cost. Ibid. In addition, he says that such recognition “would help the Postal Service to be a more effective delivery organization, and would improve the lot of mailers.” Ibid.

[68] *Mitchell contends that current Periodicals rates provide mailers with poor signals.* Mitchell notes the importance throughout the economy of providing signals in prices, but says that current rates send underdeveloped signals, and thereby fail to provide mailers with “a reasonable and valuable avenue” for responding to high costs. Id. at 811. He also claims that it is difficult to accept that putting mailers in this position is consistent with the ratesetting guidance in the Postal Reorganization Act. Ibid.

[69] As an example of the inadequacy of the signals in current rates, Mitchell notes that attention for many years has focused on whether costs were piece-oriented or pound-oriented, with some recognition of cubic measures in parcel post. However, he says that attention more recently has focused on cost drivers and linkages among cost drivers and volume, partly due to the Service’s increased use of mechanization and automation. He notes:

For example, with bundles now being sorted on small parcel and bundle sorters (SPBSs), the cost of sorting bundles is virtually independent of the weight of the bundles and the number of pieces in them. Similarly, with the use of sack sorters and lift trucks, the costs of sorting sacks and pallets are virtually independent of the nature of their contents. Moreover, the processing these receive depends on their makeup and their entry point.

Id. at 812 (footnote omitted).

[70] Mitchell asserts that when these factors are not recognized in rates, mailers cannot be expected to understand or respond to the costs of handling their mail. *Ibid.* He says that the proposed rates, by taking significant steps toward recognizing these factors, would increase the efficiency with which the mail is prepared and handled. *Ibid.*

[71] Mitchell also claims that the current relationship between rates and actual processing is disjointed and sometimes perverse, citing Time Warner witness O'Brien's testimony in Docket No. R2000-1. *Ibid.* As an example, he says the same carrier route bundles receive different processing and incur different costs depending on whether they are on 5-digit pallets or 3-digit pallets, yet these pieces pay the same rates. He says that in the face of such signals, mailers cannot be expected to consider the cost implications of the preparation decisions they make. *Id.* at 812-13.

[72] Mitchell also cites the tradeoff between bundles and sacks, with some mailers having a choice of preparing one 24-piece bundle or 24 sacks with one piece. He claims that processing the sacks is "vastly more expensive" than processing the bundle, but that the rates are the same. *Id.* at 813. He says that if the mailer, given appropriate signals, values the sacks and is willing to pay for their handling, the outcome is consistent with efficiency, or the mailer could decide that the return from using the sacks is not worth the cost. *Ibid.* However, he says neither of these things is happening, given improper pricing signals. *Ibid.*

[73] Mitchell cites with approval the changes that have occurred in Standard Mail since dropshipping was introduced, noting that dropshipped volume has gone from 14.6 percent to 73.3 percent. *Ibid.* He asserts that this difference represents an enormous waste of resources at the expense of Standard mailers, and equates Periodicals mailers situation now with the situation Standard mailers were in prior to the introduction of dropshipping. *Ibid.*

[74] Mitchell further notes that it is unreasonable to expect printing bids to reflect the additional transportation costs the Service incurs in delivering mail to more distant locations or to expect publishers to recognize those costs. *Id.* at 814 (footnote omitted). He observes:

In the extreme, if service were not an issue and rates were not dependent on distance, all printing could be done in Guam and the publisher could not be faulted for making a bad decision. But publishers collectively would nonetheless suffer from such decisions, because *all* of the handling and transportation costs for Periodicals *are* attributed to Periodicals, even if they are not transcribed into rates that recognize actual handling and distance.

Ibid. (emphasis in original).

[75] Mitchell contends that the implications are clear: if efficient distribution and related printing decisions are to occur, and thereby bring about efficient, low-cost postal services, postal rates must reflect the Postal Service's costs. Ibid. However, he says the extent to which they currently do so is limited for two main reasons. First, due to the unzoned editorial pound rate, the postage paid does not reflect the higher *transportation* costs associated with the higher zones. Second, as Periodicals rates have been developed thus far, postage does not reflect the higher *non-transportation* costs associated with the higher zones. Id. at 814-15 (emphasis in original).

[76] Mitchell notes that recognizing the importance of rates as signals for efficient behavior is not new, citing the Commission statements in Docket No. MC95-1 to this effect with respect to automation and bulk bypass issues. Id. at 815. He claims: "Rates that are better aligned with preparation options and their associated costs, as proposed in this Complaint, would undoubtedly have an effect on mailer decisions, whether it be on the sizes of the bundles, the containers selected, the makeup and contents of the containers, or the entry points." Ibid.

[77] *Mitchell's perspective on the impact of zoning the editorial pound rate.* Mitchell discusses the history and purpose of the unzoned editorial rates (at Tr. 3/815-17), and concludes that the decision not to apply zoned editorial rates but "to arrange a low, clearly subsidized rate for editorial matter was a compromise reached after publishers argued that applying the zone rates uniformly would have deleterious effects on the distribution of publications." Id. at 817. He notes that both the Commission and the MOAA court have expressed similar concerns. Id. at 817-18.

[78] Mitchell notes that the local and regional publication category includes publications devoted to particular industries or professions, publications centered on individual cities, state travel magazines, college alumni magazines, regionally and locally oriented religious publications, and publications that cater to geographically concentrated ethnic communities or interest groups. *Id.* at 819-20. He observes that around the subclass average, a publication's implicit cost coverage is a function of its proportion of advertising content, among other things, and contends that this reflects ECSI value. *Id.* at 820. He states:

In order to abstract from this effect, and to allow balanced comparisons, I assume that all local and regional publications have an average proportion of advertising content. It follows that if they were average in other respects as well, their cost coverages would all be equal to the average for the subclass. But these publications are not average in other respects. Importantly, their final delivery occurs primarily in limited geographical areas, regardless of where they are printed. I know of one city magazine that is entered in zones 1 and 2. Ninety-four percent of its copies stay within those two zones.

Ibid.

[79] Mitchell asserts that another factor affecting publications' implicit cost coverage is their postal zone, and that local and regional publications may be viewed as falling into either Camp 1 or Camp 2. He describes Camp 1 as composed of publications printed in close proximity to their final delivery area, with short hauls and relatively high cost coverages. He says they represent "what would seem the natural and expected model for publications with geographically concentrated subscriberships." *Ibid.* On the other hand, he describes Camp 2 as composed of publications printed some distance from their delivery area and then carried to the delivery area by the Postal Service. He says these publications have a substantial haul and relatively low cost coverages. *Ibid.*

[80] Mitchell notes that Camp 2 publishers have made decisions to print some distance from their home base, and grants that there is no reason to believe that these

decisions are not rational, given the rates these publishers see. However, he adds that the rates these mailers pay do not show the full costs of their decisions, and thus believes that they cannot be expected to make efficient decisions. *Id.* at 821. He sees the situation this way:

Because the increase in postal rates attendant to a decision to print at a distant location is less than the associated increase in postal costs, Camp 2 publishers have unknowingly made decisions that imposed extra costs on someone else. Camp 1 publishers, who are printing in close proximity to their delivery area, are paying these extra costs, and thus are helping to finance longer-distance mail.

Ibid.

[81] Mitchell's view is that Camp 1 publishers should not be discriminated against, and Camp 2 publishers should not be blinded to the resource implications of their decisions. Instead, he contends that both should be given cost-based signals and then allowed to choose where to print. He asserts that those who decide to print locally should not be required to pay elevated postal rates to help support publishers who make different decisions or who mail more broadly. *Ibid.*

2. Mitchell's alternative rate design
 - a. General considerations

[82] Mitchell develops and documents an alternative rate design for Outside County Periodicals flats, and provides a related rate schedule. *Id.* at 823-40. In support of his approach, he asserts "... the costs of the mail are recognized in the rates, consistent with accepted rate-design principles, in such a way that mailers are able to decide whether the value they receive from higher-cost services is greater than the value they receive from lower-cost services, after considering any costs they might incur to prepare their mail in one way or another. ...” *Id.* at 823.

[83] *Summary of similarities and differences.* Mitchell says the proposed rates zone the full weight of the publication, recognizing transportation costs according to the way

they are incurred, and at the same time recognizing alternatives associated with the preparation and usage of bundles, sacks and pallets. Ibid. He claims that mailers have alternatives in all of these areas, and that it is accordingly important that the cost consequences of these alternatives be reflected in rates. Ibid.

[84] Mitchell says the *non-transportation* portion of distance-related costs is reflected by having the charges for containers vary with point of entry. Id. at 824. Presortation continues to be recognized, but with one change: the new schedule provides expanded recognition, in the sense of giving separate recognition to pieces sorted into mixed ADC bundles, ADC bundles, and 3-digit/SCF bundles. Ibid. Currently, the costs associated with these levels are captured, but are averaged together in one discount. The new design retains, and makes no change, in the recognition currently accorded 5-digit and carrier route (which includes high density and saturation). Ibid. It also continues to recognize prebarcoding, but adds recognition of machinability for all sortation levels except carrier route. Ibid.

[85] In general, Mitchell says the resulting rates recognize the distinctions necessary to allow mailers to make efficient decisions, but also preserve to the maximum extent possible the Commission's recommendations in Docket No. R2001-1: they preserve all applicable discounts; are based on the same costs and the same cost studies; are revenue neutral; are based on the same volumes and billing determinants; and result in the same cost coverage. Id. at 824-25. Also, although the proposed design eliminates the existing pallet discounts as separate rate categories, Mitchell says the costs avoided due to this activity are recognized "more thoroughly and more uniformly" via the per-sack and per-pallet charges that vary by container type and entry point. Id. at 825.

[86] Mitchell's position is that mailers should be given cost-based signals in rates; he believes many mailers will find it in their best interest to make changes if these signals are provided; and he believes that these changes will improve the general situation of Periodicals mailers as a class and the efficiency of Periodicals mail. Ibid.

b. Specific elements of Mitchell's proposed rate design

[87] *Recognition of presort*. Mitchell's design continues to recognize presort, with one modification. This change reflects the fact that the mail flow models that underlie current rates give separate recognition to pieces sorted into mixed ADC bundles, ADC bundles, and 3-digit/SCF bundles. Thus, in the interest of following costs, Mitchell proposes that these three presort levels be added. In particular, he says including the cost of SCF bundles in the existing 3-digit category is consistent with the cost analysis on which the current rates are based. *Id.* at 824. Mitchell's design retains recognition of sortation to the 5-digit and the carrier route levels (the latter including high density and saturation). *Ibid.*

[88] *Bundle charges*. Mitchell says that bundle handling depends on the makeup of the bundles and on the level of the container on or in which they reside. *Id.* at 826-27. His design reflects this in per-bundle charges that depend on the level of the bundle and its container. *Id.* at 827.

[89] *Sack and pallet charges*. Mitchell's design reflects several considerations, including his belief that mailers generally have options concerning not only the kind of container they use, but also container makeup, and that the container's entry point affects costs. *Ibid.* Thus, he provides specific recognition to destination facilities. *Id.* at 828. Facilities that do not qualify as destinating facilities are categorized as origin facilities. *Ibid.*

[90] *Zoned pound rates*. Mitchell's pound rates are developed following the Commission's longstanding procedures, but are applied to the full weight of the publication. *Ibid.* A detailed description, including Mitchell's correction to two apparent errors in the existing development of the pound rates, appears at *id.* 828-31.

[91] *Dropship discounts*. Mitchell reviews the way dropship discounts are currently developed and raises several criticisms, including the contention that some of the discounts are not well aligned with costs. He says the proposed rates recognize the dropship savings in both transportation and non-transportation costs in "fairer, more balanced, and more appropriate ways." *Id.* at 831. In support of this contention, he cites

three changes: transportation savings are recognized in the zoned pound rates, and are applied to the full weight of the mailing; both the per-sack and the per-pallet charges vary with the makeup of the container and with the entry point of the container; and per-bundle charges vary with the makeup of both the bundle and the associated container. *Ibid.* Mitchell says that when the options are offered in this way, dropshipping decisions are integrated with other alternatives that mailers have, all of which have cost consequences. *Id.* at 831-32.

[92] *Pallet discounts.* Mitchell notes that current rates reflect an “overlay of three pallet discounts.” He claims they reflect costs in an uneven way and fail to present mailers with a true reflection of the cost consequences of their decisions. *Id.* at 832. In contrast, he says that recognition of pallets in the proposed rates is uniform, cost-based, and much simpler, as it occurs implicitly through the per-sack and the per-pallet charges that vary by container makeup and entry point. *Id.* at 832-33.

[93] *Recognition of editorial content and related funding.* Mitchell notes that traditionally, editorial content in Periodicals has been recognized in two ways. First, editorial matter in all zones and at all entry points has paid a pound rate that generally has been set at 75 percent of the pound rate for advertising going to zones 1 and 2. Second, since Docket No. R84-1, an editorial discount has been given on each piece. This discount now amounts to 7.4 cents times the proportion of editorial content. Thus, if a piece has 70 percent editorial content, it receives a per-piece discount of 5.18 cents (7.4 times 0.70). *Id.* at 833.

[94] Mitchell notes that this benefit is currently funded by increasing all Periodicals rates — both pound and piece rates — both advertising and editorial. *Ibid.* For example, he says that to support the unzoned editorial rate, all of the pound rates for advertising have been increased. *Ibid.* In other words, he says that when the editorial rate was set at 75 percent of the increased zones 1 and 2 rates, the editorial rate became higher as well. Similarly, he says that to support the per-piece editorial discount, piece rates have been increased. *Ibid.*

[95] Mitchell says the proposed rates maintain implicit cost coverages, and that substantial deference is therefore provided to the educational, cultural, scientific and informational value of Periodicals, as required by section 3622(b)(8) of the Postal Reorganization Act and as reflected in current rates. The current per-piece editorial benefit is maintained, while the per-pound benefit, which Mitchell says is “currently skewed by distance,” takes the form of a new discount equal to 10.1 cents per pound of editorial matter. *Id.* at 834. Mitchell says that arranging the editorial benefit this way does not favor some (longer-distance) editorial matter over the other (shorter-distance) editorial matter. *Ibid.*

[96] Mitchell says the unzoned editorial rate has provided “considerable deference” to higher-zone publications, depending on their editorial content percentage. In fact, he claims they generally are carried below cost. *Id.* at 836. However, he believes these publications would be treated “quite favorably” under the proposed rates. They would pay only the *additional* costs associated with distant entry, and no additional fixed costs. *Ibid.* (emphasis in original). Thus, their rates would tend to exceed their marginal costs by less than the rates of other mailers, and rates equal to marginal costs are generally understood to be ideal. The result, he asserts, “is a high form of consideration.” *Ibid.*

[97] *Proportion of revenue from the pound rates and mechanics.* Mitchell observes that the proportion of Periodicals revenue obtained from the pound rates has declined over time to about 40 percent. *Ibid.* He asserts 36 percent of this 40 percent is associated with transportation costs and that the remainder, to the extent rates are cost based, is accounted for by non-transportation costs that are pound-oriented. He says 1.3 percent of pound revenue is a contribution to institutional costs. *Id.* at 837 (n.36).

[98] Mitchell says that to build the non-transportation costs into the pound rates and to recover the revenue loss associated with the unzoned editorial pound rate, the usual procedure has been to develop first-cut pound rates based on transportation costs alone, and then to add an additional amount onto each zoned rate (23.8 cents per pound in PRC LR-7, R2001-1). *Ibid.* He says that doing this does not affect the zone differences of the first-cut rates. However, he says that in the proposed rates, some of the

non-transportation costs currently viewed as pound oriented are covered by per-bundle, per-sack and per-pallet charges, as the associated costs are affected in some degree by weight. To maintain an appropriate level for the pound rates, Mitchell adopts Stralberg's conclusion that about 30 percent of the costs are pound oriented. He says that this, in effect, assumes that 10 percentage points of the revenues formerly obtained from the per-pound rates should be obtained from the per-piece, per-bundle, per-sack and per-pallet rates, and he finds that this tie to the current rates seems reasonable. *Ibid.*

c. Impact on other mail in the Periodicals class

[99] Mitchell's design does not alter the treatment accorded Nonprofit and Classroom Periodicals and Science of Agriculture Periodicals pursuant to the Revenue Forgone Reform Act. *Id.* at 839. Also, for letter-size pieces, he states that the Complainants propose that letters continue to pay current rates. *Id.* at 837-38.

d. Witness Mitchell's Appendix A — a model of publishers' decisions

[100] Mitchell also addresses an argument that information might be made less accessible to residents of Washington State than to those of Washington, DC by presenting a mathematical model.¹⁴ The model considers the conditions that might lead to reduced accessibility.

[101] Mitchell believes that if reduced accessibility is to occur, one of two things would most likely have to happen. One is that a publication might zone its subscription rates; the other is that a publisher might decide to offer the publication only to the closer zones, where postage would be lower. *Id.* at 857 (footnote omitted.) He regards the first possibility as remote, given administrative difficulties, customer confusion and possible anger. Among other things, he notes that both gift subscriptions and subscriber relocations would be more difficult, and that a subscription price increase would harm the publisher's competitive position. *Ibid.*

¹⁴ This aspect of Mitchell's testimony challenges the Kielbowicz statement regarding the effect on a zoned editorial rate on more distant zones.

[102] However, Mitchell says the second possibility — that further-zone subscribers will effectively be disenfranchised — is at the heart of questions the Commission has raised about accessibility and the court's notice of an anti-Balkanization principle. He says that if a publisher would decide to cancel all subscriptions in the higher zones and to refuse to accept new subscriptions from the zones, then it might be the case that potential subscribers in those zones would be cut off from the information in the publication. However, he says this cutoff, which he characterizes as unlikely, would be total only if the publication were unavailable in libraries, newsstands or the Internet. *Id.* at 857-58.

[103] Mitchell develops a model that focuses on the determinants of profitability. He explains that the first two terms of his equation say that if a subscriber is added in zone 8, the revenue for the year will increase by the subscription price plus the advertising revenue; then, with negative signs, it says the cost will increase by the marginal cost of maintaining a new account, multiplied by the number of issues where needed. Mitchell points out that if the last three terms of the equation, which include postage to zone 8, are high, there is a possibility that the addition to profit will be negative. *Id.* at 860.

[104] Mitchell says that one of the factors contributing to this outcome is that transportation costs today are a much smaller portion of total costs than they were in 1917. In fact, he says due to piece rates, which are the source of about 60 percent of Periodicals revenue, pound rates play a much smaller role in determining postage charges than they did in 1917. Therefore, he asserts that the increase in postage, even for zone 8, that would be occasioned by zoning publications' full weight is much smaller than it would have been in 1917, and since differential rates are now financed by other rates within the same subclass, would be partially offset by lower pound charges in the lower zones. *Id.* at 866.

[105] Mitchell asserts that this result is directly responsive to Dr. Kielbowicz's concern that a publisher might opt to drop residents of Washington State as subscribers if editorial content were increased. He says the analysis shows that Kielbowicz's standard is met just as well with zoned editorial pound rates as with unzoned editorial

pound rates. He therefore concludes that no subscriber will be disenfranchised by zoning the full weight of publications. *Ibid.*

- e. Consistency with Postal Reorganization Act policies and criteria

[106] Mitchell prefaces his discussion of the consistency of the Complainants' proposal with several observations, including the following:

At any particular time, however, cost recognition is limited by the data that are available, the analysis that has been done, and our understanding of the mail and its markets. Especially with the improved flow models now being used, our perspective is much better than it was even a few years ago. Accordingly, this case can be viewed as a significant step in the appropriate recognition of costs and in bringing Periodicals into suitable alignment with the criteria in the Act.

Id. at 842.

[107] He then identifies the nine specific criteria of section 3622(b) and the criteria in section 3623(c). *Id.* at 842-44. He assesses the Complainants' proposal in terms of these criteria, and concludes that the proposed rates, if approved, will meet the statutory criteria, send effective pricing signals to mailers, help to align mail preparation with mail processing, and increase the efficiency with which mailer needs are met. *Id.* at 856.

[108] *Fairness and equity (sections 3622(b)(1) and 3623(c)(1))*. Mitchell observes that fairness and equity require that similarly situated mailers be treated similarly. He says he believes the proposed rates "move strongly" in the direction of meeting this requirement. *Id.* at 844. Specifically, he asserts that in accordance with widely accepted rate design principles, they recognize similarities and differences in entry patterns, entry points, and distance transported. In addition, they reduce the extent to which mailers will find their rates influenced in undesirable ways by the practices of dissimilarly situated mailers whose rates do not reflect cost incurrence. *Ibid.*

[109] Mitchell says another reflection of fairness and equity involves the extent to which the rates reflect costs. He contends that the proposed rates reflect costs fairly and

lead to implicit markups that are consistent with the notions of efficient component pricing and the appropriate recognition of worksharing activities. *Id.* at 844-45. In particular, he notes: “In all cases, the makeup of the containers is recognized, consistent with their entry point.” *Id.* at 845. He says the converse of developing implicit markups in this way is that it is fair for mailers to see in rates a reflection of the resources absorbed by their mail. *Ibid.*

[110] Mitchell also contends that three other aspects of fairness warrant note. One is that it is fair to give mailers tools for responding to the situations they face, and for influencing the market into which they are essentially locked. *Id.* at 845-46. He reiterates his contention that Periodicals mailers have faced substantial rate increases for nearly two decades, and claims they have sought options for cooperating with the Postal Service in mutually beneficial ways and have been willing to invest and make changes, if given the options to do so and appropriate signals. In essence, Mitchell says mailers have had the motivation, but not the tools. *Id.* at 846. He says: “The proposed rates provide mailers with a broader range of signals relating to costs and resource usage. The rates place a little more of the outcome in the hands of the mailer themselves, so they can do more than stand and watch.” *Ibid.* Mitchell says he believes this is an inherently fair thing to do. *Ibid.*

[111] Another consideration is that for mailers who dropship, Mitchell believes it is fair to provide a rate reduction equal to the Postal Service’s associated cost reduction. He says the existing rates are deficient in this regard, while the proposed rates are not. *Ibid.* He suggests: “Costs mailers incur preparing and submitting their mail may be irrelevant to determining economically efficient rate levels, but they are not irrelevant to fairness.” *Ibid.*

[112] Finally, Mitchell says it is “an axiom of regulatory theory” that the rates that would be generated by the forces of a competitive market, were such a market possible, are fair and equitable rates, and that regulation should tend to replicate such rates, where feasible. He says it seems clear that competitive rates would be based on the

costs to accomplish delivery from that point. He contends that Periodicals rates at present do not meet this test, while the proposed rates do. *Id.* at 847.

[113] *Value — sections 3622(b)(2) and 3623(c)(2)*. Mitchell notes that these sections refer in one way or another to the value of the mail matter and the mail service to the sender and recipient. *Ibid.* He says that the rates being proposed, along with the associated rate structure, are designed specifically to allow mailers to focus on the value they place on various kinds of service and, at the same time, on the costs to the Postal Service and to the nation of providing those services. *Ibid.* As an example, he says the cost of handling a sack is relatively independent of the amount of mail in the sack. Thus, this means that a sack could have one 5-pound bundle or several bundles totaling 30 pounds. He explains under the proposed rates, the mailer using sacks can focus on the value of using the sack, with various contents. He says:

If the sack is the preferred alternative and is worth the cost, the mailer will use it, and will pay for the resources required. Importantly, and fairly, no other mailer will be required to help finance that decision. On the other hand, if the mailer decides on a different alternative, he will be able to evaluate that alternative in view of its costs and the value placed on it.

Ibid.

[114] Mitchell asserts that considerations of value are unique to each mailer. He says that neither the Postal Service nor the Commission can presume the value that various mailers place on various alternatives. However, he says that when the cost of each service is reflected in the rates, each mailer can make his own assessment, given his own value determinations. In addition, he says there is nothing wrong with a mailer using a higher cost service, as long as he is charged for that service. *Id.* at 848.

[115] *Costs (section 3622(b)(3))*. Mitchell notes that this section traditionally has been interpreted as requiring *subclasses* to recover their costs, with appropriate cost coverages. *Ibid.* (emphasis in original). However, he cites a previous Commission comment on rate design as support for the proposition that interest in tracing costs goes

well below the subclass level, and expresses his agreement with this approach. *Ibid.* (citing PRC Op. R2000-1, para. 5533).

[116] He cites other instances of Commission interest in the cost coverages of particular groups of mail within subclasses, and says: “The rates being proposed are designed to track costs within the subclass, and to do so in a way that aligns with decisions mailers must make about their mail. They are in line with interests the Commission has expressed in cost-based rates and in implicit markups.” *Id.* at 849.

[117] *Effects of rate increases (section 3622(b)(4))*. Mitchell acknowledges that the proposed rates will have effects on mailers, and says some of them may be viewed as substantial, in the sense that “the mail involved has been the beneficiary for some time of rate preferences.” *Id.* at 851. However, he contends that the impact is limited. He bases this, in part, on the fact that the revenue to be obtained from the new bundle, sack and pallet charges is only about 21 percent of the total revenue requirement, and the fact that no markup is proposed on these charges. *Ibid.* He also says that some effects are due to improvements in the piece charges, with ADC preparation no longer averaged with mixed ADC preparation, and distinctions made between machinability and nonmachinability. *Ibid.*

[118] Moreover, Mitchell says some small mailers will benefit from the changes and cites the possibility that mailers of smaller quantities may attach importance to several new aspects of the proposal, such as the new DBMC dropship discount, the absence of a restriction of pallet discounts to dropshipped mailings, and improved dropship discounts for pieces in sacks.

[119] More importantly, however, Mitchell contends that the proposed rates focus on a range of cost driving factors over which mailers have control and to which mailers would be expected to respond. *Id.* at 852.

[120] *Preparation (section 3622(b)(6))*. Mitchell notes that this criterion requires that consideration be given to the “degree of preparation of [the] mail ... by the mailer and its effect upon reducing costs to the Postal Service.” *Ibid.* He says the importance of this criterion and the role it has played is great. *Ibid.* He notes that it has been the

basis and justification for a wide and still evolving range of worksharing discounts, which have set the United States apart from most countries of the world. Ibid. Moreover, he says that in addressing the general issue of “preparation,” its importance goes beyond issue of worksharing per se and to issues of the nature of the mail itself, for the preparation of mail involves decisions on bundles, containers, and entry points. These issues are addressed specifically by the rates being proposed. Ibid.

[121] Mitchell contends that one of “the great failures” of the current rates is the extent to which they do not allow mailers to see the cost effects or the efficiency implications of the decisions they make. On one hand, he says mailers cannot be expected to do what is best when they are given financial incentives to do something different; however, on the other hand, he says these same mailers are forced to live with the cost implications of their decisions because the rates they pay are ultimately based on costs. Id. at 852-53.

[122] Mitchell contends:

The proposed rates break through this blindness and allow them to consider the efficiency improvements that are possible by aligning preparation decisions with the value of the service and its associated costs. Mailers will be expected to do nothing more than watch out for their own best interests, and at the same time reap the efficiency benefits of being able to balance the benefits and the costs. The overall efficiency of the Periodicals subclass should increase.

Id. at 853.

[123] *Simplicity (section 3622(b)(7))*. Mitchell notes that this criterion is generally referred to in shorthand as focusing on simplicity and complexity, but observes that it also highlights the importance of “identifiable relationships between the rates ... charged.” Ibid. He asserts that as rates become simpler, fairness declines, the efficiency of the subclass declines, costs get ignored and become inflated, mailers are given poor signals concerning what is best to do, and rates increase. Ibid. He says: “To

their credit, Periodicals mailers have not generally argued for simplicity. They use computers to prepare their mail and are able to respond to the signals in rates.” Ibid.

[124] In addition, Mitchell says that while the proposed rates may appear complex, they are “orderly and identifiable.” Id. at 854. Moreover, he says they are “not adorned with special discounts, restrictions, or surcharges.” Ibid. He explains:

There are per-piece charges, per-bundle charges, per-sack charges, and per-pallet charges. The charges depend in clear ways on the makeup and entry point of the containers. The purpose of the charges is clear. The options of the mailers are also clear. And, the charges are for things that mailers know and understand: mailers understand presorting, barcoding, and machinability; mailers know how many bundles they have and their makeup; mailers understand their usage of sacks and pallets; and mailers are keenly aware of their entry points. Indeed, one of the great advances of recent years has been the development of dropship software and the integration of such programs into trucking operations.

Ibid.

[125] Mitchell further contends that part of the attractiveness of the proposed rates is their freedom from the complexities caused by “the split nature” of the existing pound rates. Ibid. He claims that under the unzoned editorial pound rate, the rates are “skewed away from costs” in a way that presents “an endless array of anomalies and administrative difficulties.” Ibid. He cites three examples. One is that printers see dropship discounts that depend on the proportion of editorial content. Accordingly, two publications, identical except that one has more editorial content than the other, might have to be scheduled and handled differently. This causes disparity in printing practices, for no apparent reason. Ibid.

[126] Another example relates to the complexities of the current pallet discount. In addition to observing that the costs are pound oriented, but the discount is given on a piece basis, he notes that the discount is the same for (a) heavyweight and lightweight

pieces, and (b) pieces transported a short distance and those carried long distances, even though the cost savings vary with both weight and distance. Mitchell contends that there is no way that mailers can rationalize discounts of this kind, and asserts that the proposed rates turn these anomalies into understandable relationships. *Id.* at 855.

[127] *ECSI value (section 3622(b)(8))*. Mitchell observes that ECSI content of the materials in the Periodicals subclass is recognized in two ways: the overall subclass is given a low cost coverage of 101.3 percent, and the implicit coverage on editorial matter is 84.7 percent and 129.5 percent on advertising matter. He asserts that these are values that characterize current rates, resulting from the Commission's Docket No. R2001-1 recommendation, and says the Complainants are not proposing that they be changed. *Id.* at 856.

C. Witness Gordon (TW et al.-T-3)

[128] Witness Gordon addresses the “Nation binding” role of Periodicals through a brief review of the state of communications in 18th, 19th and 20th century America. He identifies several significant technological developments, both in printing and non-printing areas, that have affected the preparation, distribution, reach, cost and impact of printed media. Of these developments, Gordon believes the Internet, an outgrowth of computers, has had the most significant impact. This conclusion is based, in part, on his contention that, for the first time since the 1830s, “it has become cheap to enter the news business. All one needs is a personal computer, an Internet Service Provider, and a webpage design.” *Id.* at 626. Moreover, Gordon contends that the Internet is the reason the communications industry “is in a state of flux it has not seen since the dawn of the industrial age made modern newspapers and magazines possible, perhaps since Gutenberg invented moveable type more than five hundred years ago.” *Ibid.*

[129] In terms of public policy considerations, Gordon’s overall assessment is that the United States is one of the most socially and culturally cohesive countries in the world, and therefore “efforts by the Post Office to foster such cohesiveness are, at this point in our history, largely superfluous and economically unjustifiable.” *Id.* at 688.

[130] *Basis for conclusions.* Gordon states that in 1800, most communities were isolated from each other, and “even the most electrifying news traveled very slowly.” *Id.* at 613. He notes, for example, that news of the Battles of Lexington and Concord, which took place on April 19, 1775, reached New York on April 23, Williamsburg on April 28, and London on May 28. *Ibid.* However, he says two 19th century technological developments — the invention of steam-powered rotary presses in the 1820s and the telegraph in 1844 — profoundly changed matters. *Ibid.* The former allowed many more newspapers and magazines to be quickly printed at much lower cost, thereby making them “a daily habit of millions.” *Ibid.* The latter, by 1872, allowed a message to be sent from San Francisco to India in a few hours, instead of the six months it would have required a few decades earlier. *Id.* at 613-15. Gordon notes these developments were

followed by the invention of the telephone in 1876, with telephone use spreading quickly through the business districts of major cities. He says that by 1915, calls could be made across the continent. *Id.* at 615.

[131] However, Gordon states that the telephone and telegraph were very expensive, so that by the early years of the 20th century, the situation had not changed much since 1866; instead: “[i]t was still newspapers (none of which circulated nationally) and, especially, magazines that bound the nation together by providing a common culture and a common source of information.” *Ibid.* Moreover, he says available printing technology (the linotype) required that publications be produced in one place. *Ibid.* He asserts:

Thus it made sense for the Congress, in formulating the Post Office’s mandate to hold this vast, sprawling country together by facilitating the distribution of printed matter, to set uniform postal rates for magazines, regardless of where they were printed or where they were sent, in 1876 and to maintain uniform rates for editorial matter when it zoned the rates for advertising matter in 1917.

Id. at 615-17.

[132] However, Gordon contends that in the 87 years since that decision, the technology of communications has not only changed more than it had in the previous 87 years, but in the whole history of communications by means other than the human voice. *Id.* at 617. In particular, he claims: “Coupled with a computer, the cathode ray tube allowed unprecedented ease in such matters as font selection, justification, and hyphenation — a great savings in labor.” *Ibid.* Moreover, he contends that non-printing forms of communications technology — radio, television and computers — advanced even more radically, “introducing new means that were undreamed of in 1917.” *Ibid.* He says they transformed both the entertainment industry and the conduct of the nation’s politics, leading in turn to “profound effects on the printed forms.” *Id.* at 617-18.

[133] Gordon observes that the first radio networks began to evolve in 1926, and that they quickly developed national programming, which was heard simultaneously across the country. *Id.* at 618. He asserts that these new networks allowed the government to communicate directly and immediately with the citizenry when necessary. In particular, he notes that President Franklin Roosevelt began his “Fireside Chats” on March 13, 1933, a week after his inauguration, and contends that the first one — urging the public to deposit money in banks — was “a key moment in the nation’s recovery from the Great Depression.” *Id.* at 618-19.

[134] Gordon notes that television emerged toward the end of the 1930s, and says it quickly took off following the removal of World War II-era manufacturing restrictions. *Id.* at 619. He says that by 1948, when both major political parties held their conventions in Philadelphia, there were still fewer than a million sets in the country. However, Gordon claims the medium was already affecting American politics, and would, within a few years, become the dominant medium in politics, “which it has remained ever since.” *Ibid.*

[135] Gordon also says that television, like radio, “proved a powerful medium for binding the nation together.” *Ibid.* He notes, among other things, that nearly the entire nation watched the televised funeral of President Kennedy in 1964, and that space technology has made ever larger audiences possible. *Ibid.* He asserts:

With the spread of cable television, and, later, such satellite TV distributors as Direct-TV, the number of channels available has mushroomed. In the 1960’s, most Americans had a choice of no more than three channels. Today, most markets are served by well over a hundred channels. This makes it possible for small groups interested in a particular subject, such as cooking, travel, sports, pets, nature, politics, history, and technology to find that subject treated on television on a dedicated channel. This is strikingly similar to the function that in 1917 was performed only by specialty magazines.

Id. at 620.

[136] In addition, Gordon states that “a wholly new technology” — computers — began to develop after World War II, and says this has proven to be the most powerful invention to date. Among other things, he says the computer has greatly lowered the cost of communications technologies, like the telephone, by taking over functions such as the operation of a switchboard. He says this has lowered costs and created a dramatic increase in telephone calls, both domestic and international. *Id.* at 621. For example, he says:

Almost anyone can call whomever they please wherever they please whenever they please and not worry about the cost. And these calls can even be placed not just from home but from nearly anywhere. Half the people walking down the urban streets of America, it seems, are now on their cell phones. This is a situation almost unimaginable in the world of 1917, when fewer than thirty percent of American households had any phone service at all.

Id. at 621-22.

[137] Gordon concludes that the revolution in non-print communications media, coupled with the revolution in printing technology, has had large effects on how printed material is created and distributed. He notes that in 1917, newspapers and magazines had to be printed where the type was set, but that the teletypewriter made it possible to set type and print simultaneously in more than one place. *Id.* at 622. He also says that in 1917, there were no national newspapers, while delivery of the *New York Times* or the *Wall Street Journal* delivered to doorsteps in all of the country’s major cities and suburbs is not only possible, but commonplace, today. *Ibid.*

[138] Gordon asserts that composition by computer and distribution of digital images by electronic means also allows magazines to be printed simultaneously in different cities and distributed from them. He maintains that this has caused a major reduction in the transportation component of distributing Periodicals class mail, from over 44 percent to less than 15 percent. *Ibid.* However, he believes the Internet is the most important communications medium associated with the computer. He says: “Almost

forty million Americans now have high-speed access. This makes it possible to download complex material, such as photographs and even movies, in very little time. Thus magazines that could once only be delivered by mail, can now be delivered electronically at very little cost.” *Id.* at 624. Moreover, Gordon finds that in the last 10 years, the Internet has not only emerged as a rapidly growing avenue of commerce, but a communications medium of unprecedented power, with variations such as e-mail, newsgroups, and weblogs. *Id.* at 624-26.

[139] Gordon notes that the United States, geographically, is far larger and more far-flung today than in 1917, given the addition of Hawaii and Alaska, but is “far, far smaller” in a different sense. He notes reduced travel time, at lower cost, between New York and Los Angeles, “essentially free” telephone calls, live broadcasts on dozens of TV channels, and Internet newsgroups for arcane and obscure topics. *Id.* at 626-27. He contends:

Today the United States is tightly bound together by many forms of communications, many of them undreamed of in 1917. The United States, the third largest nation in the world in terms of geography, has become one vast neighborhood, where everyone can be ‘talked’ to across the back fence. There is no longer the slightest chance that setting postal rates for editorial content in Periodicals class mail by zones to reflect actual costs would cause the country to be divided by these zones. That is a concern that belongs to an age long past.

Id. at 627.

D. Witness Schick (TW et al.-T-4)

[140] Witness Schick addresses the relationship of the Mitchell-Stralberg theories to practical printing and distribution issues. His position is that the proposed rate structure will move mailers and the Postal Service closer to a business and process model based on the concept of lowest combined cost. He considers this approach desirable because it allows each member of the process value chain to do the work they find most efficient and economical, thereby creating the lowest combined costs from design to delivery, rather than “just shifting the cost (and possibly increasing the combined costs) from one part of the process to another.” Tr. 2/338.

[141] In support of his position, Schick reviews the current printing and mailing industry environment based on his more than 20 years in the industry and from his perspective as Director of Postal Affairs for Quad/Graphics, Inc., the largest privately held printing and distribution company in North America. He describes Quad/Graphics’ efforts to maximize worksharing, including co-mailing and co-palletization; discusses changes that might result from the proposed rate structure, and identifies potential problems associated with inaction. He concludes that substantial changes are needed. In fact, he contends that “[t]he days of trying to incent behavior by adding pennies to a disjointed discount structure, when dollars are needed for capital investments to realize the benefits, are gone.” Id. at 350.

[142] Schick claims that the mailing industry needs a clear signal from the Postal Service, via a rate structure that is more aligned with real world pricing, “where you pay for what you use.” Ibid. He maintains that the Complainants’ filing reflects this type of structure, and makes three related assertions: that the industry is willing to invest in the technology and software needed to produce more cost-efficient mail; that co-mailing technology and routing and sorting software is already available from several suppliers; and that use of the mail.dat file format has been commonplace for years. Id. at 351. He therefore asserts: “... the reality of the situation is that we are in a plug-and-play environment, and all that is needed to move the industry forward are the proper rate incentives.” Ibid.

[143] *Current environment.* Schick observes that when mail is the product involved in a transaction, “the Postal Service obviously has a distinct impact on some of the business decisions that are made.” *Id.* at 339. He points out, for example, that postage rates dictate the way mail is presorted and packaged, and that speed of delivery dictates how mail is containerized, transported and distributed. *Ibid.* He asserts that while logical decisions about these matters are made in many cases, this does not happen often enough, given the current rate structure. He maintains that this results in “win/lose/lose” situations for customers, the Postal Service and the mail service provider because “[w]e are forced to make decisions that we know are not in the best interest of the ‘lowest combined costs’ model.” *Ibid.*

[144] Schick provides several examples of the type of decisions that arise under the current structure, ranging from those he considers easy (where the customer’s interest is only in the lowest possible postage), to the more difficult (where the customer has a time-sensitive product, and is willing to pay more for transportation and distribution), to the very difficult (lowest postage and quickest, most efficient delivery). *Id.* at 339-40. In some of these situations, such as when the mailer of a time-sensitive publication is willing to pay more for quicker delivery, he says Quad/Graphics might create 50 to 75 individual 5-digit sacks instead of building one ADC pallet with 100 packages, under the assumption that the sacks will travel directly to the destination delivery unit before being opened. He notes that while postage might be the same under either preparation scenario, the overall costs to everyone involved would be much higher if sacks are used. *Id.* at 340.

[145] However, Schick indicates that cost and service tradeoffs are not always required, and cites a decision made by *IN STYLE* magazine as an example of an instance where mail preparation changes have had a positive impact on the Postal Service, without a corresponding negative impact on the publisher. He explains:

IN STYLE reduced the number of sacks per issue from 4,059 (October 2003) to 1,418 (April 2004), a reduction of 65%, merely by altering the presort parameters. There was no added expense to Time Inc. to make this change, but the elimination of 2,641 sacks significantly reduced USPS costs. Those sacks would have been entered at origin at a cost of \$3/sack, while the cost of mail on pallets entered at either the DSCF or DADC would be \$13/pallet according to the data in witness Stralberg's testimony. The change from sacks to pallets also created less cost and more efficient production for Quad.

Id. at 340-41.

[146] Schick says the situations he faces every day are generally those in the "very difficult" category, and that the depth of worksharing discounts limits opportunities in these situations. He attributes this to the fact that the costs of increased investment in existing technologies (such as co-mailing and co-palletizing) and additional investment in new technologies and processes outweigh the return that could be obtained from a reduction in postage. Id. at 341. He therefore contends that if the world of "hard-copy, ink-on-paper distribution" is going to continue to be a viable medium, the paradigm for the way postage rates are structured and the way that worksharing is developed must change. Ibid. He further claims that the Complainants' proposed rate structure "would be the first step in creating the incentives needed to effect changes that would help to lead to the viability of our industry now and in the future." Ibid.

[147] *Worksharing in the current environment.* Schick notes that the three main elements in today's worksharing are presort, automation and dropshipping, and says that to maximize each of these elements, Quad/Graphics can look at mailings individually or as groups of mailings being combined into one. In either case, however, he says that volume generally dictates how much can be done and to what extent. Id. at 342.

[148] Schick briefly reviews the introduction and development of co-mailing at Quad/Graphics, noting that the company realized very early on that “pooling” product was the only way it could compete with much larger competitors.¹⁵ Ibid. The first effort involved the creation of a newsstand pool in the early 1970s, and mail followed in the early 1990s, when dropship discounts were introduced. Ibid.

[149] The pooling concept was applied to Quad/Graphics’ development of co-mailing in the mid-1980s. Schick says this allowed a number of different periodicals to be combined into one presorted mailing, resulting in improved presort for each title and more palletized mail. In fact, he says that this process has proven to be one of the most important in the growth of Quad/Graphics’ business, helping to differentiate it from the competition and attracting publications with both large and small circulations. Ibid.

[150] Schick further observes that “[a] strange thing happens when developing technology and new processes. In almost every case, the value is never really fully known until after implementation.” Ibid. He points out that Quad/Graphics’ “number one goal” in developing its co-mailing capability was to improve presort for customers and to reduce their postage, or “making smaller circulation periodicals look and feel the same as larger circulation periodicals.” Ibid. However, he says the company soon realized that there were many more benefits, such as a reduction in sacked mail, which equated to savings associated with labor, material handling, and warehousing; increased efficiencies on binding lines, achieved by moving the addressing operation to an offline co-mail process; maintenance of product quality through postal processing because of fewer handlings; and maintenance of package integrity through reduced package handlings. Id. at 342-43.

[151] Schick contends that the Postal Service also has benefited from Quad/Graphics’ move to co-mailing, noting that the company presents one mailing for verification and acceptance, instead of multiple separate mailings, and that the associated documentation is used to support the postage paid and discounts claimed by

¹⁵ Schick says “pooling” simply means combining multiple print jobs into one larger grouping, and says this can be done within a package, on a pallet, or in a truck. Ibid.

each individual publication within the co-mailing. *Id.* at 343. He asserts that this benefit carries over to every step in postal processing, with reductions along the way in terms of handlings associated with pallets, packages and pieces. He also believes there are some benefits in terms of staging pallets and the handling, transportation and inventory of mail transport equipment, sacks and pallets. *Ibid.*

[152] Schick says that “[t]he key to success has and will continue to be volume[,]” and says his company realized that it had to make entry into its co-mailing program as easy as possible for its customers to ensure that they would stay in it.¹⁶ *Ibid.* He says that Quad/Graphics’ current co-mailing program includes 120 different publications, with list sizes varying from a main run of 500,000 copies to supplemental mailings or back issues of 1,500, and allows a publication to co-mail just a version of the publication.¹⁷ He explains:

We are comailing on a weekly basis across five comailing lines in our Sussex, WI printing plant. In addition, we have instituted what we are calling a co-wrap process in our Sussex plant for polywrapped publications. It is designed in the same manner as our comail/multimail program. In a short period of time, that program has attracted a number of publications and has resulted in our need to purchase new wrapping equipment that can accommodate more publications (more feed stations).

Id. at 344.

[153] Schick says that on average, Quad/Graphics is co-mailing about 3 to 6 million pieces each week, and that the result speaks for itself: the average percentage of carrier route presort for each publication is about 12 to 14% before co-mailing, but increases to

¹⁶ Some of the improvements he cites include adding leveling tables to allow for variances in thickness; providing multiple addressing choices; using inkjet and/or paper labels with a choice of glue type (permanent or releasable); providing feeder pockets designed for perfect bound and saddle-stitched publications; and using video technology that allows matching each address to the appropriate magazine to ensure that no subscriber receives the wrong publication. *Ibid.*

¹⁷ Corporate-wide, Quad/Graphics is averaging 10 co-mails per month. *Id.* at 390.

about 75 to 85%, depending on the total number of copies, after combining all lists and presorting into one co-mailing. Ibid. In addition, Schick finds that co-mailing also yields mailings with 99%+ palletization. He says the only reason palletization is not at 100% is because of Quad/Graphics' segmenting process, which allows customers to use a number of versions within the co-mail and ensures maximum efficiency in the production process. Ibid. Schick says Quad/Graphics will be upgrading its software in the near future to create 100% palletized co-mailings. In addition, he says the company is able to dropship almost 90% of the total copies in the co-mailing, despite the variance in advertising percentages of the different publications. He says that of the total dropshipped volume, about 80% is at the destination SCF level, with the balance going to the destination ADC. Ibid.

[154] Schick presents an eight-page exhibit (Exhibit A) showing actual results from a co-mail pool of 2.7 million copies. He says the exhibit illustrates the positive movement of mail to finer levels of presort, the reduction in the overall number of packages, the shift from sacks to pallets, and the opportunities for increased dropshipping that result from this process. Id. at 344-45. The first table in Exhibit A is reproduced below:

**Summary of Containers with Singular
and Combined Sorts**

		Singular Sorts		Combined Sorts	
		Containers Created	Pieces on Containers	Containers Created	Pieces on Containers
Pallet Types	5DG CRRTS	13	6,562	167	154,287
	5DG	35	37,526	233	242,528
	SCF	1,036	1,461,575	978	2,194,411
	ADC	689	834,112	157	185,481
	Total Pallets	1,773	2,339,775	1,535	2,776,707
	Total Sacks	10,282	449,775	283	12,843

Source: Tr. 2/353.

[155] Schick states that his company is now co-mailing Periodicals to varying degrees in some of its printing plants outside of Wisconsin, but says these programs are in the early stages of development and lack the volumes to achieve “the remarkable results” illustrated in his exhibit.¹⁸ However, he claims: “we know that any improvement is better than none, and that you have to start somewhere. So if we’re not able to achieve high levels of carrier route, we at least are able to move basic rate mail to 3 digit, and 3 digit mail to the 5 digit level.” *Id.* at 345. He further asserts:

Harry Quadracci founded and built our company on the ‘Ready, Fire, Aim’ theory. That is why we started comailing in Sussex, and why we continue to expand that process to other production plants. If you build it, they will come. A rate structure with the proper incentives, such as what is proposed in the Complaint filing, would facilitate each and every one of our print facilities to look for new and/or additional opportunities in comailing, copalletization, and dropshipping, and then make the necessary capital investments to initiate and develop the processes.

Ibid.

[156] *Perspective on dropshipping.* Schick reiterates that co-mailing creates opportunities for dropshipping, and says that on average, his company anticipates that it will dropship 95 to 98% of Standard Mail and Bound Printed Matter, and that its Parcel Select subsidiary will dropship 100%. He distinguishes these high percentages from the result for Periodicals, explaining:

However, when planning distribution around Periodicals there is always a mystery about what percentage of the mail will be cost-effective to dropship. The average percent of Periodicals that we produce that will dropship is 80-85%. Why? The reason is simply because of the variability of

¹⁸ Schick notes that co-mailing is not limited to Periodicals. He addresses Standard Mail production at Tr. 2/345, and direct mail operations at Tr. 2/346. In general, he finds that the concept and results are the same, although the production process differs.

weight, distance, and the advertising percentage. Weight and distance are both variables in determining what will dropship in Standard and Bound Printed Matter, but the advertising percentage is not a factor. In general, heavier weight publications with low advertising will not be able to dropship based purely on the postage savings versus cost of transportation. The unzoned editorial rate is a major impediment to dropshipping, and it needs to be changed to reflect the realities of logistics in today's world.

Id. at 346.

[157] Schick says he realizes that consideration must still be maintained for the ECSI value of periodicals, but firmly believes that the Complainants' proposed rate structure reflects that balance. Ibid.

[158] *Impact of the proposed rate structure.* Schick identifies several previous changes to the Periodicals rate structure, such as dropshipping and automation, and increased presort differentials, and notes that mailers have responded to each of them. Thus, he says that in general, when provided with proper incentives, the mailing industry will react by changing mail preparation to capture the discounts offered. Id. at 347-48. He says he firmly believes that in a cost-based structure where there are natural incentives to create finer sorts, fewer packages and containers (with greater incentives placed on the use of pallets), and more dropshipments, more printers and other mailers will make investments in technology, software and processes designed to create the lowest cost mail, while creating the most efficient production process. He asserts that the net result will be the lowest combined costs for the preparer of the mail and the Postal Service. Id. at 348.

[159] Schick acknowledges a concern that small or mid-size printers and publishers will be hurt by a cost-based approach to rates, and concedes that this might be true for some "who are in unique situations and are unable to change anything in their mail preparation or mailpiece design without negatively impacting their business model." Ibid. However, he contends that in most cases, such expectations sell the industry short. He believes that printers and publishers, provided with the necessary incentives, will utilize

equipment already available to them and be creative enough to build processes that will allow them to take advantage of a new rate structure while enhancing their business model. He asserts they will also develop co-mailing to fit their needs, and may redefine co-mailing in the process. Ibid.

[160] *Zoned editorial pound charge*. Schick notes that the proposed rate structure includes a change to zone the full weight of the publication. He believes this will provide the extra incentive for a number of publications with low advertising content to be able to dropship (or zone skip). He says that the advertising percentage of a publication usually dictates today whether or not dropshipping makes economic sense, in terms of whether the savings offset the cost of transportation that must now be provided by the mailer instead of the Postal Service. In most cases today, he says publications with low advertising will not see enough savings to justify the cost. Ibid. He claims that “[t]he math is very simple[,]” and explains:

Today the discount only applies to the advertising pounds of the publication. However, freight is being paid on the full weight of the publication. That would be like shipping oranges and paying freight on the entire weight, but only being able to discount the weight of the juice. From a pure transportation standpoint, it doesn't make sense. The discounts, like the freight rate, should apply to the entire product (in this case publication) that is on the truck.

Id. at 349.

[161] Thus, Schick says zoning the full weight of the publication is the correct approach if the goal is to incent more dropshipping, because it will help move more Periodicals from postal-supplied transportation to private transportation. If this does not happen, he believes Periodicals costs will continue to rise. His reasoning is that the majority of Standard Mail, Bound Printed Matter, and Parcel Post (Parcel Select being 100% dropship) are already utilizing dropshipment, while Periodicals are lagging far behind. Id. at 350. He cautions: “At some point, if that doesn't change, Periodicals will find themselves sharing postal transportation with no one else and having almost all of

the cost of that transportation attributed to them.” Ibid. He states that the result will be higher rates. Ibid.

II. RESPONSIVE PRESENTATIONS

A. American Business Media

1. Witness Cavnar (ABM-T-1)

[162] Witness Cavnar¹⁹ addresses ABM's position on the Complainants' proposal; discusses co-palletizing; and responds to four points in the Complainants' testimony. The latter includes an assumption about advertising revenue in witness Mitchell's Appendix A and related subscriber issues; recognition of ECSI value; the nation-binding role of publications, especially relative to the emergence of the Internet; and worksharing's link to driving costs out of the system.²⁰

[163] *ABM's position.* Cavnar states that ABM had not developed a final position as of the filing of his testimony, but had reached several conclusions. One is that print publications are not anachronisms, and that television and the Internet are not now, and in the foreseeable future will not be, viable substitutes for print publications. *Id.* at 1745. Another is that the nation will be worse off if postage rates result in fewer Periodicals, or if rate design causes some Periodicals to reduce circulation in distant or rural areas. *Ibid.* A third conclusion is that changes in the way publications present their mail to the Postal Service to make it less costly to handle are already taking place and are increasing, without the need for new price signals. *Ibid.* A final point is that the Complainants do not deny that some publications will be unable to avoid "punishing" rate increases if the rate structure and level proposed are implemented, given valid service issues, weekly publication schedules, small circulation, or use of small printers in out-of-the-way locations. *Ibid.*

¹⁹ Cavnar is Vice President of Circulation for Hanley Wood LLC, of Washington, DC. Hanley Wood is a business-to-business publisher specializing in the construction industry. Tr. 6/1722.

²⁰ Witness Cavnar also presents two exhibits. Exhibit NC-1 is a press release about the 50th anniversary of American Business Media's Jesse H. Neal National Business Journalism Awards. Exhibit NC-2 contains synopses of recent award winners. *Id.* at 1742.

[164] Cavnar therefore states that ABM opposes “significant structural changes likely to increase rates for many Periodicals” in the absence of:

- an alternative to sacks for those that cannot palletize;
- protection for mailers that cannot change their current practices;
- better information on the effect of anticipated operational changes, such as delivery point sequencing and automated package processing;
- a convincing case that the Postal Service can capture theoretical savings; and
- reasonable notice of, and phasing in, of major changes.

Id. at 1745-46.

[165] *Co-palletizing*. Cavnar reviews Hanley Wood’s recent co-palletizing experience, noting that the company was the first publisher to participate in a co-palletization program introduced at RR Donnelley’s Bolingbrook, Illinois facility. He says that Hanley Wood mails 12 magazines at Periodicals rates, and that all are co-palletized by Donnelley at Bolingbrook and shipped for direct entry at points around the country. This program includes Hanley Wood’s smallest publication, which has a circulation of 17,000. Id. at 1723.

[166] Cavnar estimates Hanley Wood’s direct postage savings at about 15 percent for magazines that otherwise would be mailed almost completely in sacks from a single entry point, but says net savings are substantially less (one percent), given the costs of co-palletization and shipping. However, he expects that as more publications enter the pool and as more co-pallet programs are introduced, competition and declining administrative costs will increase net savings. Ibid.

[167] Cavnar maintains that Hanley Wood’s commitment to co-palletization goes beyond immediate postage savings, based on the recognition that making Periodicals mail more efficient for the Postal Service can help contain rates on a long-term basis by driving cost out of the system. He acknowledges that sacks are a cost issue, but claims that a dramatic reduction in the use of sacks already has been achieved. As examples, he points to *The Concrete Producer*, which previously mailed 20,000 copies in 445

sacks, but used only 8 sacks in its most recent mailing, and to a recent Donnelley co-palletization pool, which reduced sack usage from 2,806 to 79. Ibid.

[168] At the same time, Cavnar says discussions with other publishers led him to conclude that not all periodicals can be palletized, at least today. He notes that other ABM witnesses, as well as Time Warner et al. witness Schick, have acknowledged that factors such as publication frequency, trim size, inserts and circulation size, either alone or in combination, can preclude certain publications from participation in co-mailing or co-palletization. Id. at 1724. He further states that although service delays have not been an issue for Hanley Wood (which has monthly and bimonthly publication schedules), some publishers experience substantial delays with co-palletization and dropshipping, relative to mailing in sacks. Ibid. Moreover, based on experience working with time-sensitive magazines at other companies, Cavnar asserts that a single day's difference in delivery time can be critical in retaining subscribers and advertisers. Ibid.

[169] Cavnar also asserts that even if an individual magazine may be well suited for co-palletization, not all magazine printers can offer their clients this service, given the volume of periodicals they print, equipment or floor space. Id. at 1724-25. Thus, he contends that for the foreseeable future, especially if the Postal Service does not develop a container that can replace sacks, there will be publications that have no choice but to continue using sacks, either because alternatives are precluded by their mailing characteristics and delivery requirements, or because the service is not available to them. Id. at 1725. In fact, he claims that these publications will be heavily penalized if Periodicals rates are restructured as proposed by the Complainants. Ibid. He asserts that this will ultimately affect not only the publishers, but their subscribers, especially those who become most costly to serve. Ibid.

[170] *Advertising revenues.* Cavnar takes issue with a formula in witness Mitchell's Appendix A, claiming it reflects a lack of understanding about how publishers of business-to-business and other special interest periodicals set advertising rates and collect advertising revenues. In support of this criticism, he claims that Mitchell's "guaranteed rate base" hypothesis is untrue and that even when there is a guarantee,

there is no reason to believe that the loss of a minimal number of subscribers will have any effect on advertising revenues. *Id.* at 1726. He distinguishes among several approaches to advertising rates, explaining:

In my experience, the notion of a guaranteed rate base is associated primarily with general interest publications, such as *Time*, and not special interest publications, such as *Motocross* and, especially, business-to-business publications. The former are selling access to ‘eyes.’ That is, advertisers, while interested in the demographics of the readers, are primarily buying a certain number of readers.

For special interest and business-to-business publications, advertisers care far more about the quality of the readership. They want to reach only people who are truly involved in a particular field, and therefore likely to buy their products. That is why the detailed demographic information in our audited circulation statements is so important. Most business-to-business publishers could, and do at times, trim the total number of subscribers without affecting the quality of the readership in the eyes of the advertiser or the page rate paid by advertisers. More importantly for purposes of refuting witness Mitchell’s formula, we can reduce our readership marginally—or even more than marginally — without affecting either our promise to advertisers (because there is none) or our page rates.

Id. at 1728.

[171] Cavnar further criticizes Mitchell’s use of *Pit & Quarry* as an example of the formula’s application and the related conclusion that the “implied profit” from a zone 8 subscriber is \$100.37.²¹ *Id.* at 1730. Instead, he claims that a review of *Pit & Quarry*’s rate card and circulation history shows that revenues do not vary with modest changes in circulation, but with the market, the economy and other factors. *Ibid.* More generally, Cavnar points out that even if a publisher were to consider each subscriber responsible

²¹ This amount is based on the assumption that the magazine would lose 1/24,000 of its advertising revenue if it ceased delivery to that subscriber. *Ibid.*

for a pro rata share of advertising revenue, a publisher constantly evaluates subscribers by their cost to acquire and serve, explaining:

We compare the cost of acquiring and renewing subscribers by direct mail to the cost of telemarketing or broadcast email, and shift our sources accordingly. We also look at any factors that would increase the cost to serve a particular subscriber, including and especially the cost of postage.

Id. at 1731.

[172] Finally, Cavnar maintains that under the Complainants' proposed rates and schedule, zoning editorial content would not only cause certain copies of a publication to experience larger rate increases than other subscribers, but other features of the proposal, such as "the very large" sack charge, would cause an enormous increase in rates for many copies that, for one reason or another, must be mailed in small sacks. Ibid. Thus, he says that the temptation to reduce circulation to save a disproportionate amount of postage, or to market in particular areas, could affect not only subscribers far from the entry point, but also subscribers in less densely populated areas of the country, where large sacks may be impossible. Id. at 1731-32. He further asserts that if costs for serving different subscribers within the United States varied as much as or more than the current cost for mailing into Canada or Mexico, publishers would find ways to identify and restrict the most expensive subscriptions. Id. at 1732.

[173] *ECSI value and Periodicals rates.* Cavnar states that the Complainants, through witness Gordon's testimony, claim to address the limited question of whether a flat editorial rate is still necessary to assure that the nation is bound together by the wide distribution of periodicals. Ibid. However, he contends that witness Gordon's testimony goes well beyond this issue and that the Complainants' presentation fails to address the proper role of ECSI value in setting Periodicals rates. Ibid.

[174] In particular, Cavnar characterizes witness Gordon's cross-examination responses on rate preferences as confused, and asserts that this demonstrates that he lacks the perspective and experience to offer views on postal rates. Id. at 1733-34. He

maintains that he and ABM disagree with witness Gordon's view that the role of preferential rates in binding the nation together is "marginal at best[.]" Instead, he says they believe (as does witness Schick) that reflection of ECSI value in rates continues to be important to maintenance of a "healthy, vibrant and diverse" Periodicals class. Id. at 1734.

[175] Cavnar also claims that witness Gordon's "basic thesis" is that television and the Internet have rendered Periodicals redundant, and again asserts that witness Gordon does not appear to have the background and experience to draw this conclusion. Id. at 1735. In addition, he states that most ABM member publications operate related websites, and that some duplicate and update the content of the publication, while others do not, and some have associated charges, while others do not. Id. at 1736. He says Hanley Wood has a very successful eMedia division that provides websites and e-mail newsletters, which incorporate content from the magazines along with unique online content. However, he says the company maintains websites for less than half of its 20 magazines, and asserts that even the most robust sites do not attempt to carry all of the editorial and advertising information in the related magazine. Ibid. He adds:

... the great majority of business-to-business media companies, like Hanley Wood, do see the Internet as crucial to their financial futures. We recognize that our readers now look to the Internet—as well as the hard copy publication—for information. The ability to offer both readers and advertisers multi-media exposure is moving from a nice fringe benefit to essential. But with very few exceptions, and those tend to be in the high-tech industries, publishers are not even considering the abandonment of hard-copy publications. The Internet provides value added but well less than full value. ...

Ibid.

[176] Cavnar asserts that it should be clear that if a publication folds due to high costs, such as high postage costs, its websites are highly likely to disappear along with it. He says that websites can and do provide incremental advertising revenue, but not

enough to replace the print advertising that supports a publication's editorial content and its distribution. *Id.* at 1737. Thus, he contends there should be no serious debate about the fact that, "if a publication carrying important information ceases publication, the broad dissemination of information will be adversely affected." *Ibid.*

[177] On the question of substitutability, Cavnar's position is the number of people who are willing and able to access information electronically, which would often require hours of reading off a computer screen, are limited. In fact, he says virtually all publishers recognize that many of their readers "simply will not accept the same information on a computer." *Id.* at 1738. He maintains that different industries and population segments require different mixes of media. Moreover, he says that many rural and remote areas of the country still do not enjoy the same quality of Internet and telephone service as urban areas, and asserts that these are the same subscribers who could become most costly to serve under the proposed rate structure. *Ibid.* Thus, he says that the individuals most susceptible to losing their printed magazine subscription due to high postal costs might also have greater difficulty accessing an electronic replacement. *Ibid.*

[178] Cavnar contends that it is fair to conclude that the Complainants view ECSI value and its role in setting rates more narrowly than he and ABM do, explaining:

We think that when Congress insisted that ECSI value be considered, it sought to ensure that the Commission recognized, in the famous words of Congressman Ford, that 'a book, a magazine or a newspaper has more intrinsic value to the public than a brick' and that periodicals are granted a rate preference in order to bind the nation together through the broad dissemination of information. We believe that the Commission may and in some circumstances must assess the overall impact of a rate proposal and its potential effect on segments of the periodicals industry with ECSI value in mind, and it is not enough simply to say that every pound of

editorial matter gets the same discount, so no more is needed.

Id. at 1739-40.

[179] Cavnar then quotes several excerpts from past Commission decisions addressing ECSI value; asserts that in this case the Commission should also consider the needs of “all types of publications,” of “both large and small circulation publications”; and claims that if it does so, it will not endorse the Complainants’ recommendations. Id. at 1740.

[180] Cavnar makes two additional points. One is that the Commission need not adopt the Complainants’ recommendations to assure that they receive credit for their publications’ ECSI value, given his contention that they already enjoy substantial savings. In this regard, Cavnar notes that witness Stralberg has provided a comparison of Standard and Periodicals rates for several of the Complainants’ publications showing that the differential is very large. Id. at 1741. By contrast, he believes that at the proposed rates, many Periodicals mailers would see their rates increase above Standard rates, thereby creating “an ECSI penalty.” Ibid. Cavnar’s other point relates to allegations that under the present rate schedule, large publications subsidize smaller ones. He rejects the contention that publications paying higher markups are necessarily subsidizing those with lower or no markups, and raises the possibility, among others, that publications with lower than average markups are being “subsidized” by mailers in other classes. Id. at 1741-42.

[181] *Driving costs from the system.* Cavnar observes that a linchpin of the Complainants’ case is the contention that their proposal will cause mailers to change their behavior, and thereby drive costs from the system. He says his question, however, is if the significant changes made by all segments of the Periodicals industry in the past 20 years did not have the expected effect of “driving costs out of the system,” why should we believe that similar changes in the next few years will have that effect? Id. at 1743. Cavnar then notes that witness Stralberg, in the past, has advanced an “automation refugee” hypothesis, which theorizes that the Postal Service has difficulty reducing costs

as activity in specific functions declines, possibly because excess personnel are reassigned to functions where additional labor is not necessarily needed. *Id.* at 1744. He asserts that he sees nothing that convinces him that the same phenomenon will not continue to exist, and concludes that if these fears are correct, “then rates that assume cost reductions that do not exist will soon have to be raised as cost coverage drops into the negative zone, leaving behind those publishers, who may become former publishers, who were unable to respond to the price signals and faced rate increases of 30%, 50% and even 80%.” *Ibid.*

2. ABM witness Bradfield (ABM-T-2)

[182] ABM witness Bradfield’s position is that even though it might be reasonable for the Commission to consider recommending some modest changes in the Periodicals rate structure, it should reject “the major overhaul” the Complainants have proposed “for many of the same reasons that it rejected the major overhaul in the reclassification case.” *Id.* at 1687.²² Exhibit LB-1, an attachment to Bradfield’s testimony, identifies selected percentage rate changes for certain ABM member publications under the Complainants’ proposal. *Id.* at 1703-06.

[183] Bradfield’s support for the status quo is based, in part, on the contention that more co-palletizing and co-mailing “can be done, is being done and will be done” under the existing structure. *Id.* at 1701. He maintains that no rate design change is needed to encourage mailers to avoid the costs and damage of loading their publications into many small sacks or to encourage the nation’s larger publication printers to move forward in this area. An additional contention is that the main effects of the proposed rate design and rate changes “would be to provide millions of dollars of rate reductions to those periodicals already paying the lowest rates while imposing much higher postage costs on those unable to participate in the proposed ‘race to efficiency.’” *Ibid.*

[184] *Perspective on current and proposed rates.* Bradfield acknowledges the expertise of witnesses Stralberg and Mitchell, but claims their proposal does not

²² Bradford is Corporate Distribution Director for VNU Business Publications. *Ibid.*

represent appropriate rates for Periodicals. *Id.* at 1688. His primary objection is that it elevates costs and cost-based rates “so far above” all other rate factors (except ECSI value, limited to the markup and the editorial discounts) that it essentially ignores them. *Id.* at 1689. He contends that neither witness Mitchell nor witness Stralberg considered impact on mail users, and maintains that an ABM analysis shows that the range of impacts is quite large: five publications experience modest reductions, but 10 have increases greater than 50 percent. *Id.* at 1690-91. He adds: “As I would have guessed from the rate design, the largest increases tend to be for the publications with relatively high percentages of sacks.” *Id.* at 1691.

[185] Bradfield acknowledges that the analysis he refers to assumes no change in mailing practices, and that increases for some of the ABM publications in the analysis could be ameliorated or reversed through increasing sack size, co-mailing or co-palletizing; however, he asserts that a good number of Outside County Periodicals would face increases at the upper end of the range with no reasonable opportunity to change their mailing practices. *Ibid.*

[186] Bradfield also objects that the proposal’s “fine tuning” — which he claims creates a rate element for virtually every cost-causing characteristic — is not the appropriate goal of postal ratemaking, especially for Periodicals. *Id.* at 1692. In support of this contention, he cites passages from several previous Commission decisions, including one from Docket No. MC95-1, to the effect that efficiency considerations must be balanced with other important considerations, such as impact on those that cannot change their behavior. *Ibid.*

[187] Moreover, Bradfield contends that a reading of the Complainants’ case could lead to the conclusion that existing rates are not cost based. He asserts that this is not true, and points, among other things, to the fact that the rates for supplemental mailings are higher than for the main mailing because the Postal Service’s costs for these smaller, less work-shared mailings are higher. *Id.* at 1693-94. He also claims that Periodicals rates appear to be at least as cost based as the rates for other classes of mail, and further notes that Periodicals rates are supposed to reflect content, which is not a cost

consideration. Thus, he says deviation from pure cost-based rates is to be expected. *Id.* at 1694.

[188] *Other reasons for opposing the Complainants' proposal.* Bradfield lodges some limited criticism of witness Stralberg's model, primarily claiming that the data, productivity, mail flow assumptions and other inputs are at least two years old. *Id.* at 1695. He also asserts that the Periodicals processing environment is changing, pointing to the widespread use of AFSM-100 flats processors; the introduction of the Automated Package Processing System; the steps that have been taken to reduce bundle breakage; a substantial reduction in the use of processing annexes; and changes in transportation modes. *Id.* at 1695-96. He also sees the potential for more changes, noting reports that the Postal Service is moving ahead with plans to develop the ability to package or sequence flats to delivery points. *Id.* at 1696. Bradfield maintains that these considerations mean that the pattern of cost incurrence is likely to undergo significant change in the next few years, and believes that it would be a mistake to restructure rates without consideration of those changes. *Ibid.*

[189] *Co-mailing.* With respect to co-mailing, Bradfield asserts that he and witness Schick are generally in agreement that co-mail incentives today are adequate for those who can participate, as are dropshipping incentives for some publications. *Id.* at 1697. However, he claims weeklies, very small publications, and small printers cannot easily change their mailing characteristics or the way they prepare mail, given factors such as production schedule issues, differing trim sizes and polywrap. *Id.* at 1697-98. He also points to the present inability of co-mail programs to accommodate late-breaking news or an additional advertisement, but acknowledges that this could change in the future. *Id.* at 1698.

[190] Bradfield takes issue with witness Schick's view that entry into co-mail is relatively simple and inexpensive, citing sufficient volume, floor space, financial resources and lead time as several important considerations. *Id.* at 1699-1700. Nevertheless, he claims that despite these impediments, publishers of shorter run publications are moving in the direction that the Complainants wish to "encourage" with

rate carrots and sticks. As an example, he states that VNU began co-mailing nine of its titles this summer. He says this experience, combined with comments by several printers, indicates that VNU can expect to see gross postage savings of about 9% to 15%, with the added front-end costs eroding about half of those savings. The net postage saving, for a couple of months, has been about 4.5%, a figure which Bradfield expects will improve over time. *Id.* at 1700-01.

3. ABM witness McGarvy (ABM-T-3)

[191] Witness McGarvy²³ characterizes the Complainants' restructuring proposal as "a mixture of truth, questionable assumptions and wishful thinking." *Tr.* 6/1777. Her main focus is on the potential impact of the proposal on small publications and printers of short-run publications. In particular, she claims that rates, if implemented, would sacrifice many small publications to assure "guaranteed rate reductions" for the Complainants and result in "speculative, modest benefits, at best" for the Postal Service and most other Periodicals mailers. *Id.* at 1775.

[192] McGarvy summarizes the Complainants' supporting rationale as follows: present rates are unfair because some publications pay too much while others pay too little; present rates do not send the right "price signals," so mailers do not have incentives to make their mail less costly for the Postal Service; and with proper rates and price signals, most (but not all) mailers will be able to change the way they prepare their mail and avoid practices such as mailing in low-volume sacks "for no good reason." *Id.* at 1777. However, she claims that the proposal fails to take into account mailers' desire for better service, the degree to which rates already reflect cost differences, and the fact that changes are now underway without any additional rate incentives. *Ibid.* She further claims that the proposal "suggests near indifference" to the service and other problems that could confront many publishers of small circulation Periodicals if they sought to avoid the very large increases that the new structure could impose. *Ibid.* McGarvy

²³ Witness McGarvy is Corporate Distribution Director for Crain Communications (Crain). She describes Crain as primarily a publishing company with 30 titles "providing vital news and information to industry leaders and consumers." *Id.* at 1776. Most of its publications are short-run, but one (*Autoweek*) is larger. *Id.* at 1782.

points to the Postal Service's response to the Complaint and to comments Postal Service officials have made in the past few years as support for the contention that the Postal Service intends to move forward "with caution" on certain rate design changes, to ensure that the mission to "bind the nation together" is not unduly impeded by the unintended consequences of a massive, one-time shift in rate design. *Id.* at 1777-78.

[193] *Perspective on the current state of the industry.* McGarvy maintains that a major shift in mailer behavior is already underway, based on the existing structure, and describes several developments. *Id.* at 1778-80. She notes, for example, that Crain is co-mailing and co-palletizing some of its publications, as are some other ABM members. *Id.* at 1778. Moreover, she states that ABM has been encouraging its members to investigate co-mailing and co-palletizing; that members are doing so; and that some printers who serve shorter-run publications have the capability to provide these services. *Id.* at 1779. In addition, she says:

Even more recently, Fairrington, a transportation services company with substantial involvement in the Periodicals industry, announced that it is moving forward with a consolidation, co-palletization and transportation initiative that, it is hoped, will eventually allow publishers who use printers that cannot co-palletize to have their mail co-palletized and drop-shipped.

Ibid.

[194] McGarvy attributes these decisions to an understanding, on the part of those involved, that present postal rates, combined with mailers' desire to get out of sacks whenever they can, have produced an environment in which Periodicals "are changing and will continue to change." *Ibid.* She claims: "We do not like excessive sack use any more than the printers do, or the Postal Service does, because sacking mail imposes costs on printers that are passed on to us." *Ibid.* However, McGarvy also acknowledges that she cannot predict whether the changing mailing patterns that will occur in the next few years without a rate design shift will move enough mail so that the remaining

high-cost mail imposes “a minimal and acceptable burden on the subclass,” but claims this is a possibility. *Id.* at 1779-80.

[195] *Obstacles to change.* McGarvy criticizes the assumption that all publishers have the ability to adapt to the proposed rate structure and identifies numerous problems small publishers and printers of short-run publications might face. These include little flexibility as to mailing dates for weeklies and dailies, which limits co-mailing and co-palletizing; a reluctance to increase sack sizes because of service concerns; the difficulty of weighing various rate and service options; and the difficulty of meeting a threshold volume to participate in or create efficient co-mail pools, especially for publishers of tabloids, which cannot be co-mailed with standard trim size Periodicals. *Id.* at 1780-83. McGarvy also maintains that printers who have the volume and capital to offer co-palletizing and co-mailing are generally not interested in printing one or two short-run publications, especially if that is all a publisher has, or if interested, would not provide the kind of assistance a small publisher might need. *Id.* at 1783. She also claims that changing printers, if this could be done, might cause a delay of up to several years to avoid a breach of contract, as printing contracts generally have a duration of three to five years. *Id.* at 1783-84.

[196] McGarvy acknowledges that the concern about service erosion is “a somewhat controversial issue,” and states:

As I understand it, there is no *theoretical* reason why, for example, mail arriving at a destination SCF in a 3-digit sack should not be processed and delivered on the same day as mail received at that SCF in a 5-digit sack that is sent directly from the SCF to the DDU. As a member of the Periodicals Operations Advisory Committee, I also know that, with product supplied by Crain containing Planet Codes (used to track delivery), the Postal Service just completed a very small experiment in Carol Stream, Illinois, to determine whether this belief is accurate. The results of that study were not consistent with our belief that service would be eroded, but everyone involved recognizes that the sample was far too

small to permit any conclusions, other than that a better test should be conducted.

Id. at 1781 (emphasis in original).²⁴

[197] McGarvy maintains that because delivery times are absolutely crucial for weekly publications, “we cannot afford to make a mistake in this area.” Ibid.

[198] *Interest in adequate notice and a “measured pace.”* McGarvy claims that the considerations she and other ABM witnesses have raised require that fundamental changes to the Periodicals, if implemented, must be made with adequate notice and at the “measured pace” witness Mitchell claims to have adopted, but which she believes he has not. Id. at 1784. In addition, she asserts that the current rates “are not as unfair and insulated from cost considerations” as the Complainants suggest. She provides several comparisons between postage paid on physically similar publications by Crain and by Time Warner, which generally show that Crain pays higher postage. She acknowledges that some fundamental differences in mailing practices underlie her comparison, in that Time Warner palletizes nearly all of the copies of the referenced publications and rarely mails beyond zones 1 and 2, while Crain palletizes only 21% of *Creativity*, which has a mailed circulation of 31,320, and does not dropship. However, she asserts that this comparison nevertheless shows that the current rates already “to a very substantial extent” reflect differences in Postal Service processing costs, as well as her general understanding that, over the past 10 or 15 years, smaller circulation publications have faced larger rate increases than the mass circulation magazines. Id. at 1785-86.

[199] *Conclusion.* McGarvy claims that the Complainants stand to save substantial amounts of postage under the proposal without changing anything they do and without saving the Postal Service any money even if everything they claim about postal costs, the responsiveness of postal costs to changes in mail preparation and the ability of mailers to change “is absolutely incorrect.” She states that she is concerned that if their

²⁴ McGarvy says for the small test in Carol Stream, “we were so concerned about service that we did not use our subscriber copies but added new addresses (of postal employees) for the test copies.” Id. at 1782.

forecasts are wrong, the postage reductions will require postage increases “of equal magnitude” for the remainder of the class “merely to maintain the very modest cost coverage for the class.” *Id.* at 1786-87.

[200] McGarvy therefore contends that it would be “far preferable” for the Commission to encourage the Postal Service to investigate and study all of the issues raised in this proceeding, and to use the next rate case as a vehicle for proposing any rate structure changes, along with associated rates, that it believes will encourage mailers to continue moving away from sacks, but will also provide some degree of protection to those mailers who, due to their size, their business models, or other factors, would not be able to avoid large, crippling increases if the proposals “did not account for their existence.” *Id.* at 1787.

[201] In addition, McGarvy notes that she believes that the rapid increase in Periodicals processing costs that characterized much of the past 20 years is leveling off, and fully expects that greater mailer awareness and the entry of new co-mailing and co-palletizing providers is “just the beginning of a major trend” in that direction that will have a very significant impact on processing costs of the type that the Complainants are seeking through a carrot and stick approach. *Ibid.* She maintains that mailers do not like sacks, and says that if given a reasonable way to get out of them or an assurance that increased sack size will not compromise service, they will move away from sacks. *Ibid.* Moreover, she claims “[i]t looks like we are getting there, and doing it without inflicting harm on countless small and under-represented publications that will become the collateral damage of the Time Warner proposal.” *Ibid.*

B. The McGraw-Hill Companies, Inc.

1. Witness Schaefer (MH-T-1)

[202] Witness Schaefer²⁵ addresses the impact of the Complainants' proposal on periodicals published by McGraw-Hill and describes the company's position on the proposal. He also presents an assessment of the impact of past postage increases on smaller circulation publications; discusses existing incentives for more efficient mailing practices; identifies practical constraints on reducing the use of sacks; discusses fees associated with co-mailing and co-palletizing; and explains why he views the proposed structure as "unmanageably complex" for most Periodical mailers. *Id.* at 1920-21. Schaefer also urges the Commission to maintain the cost averaging that now exists and to retain the unzoned editorial pound rate. *Id.* at 1921.

[203] *McGraw-Hill's interest.* Schaefer asserts that McGraw-Hill publishes a wide range of Periodicals that in many ways mirror the characteristics of Periodicals as a whole. These include magazines, newsletters, newspapers, and looseleaf Periodicals in the fields of business, finance, healthcare and construction. *Id.* at 1922. Schaefer says these publications vary widely in terms of mailed circulation, and thus in their ability to use pallets and to dropship highly presorted mailpieces. *Ibid.* He also says that McGraw-Hill is involved in electronic publishing, with many of its publications providing editorial content on publicly available websites, on subscriber-only websites, or via electronic publications in formats such as Adobe PDF and Zinio. *Id.* at 1923.

[204] *Impact of proposal.* Schaefer states that McGraw-Hill's analysis of the rate impact of the Complainants' proposal yielded a wide range of results, given the diverse range of its publications, and overall savings of about \$300,000 annually. This is primarily due to savings on *Business Week*, which would realize savings of about 11%, or \$1.175 million on an annual basis, and rate increases for all but three of the company's other publications. *Id.* at 1923-24. Schaefer says *Engineering News Record*

²⁵ Witness Schaefer is General Manager, Logistics and Postal Affairs, for The McGraw-Hill Companies, Inc. McGraw-Hill publishes 84 Periodicals, consisting of 19 monthlies, 10 weeklies, 2 bi-weeklies and 53 daily bulletins. *Id.* at 1922. Schaefer states that McGraw-Hill is a member of both American Business Media and Magazine Publishers of America. *Id.* at 1922-23.

would experience the largest dollar increase, at \$140,000 or 13%, on an annual basis. Id. at 1923. The estimated impact on *Dodge* and *Standard & Poor's* publications, which have small circulations, is postage increases on the order of 50%. Id. at 1924.

[205] Schaefer claims that in this proceeding, as in the Docket No. MC95-1 reclassification case, McGraw-Hill has been less concerned with overall savings that might be realized than with the adverse impact on smaller publications. He adds:

Due largely to their lower circulation, smaller publications already bear a substantially higher cost burden than larger-circulation publications, and would not likely be able to avoid onerous rate increases by changing their mailing practices. Beyond the adverse impact on most of McGraw-Hill's own publications (which must stand on their own financially), we are concerned that the extensive de-averaging of costs and rates proposed by Complainants would undermine maintenance of a broad, vibrant and diverse Periodicals class, and could bring into question its long-term viability. We further believe that more efficient mailing practices can be fostered and rewarded as appropriate through rate design changes that are more balanced and equitable than those proposed by Complainants.

Id. at 1924-25.

[206] *Contention that smaller circulation publications have borne the brunt of cost increases.* Schaefer takes issue with witness Mitchell's reliance on Periodicals cost increases as a rationale for de-averaging Periodicals costs and rates. In particular, he notes that witness Mitchell presents a chart illustrating that Outside County Periodicals rates, at a constant markup index, have grown at a rate considerably in excess of inflation as measured by CPIU, and that this occurred over a period of technological advances, resulting in "*negative technological productivity change.*" Id. at 1925 (emphasis in original).

[207] Schaefer says that while witness Mitchell describes this situation as troubling, he contends that “the situation has been much more ‘troubling’ for smaller-circulation publications that lack presort density than it has for large titles.” *Ibid.* To illustrate this point, he modifies a chart from witness Mitchell’s testimony to include some additional information. Schaefer claims the results (in Chart A) make clear that the constant markup rates for *Engineering News Record* exceed CPIU by approximately twice as much as do the corresponding rates for *Business Week*. *Id.* at 1926. Schaefer claims this indicates that smaller circulation publications like *Engineering News Record*, rather than large circulation publications like those of the Complainants, have borne the brunt of the costs attributed to Periodicals since 1985. *Ibid.*

[208] Schaefer maintains that the rate difference continues to grow at an alarming rate, and claims that the rate differential would widen significantly under the proposed rate structure, with *Business Week* experiencing an 11% decrease in rates, and *Engineering News Record* a 13% increase. *Id.* at 1926-27. In fact, Schaefer says that even if *Engineering News Record* were able to take steps to mitigate some of the increase, the rate disparity would still grow considerably. *Id.* at 1927. Thus, Schaefer claims it is hard to believe witness Mitchell’s contention that “the current rates provide signals that are ‘hidden by excessive tempering.’” *Ibid.*

[209] Schaefer presents two additional charts that compare actual postage paid by relatively large and small Periodicals mailers from early 1985 to mid-2002. He explains that Chart B is similar to Chart A, except that it reflects actual markups and postage paid, and that Chart C is similar to Chart B, except that it includes all McGraw-Hill publications except its *Dodge* and *Standard & Poor’s* publications. *Id.* at 1927-28. Schaefer, among other things, notes that while the average increase for regular rate Periodicals from January 1995 to January 1999 was 5%, many large publications apparently saw a decrease in postage, as did *Business Week*. *Id.* at 1928. Moreover, he says that if one puts aside witness Mitchell’s “constant 24% markup” — which he views as artificial — Chart B makes clear that the actual aggregate postage increases incurred since 1985 by *Business Week*, and presumably by other high circulation publications like those of

Complainants, have *not* generally exceeded CPIU, while smaller circulation publications like *Engineering Record News* have incurred aggregate postage increases nearly *double* the CPIU. *Id.* at 1928-29 (emphasis in original).

[210] Thus, Schaefer asserts that the remedy advocated by Complainants — which he characterizes as a radical de-averaging of Periodicals rates that would provide an enormous windfall to a relatively few large circulation publications such as those of the Complainants, even with no change in their mailing practices, while exposing most smaller circulation publications to corresponding rate increases — seems wholly misaligned with the chronic problem of above inflation cost increases for Periodicals. *Id.* at 1929. Instead, he contends that it is the smaller circulation publications, not the large circulation publications, that have borne the brunt of cost allocations. He therefore claims that it seems misplaced for the Complainants to seize upon these cost allocations as a reason to further increase the cost burden borne by smaller circulation publications. *Ibid.*

[211] Moreover, Schaefer says that he questions whether the high cost increases attributed to Periodicals as a whole are due primarily to inadequate price signals, and instead proposes that it seems at least as plausible that many smaller publications have simply lacked the circulation density (or practical opportunities to combine their mail with other publications) to increase significantly their worksharing and palletization. *Id.* at 1930. He also claims that the sharp increases in Periodicals costs indicates that considerable caution is warranted before undertaking what he considers the “radical rate design changes” the Complainants have proposed, and suggests that prudence seems to dictate a more incremental approach. *Ibid.*

[212] Schaefer also testifies that Periodicals mailers already have significant incentives to prepare Periodicals mail on pallets, rather than sacks, to the extent feasible, and asserts that these extend “well beyond” the pallet and dropship discounts in the current Periodicals rate structure. *Id.* at 1932. In support of this position, he cites the expense associated with handling sacks in printing plants (given that they are more labor intensive) and in transportation. *Ibid.* He notes that practices such as setting sack

minimums at 24 pieces and pallet minimums at 250 pounds have not only reduced McGraw-Hill's postage bill, but have helped the company avoid incremental expenses from their printer and to lower non-postal transportation costs. *Id.* at 1933. In addition, Schaefer says that *Business Week* and *Aviation Week* have eliminated over 1,000,000 sacks on an annual basis over the course of the last four years, and maintains that Complainants have likewise heeded the existing incentives to palletize rather than sack their Periodicals mail. *Id.* at 1932-33. He also notes that both Brown Printing and Fairrington Transportation have announced plans to commence co-palletization programs and associated dropshipping pools by early next year, and that Quebecor World has announced that it would invest in co-mailing technology. He considers these announcements as positive steps in creating additional opportunities for Periodicals mailers to save postage through greater presort density, palletization and dropshipping, and notes that "these developments are occurring under current postal rate incentives, and thus further call into question the need for the type of structure proposed by Complainants." *Id.* at 1933.

[213] Schaefer contends that there are many reasons why many publications may not be able to respond effectively to the price signals the Complainants propose. One is the costs of co-mailing and co-palletization absorb much of the associated postage savings. He notes that his company's experience is that printers typically charge a fee of at least one-half of the postage saved by each participating publication, and claims that witness Schick confirms that this is a reasonable approximation. *Id.* at 1934. Thus, he claims that when the cost to publishers of co-mailing or co-palletization is considered, it is clear that substantial rate increases for many smaller publications could not likely be avoided under the proposed structure. *Id.* at 1934-35.

[214] Additional reasons include the unavailability of dedicated co-mailing equipment and programs at printers a publisher uses; manufacturing constraints associated with selective binding technology; and production constraints for time sensitive publications, small circulation publications and loosely bound publications. *Id.* at 1937-42.

[215] Schaefer also contends that the proposed price signals would be unmanageably complex for most Periodicals mailers. He criticizes witness Stralberg's contention that anyone with a tenth-grade math education could optimize a mail stream under the proposed rates as "an oversimplification that fails to recognize the complex interrelationships that would be created by such a rate structure." *Id.* at 1942. He maintains that the software to perform the more complicated permutations do not exist, and claims that mail.dat software, which he notes is used extensively for mail planning today, would "be of little value" for the type of optimization rewarded under the Complainants' proposal. *Ibid.* He therefore asserts that while large mailers may be able to marshal the resources and expertise needed to undertake optimization, he questions whether small mailers would be able to do so. *Ibid.*

[216] *Perspective on current policies.* Schaefer draws comparisons between the instant proposal and the Postal Service's proposal in Docket No. MC95-1, which he says would have created a new class for "efficient" (larger circulation) publications, with large rate decreases, with corresponding larger increases for the majority of other (smaller circulation) publications. He notes that McGraw-Hill's position here is the same as it was in that case: while it may as a whole benefit financially, it is opposed to the change because of its impact on smaller circulation publications; the practical obstacles to co-mailing; and a belief that efficient mailing practices could more appropriately be encouraged through new and/or enhanced discounts that reward such practices. *Id.* at 1943-44.

[217] Within this context, Schaefer says various pallet and dropshipping discounts could be expanded if warranted, and that an experimental co-mailing discount might also be considered. *Id.* at 1944-45. He also maintains that McGraw-Hill is not simply interested in the postage benefits that it might obtain, but in the needs of the Periodicals class as a whole. In this regard, he observes:

All Periodicals, regardless of the size of their distribution, contribute to the purpose of the class and the reasons for its preferential treatment. The Periodicals rate structure should therefore continue to accommodate a broad range of publications, not simply high-circulation/low cost publications. A rate structure that marginalized small publications could ultimately marginalize the Periodicals class itself and call into question its long-term viability. Generally speaking, therefore, it seems that rate averaging is to a considerable degree the glue that holds the class together, and the price for the preferential rates afforded the class as a whole — including both *Business Week* and Complainants' publications.

Id. at 1946-47.

[218] Schaefer also pursues the service issue, claiming that McGraw-Hill's experience is that all other things being equal, palletized mail generally receives better service than sacked mail. Id. at 1947. He cites McGraw-Hill's monitoring of *Aviation Week* delivery over four weeks, and claims that service for sacked mail was generally slower than for palletized mail on the same route, and sometimes markedly so. Id. at 1948. Thus, he claims that it therefore seems fair and equitable (in the context of 39 U.S.C. § 3622 (b)(1)) to continue averaging rates (and applying appropriate pallet and dropshipping discounts) because "even if palletized mail generally costs the Postal Service less, pallets pay less and generally receive better service." Ibid.

[219] Schaefer's final point is that the Commission should not abandon its longstanding policy to promote the "widespread dissemination of editorial content" through a low pound charge for editorial content. He claims that the Complainants have not presented any valid justification for doing so, notwithstanding the testimony of witnesses Gordon and Mitchell. In particular, Schaefer asserts that the Internet has complemented, rather than displaced the role of McGraw-Hill's hard-copy Periodicals, and claims that this view is consistent with a recent survey report.²⁶ Ibid. Schaefer also

²⁶ The referenced report is cited as "The Internet and Daily Life," released by the PEW Internet and American Life Project. Schaefer states that the report is available at www.pewinternet.org. Id. at 1951.

takes issue with Mitchell's suggestion that the increase in the cost of mailing a publication across the country would likely be offset by the publication's marginal subscription revenue. He points to the possibility that a publisher's net subscription revenue may be a low percentage of the subscription price if subscriptions are sold through independent sales agents, and to the fact that advertising revenue does not commonly vary directly with circulation, and would not necessarily be affected by dropping or avoiding subscribers in high postal zones. *Id.* at 1952-53.

[220] Schaefer claims that the Commission has rejected other arguments Mitchell raises, and sees no reason why it should "reverse course" now. *Id.* at 1953. He states: "In my view, the uniform editorial pound charge is no more 'discriminatory' than any 'rate averaging,' which necessarily benefits above-average-cost mailers more than other mailers." *Ibid.* At the same time, Schaefer observes that some adjustment to the otherwise flat editorial pound charge might be acceptable, noting:

...I can state that in principle, a proposal to establish drop-ship discounts from the flat editorial pound charge may at least be a more balanced approach to the issues underlying this proceeding than the rather drastic proposals advanced by Complainants. With such discounts, those Periodicals that can drop-ship or otherwise enter their mail close to its destination would see a rate reduction, while those that cannot do so would not incur zoned editorial pound rates that would make it much more costly to reach distant subscribers.

Id. at 1954-55.

C. National Newspaper Association

1. NNA witness Heath (NNA-T-1)

[221] Witness Heath²⁷ addresses newspaper mail preparation practices, especially the use of sacks, and discusses the potential impact of the Complainants' proposal on small newspapers.

[222] One of Heath's contentions is that current Postal Service regulations require that newspapers be sacked or palletized and, with limited exception, require that pallets contain at least 250 pounds of mail.²⁸ Ibid. Thus, he asserts that if a Periodical is unable to palletize or co-palletize, sacks are the only container that is officially permitted. Ibid. He acknowledges that there are discussions within the Postal Service and some informal experimental programs that allow alternatives to sacks, and believes further alternatives are possible; however, he says today's rules require sacks, so that is what publishers use. Id. at 2065. He notes:

Sacks may not be the most desirable of containers, either from the Postal Service's viewpoint or the mailers. The plastic sacks in use today draw some criticism from mail handlers within our industry. They have a tendency to produce plastic splinters, which can be painful to the mailhandler. Brown sacks are difficult to obtain, and the good canvas ones are becoming rare as USPS moves into the cheap plastic sacks. These cheap sacks are hard to stack, because they are slick. The sack tag holders break and separate and are missing when the sacks are shipped. So sacks are not very popular with publishers. Publishers do not

²⁷ Witness Heath is Vice President of Landmark Community Newspapers, Inc. (LCNI) in Shelbyville, Kentucky. Id. at 2063. LCNI has 53 weekly and daily newspapers in 13 states with 329,000 paid circulation, 478,000 free newspaper and shopper circulation, and 384,000 free special publication circulation. It also has eight college sports publications with 65,000 circulation in Periodicals. Ibid.

²⁸ The exceptions are for mail entered for delivery at a destination delivery unit and for pallets an SCF manager has authorized to have less than the minimum load, when the pallet contains mail for the SCF area. Id. at 2064.

use these containers because they wish to, but rather because they must.

Ibid.

[223] *Service issues*. Heath notes that service to outlying zones has been one of his concerns in recent major rate and classification cases, but says that the Postal Service “has consistently said it does not ascribe to an official service standard for Periodicals mail.” Id. at 2066. However, he says that FY 2004 Quarter 1 Service Standards on CD-Rom show expectations for mail processing that assume delivery of newspapers to any point in the country should take no longer than seven days, and that delivery time should be one day in a paper’s market area. Ibid.

[224] Heath further states that Periodicals mailers have been pressing for some time for published standards and regular measurement, like the system the Postal Service uses for First-Class letter box mail (EXFC), but claims the Postal Service has been resisting this proposal. Id. at 2067. In addition, he says that “[r]egardless of whether the ‘standard’ is three days, four days or seven days,” the Postal Service has seemed unable to consistently meet an expectation, and often delivers newspapers in clumps. He attributes this to processing plants that fail to deal efficiently with sacked mail, and suggests that one reason may be that sack sorting machines are being removed from most plants, with sack sorting occurring in more costly manual handling. Ibid.

[225] Heath is generally critical about the state of delivery service, but notes that some publishers, often working with local postmasters, have achieved the service promised by the Postal Service by carefully packaging and sacking their mail to move these copies to their destination as directly as possible. Ibid. As an example, he explains that an NNA-requested exception (under DMM section 210.1.5) is allowed in situations where a publisher determines that preparation of smaller bundles or sacks with one to six pieces improves service, provided the smaller bundles are placed in 5-digit, 3-digit or SCF sacks. Id. at 2067-68. Because of this exception, he says that newspapers like to use 5-digit sacks when at all possible for their longer distance mail,

and notes that this has led to the use of “skin sacks.” In fact, he says that newspapers are often told by postmasters to use these low-volume sacks after other efforts to improve service have failed. *Id.* at 2068.

[226] Heath maintains that skin sacks “have turned out to be a big help in getting, not better service, but minimum service at the service expectation set out by the Postal Service.” *Ibid.* He indicates that this is because with larger volume sacks, sortations are then forced upstream to 3-digit or ADC levels, and service suffers. However, he says that newspapers would be happy to prepare larger, fewer sacks, if the Postal Service could achieve the delivery it promises with those larger sacks. *Ibid.*

[227] *Pallets.* Heath attributes the lack of pallet usage among local newspapers to the 250-pound minimum; a lack of forklifts and space to stack pallets; and the use of mail processing software that differs from that used by large Periodicals publishers. *Id.* at 2068-69. With respect to the pallet minimum, he asserts that most newspapers do not have the requisite 250 pounds of SCF mail, noting that the typical NNA member newspaper is a weekly with about 3,500 circulation. Moreover, he says that only about a fourth of that amount, at the maximum, goes outside the trade zone, placing outside county volume at about 750 pieces. He says:

In order to meet a single pallet’s minimum weight, each copy would need to be between 5 and 6 ounces. But that would be an extremely rare and unique community newspaper. Particularly because most save postage by not including their inserts in copies going outside the retail trade zone, a typical mailed community paper probably is closer to 3 to 4 ounces.

Id. at 2068.

[228] Heath also states that pallets require forklifts, and asserts that many community newspapers and small post offices do not own this type of machinery. He also says that many small post offices do not have the room to stack pallets, even if they had this equipment. Thus, he says many rural post offices cannot accept mail on pallets. *Id.* at 2069. As to software, Heath says that some local publishers use off-the-shelf

products; some use Interlink CM2, a low-cost PAVE-certified provider popular in the industry; and some use inexpensive programs designed for bulk mail. Ibid. He asserts that none of these contain modules for calculating pallets, that palletization software can be extremely costly to purchase, and that it may not be available at all in modules that work with a newspaper's current software. Ibid. Heath further observes that because newspapers are generally not eligible to use pallets, few publishers have been concerned about this problem. Thus, he says that if a requirement for pallets were instituted, the Postal Service would need to create an exception that would permit software approved for sack sortation to be used if it hopes to achieve any amount of compliance by small newspapers. Ibid.

[229] *Alternatives.* Heath says he has worked for several years to persuade the Postal Service to permit alternatives to sacks or pallets, as it has become clear to him "that the former are becoming a *bête noire* in the system, and the latter will not be usable for small volume mailers." Ibid. He notes that in addition to numerous experiments with plastic tubs for newspapers, a Jackson, Mississippi SCF is experimenting with allowing newspapers to place small bundles or even unbundled loose newspapers prepared in proper sortation in white, two-handled tubs. Heath says these tubs do not seem to present the same problems with opening and emptying that sacks have sometimes created; instead, they are "cheap, easy to handle and easy to stack." Id. at 2070.

[230] In addition, Heath points to the possibility that all newspaper mail for delivery beyond the local area could be entered unsacked in bundles at DDUs, and then placed in all purpose containers (APCs) with First-Class Mail destined to the next upstream SCF/ADC. Ibid. He says that he knows of some small newspapers and their post offices that already use APCs this way, simply dropping bundles of newspapers on a loading dock after hours when the press run is complete, but the DDU is not yet open. Ibid. He also says that other newspapers are placed in canvas or plastic hampers, which are other types of rolling stock used to transport mail between postal facilities. Ibid.

[231] In support of these alternatives, Heath says that the new Automated Package Processing System (APPS) bundle sorting machines scheduled for deployment in

2005-2006 will be even better prepared to handle bundles, without either sacks or pallets. He explains that with this equipment, a bundle could arrive at an ADC in an APC, be rolled directly to the APPS machine and sent to its next destination in whatever container that ADC is using for its next shipments. *Id.* at 2070-71.

[232] *Potential impact of Complainants' proposal on small newspapers.* Heath said he attempted to perform an analysis using Landmark's publications, using a simpler version of the program provided by the Complainants' expert, but found the exercise frustrating and time-consuming. He says:

My 'model' weekly with 573 copies and 564 addressed pieces outside the county, *Cynthiana Democrat* (KY) would experience an increase on those pieces under T-W proposal from \$209 to \$363, +\$154 or 74%, but only if automation rates are retained. (As proposed, they couldn't be since most newspapers are not AFSM100 compatible.) Under that scenario, with no auto, costs go up to \$389, +\$180, or 86%. ... Weight was .5425 lbs. at 45% paid advertising. The weekly has 1,898 addressed pieces in-county, 1989 total in-county.

Id. at 2072.

[233] Heath acknowledges that some NNA newspapers might benefit to some degree, if they have only within county and carrier routed, DDU-entered outside county mail. *Ibid.* He says that newspapers that would see the most harm would be those that have significant snowbird or seasonal readership, and must retain them as readers as they come and go from the community; those that depend upon long distance readers, such as those with readers who have moved away and college students; and those that publish niche products to generate revenue that keeps the company alive. *Ibid.* With respect to the last type, Heath says that NNA has members who publish antique traders, hobby newsletters, children's magazines, Civil War buffs' journals and other niche newspapers that may serve a regional or national audience. *Id.* at 2072-73. He says that while these publications may not be community newspapers by the strictest

definition, they serve a community of topical interest. He says that the economics of community newspapering are sufficiently challenging that he believes many companies are being forced to stretch outside their traditions to survive with such specialty publications. He concludes that any of these publications would be small, low-density periodicals whose mailing characteristics would be like those of community newspapers' out-of-town readership — and hit hard by the proposed rates. *Id.* at 2073.

[234] *Precedent.* Heath expresses a specific concern about the Complainants' use of the section 3623 mechanism to pursue their position, as well as a more generalized concern about the complexity of Commission proceedings. In particular, he asserts that matters of policy have given way to sophisticated economic theory and claims that while monitoring the Commission's website generates quite a bit of expense, "litigation can tie up an association's budget for a year or more." *Id.* at 2074. Thus, he cautions the Commission against opening the complaint docket to competing theories of rate design, based on the conviction that these should be proposed during the course of omnibus rate cases. *Ibid.* He further claims that while rate stability is at issue, he also believes that the possibility of litigating smaller mailers into silence is at issue.

[235] *Conclusion.* Heath asserts that the sack charge is the most critical aspect of this case for community newspapers. He agrees that eliminating sacks would be a positive step for mailers and for the Postal Service, but says that sacks are indispensable at this point because alternatives are unworkable or unavailable. He says that if this case were brought in 2006 or 2007 when the APPS equipment is in operation, and the use of tubs or APS is in place, the Complainants might have a legitimate concern that mailers had alternatives available and simply were not using them. However, he maintains that is clearly not the case now. *Id.* at 2075.

2. NNA witness Crews (NNA-T-2)

[236] Witness Crews²⁹ addresses two main points: the impact of the Complainants' proposal on local newspapers and newspapers' use of the Internet. His overall

²⁹ Witness Crews is Executive Director of the Missouri Press Association. *Id.* at 2025.

conclusions are that outside county readers are important to small newspapers; that the Internet is not a suitable substitute for the foreseeable future; and that sacks are still a significant part of the mail preparation picture. *Id.* at 2036. He asserts that if the cost of sacks escalates before the tub option is fully available, the net effect on Missouri newspapers will be a circulation loss. Therefore, he contends that the prudent thing to do is to provide tubs or other containers as viable options before penalizing mailers for a mailing practice they cannot avoid. *Ibid.*

[237] In support of this position, Crews reviews the mailing practices of three local publishers. All perform some degree of presorting, and those that rely on software programs generally use off-the-shelf products rather than proprietary programs, given the cost of the latter. *Id.* at 2026. In general, Crews says that most weekly newspapers focus primarily on their own counties, but notes that the size and number of counties can vary: some states have a few relatively large counties, while Missouri, with 114 counties, has mostly small ones. *Id.* at 2027. He says it is not uncommon to find newspapers serving multi-county areas, and says that weeklies in small cities in Missouri are the principal newspapers for a trade zone, even if some of the even smaller towns within their home counties and adjacent counties have newspapers of their own. *Ibid.*

[238] *The Cameron Citizen Observer*. Crews says that the *Citizen Observer* serves a four-county area, claiming in-county rates for copies mailed to Clinton addresses and paying outside-county rates for copies mailed elsewhere. He identifies four major categories of readers: within the county; outside the county, but within the retail trade zone; outside the county, but in the nearby Kansas City or St. Joseph areas who may have direct ties to one of its four counties; and outside the county, but as far away as Arizona and California. *Id.* at 2027-28. The newspaper's mailing pattern, for 1,167 copies, is as follows: all copies are entered in the Cameron post office, with the 783 copies destined for Cameron remaining in that office; the remaining 384 copies travel to St. Joseph, Missouri, in 5-digit, 3-digit ADC or mixed ADC sacks, as volumes permit. The mailing is not palletized, as it does not meet the 250-pound minimum. *Id.* at 2028. The newspaper's regular subscription price is \$34; \$38 (an out-of-town rate) beyond the

four-county area, and \$49 out of state. Snowbirds are charged the local rate, because the publisher considers these people local subscribers. College students and permanent nonresidents pay the out of state rate. *Id.* at 2030.

[239] Crews says the *Citizen Observer* cannot combine its copies at a central printing plant to achieve sufficient volume for a pallet because it does its own printing. *Ibid.* at 2028. He says the newspaper also prints a couple of the smaller circulation neighboring newspapers, but says each product is time sensitive and cannot be warehoused at the printer while others come off the press to be co-palletized. *Ibid.* Thus, he believes sacks are its only option. *Ibid.* Accordingly, Crews contends that if the proposed rates create a charge for sacks, the *Citizen Observer* would be faced with critical choices: passing along the cost of the sacks to the outside county readers or dropping these readers. *Id.* at 2028-29. Crews does not believe that NNA publishers could absorb significant postage increases. *Id.* at 2029. He acknowledges that there is a possibility that the newspaper could sell subscriptions to snowbirds just for the months they reside in Missouri, but says most weeklies sell yearly subscriptions, and suggests that partial subscriptions would bring about additional costs, such as those associated with extra bookkeeping, more frequent invoices and additional promotion cost. *Id.* at 2029-30.

[240] Crews performed an analysis to determine whether it would be reasonable to have readers absorb the sack surcharges. He used seven subscribers in zone 7 as his base, and assumed that these copies travel in an ADC sack. He says that under the proposed rates, these seven subscribers would share a \$3.25 sack surcharge, or .46 cents per issue. He says that if the proposed rates in this case were put into effect along with new rates from the next omnibus rate case, the effect might be an additional \$20 surcharge on these subscriptions. At the same time, he also says that this surcharge would probably cost the newspaper most of those readers, and says the readers would lose their hometown newspaper. *Id.* at 2031.

[241] Crews notes that the newspaper maintains a website, but does not post the entire newspaper. Among other things, he says this approach may reflect lack of

demand, due to readers' interest in the printed product; an older population, both among local subscribers and the snowbirds; seniors who are less Internet savvy; and advertising issues, especially those related to small business operations. *Id.* at 2031-32. Thus, he concludes that most of the *Citizen Observer's* outside county readers have no real alternative to the printed newspaper. *Id.* at 2032.

[242] *The Atchison County Mail*. Crews reports the *Atchison County Mail* mails primarily within Atchison County. The mailing process involves taking mail in sacks through an exceptional dispatch arrangement to at least three small post offices, and taking mail in tubs to the Rock Port post office. Crews explains:

He [publisher Farmer] was in the post office one day when the Tarkio postmaster was visiting. The Tarkio postmaster mentioned that he was receiving some periodicals in tubs. The Rock Port postmaster thought that was a good idea. He began to do it with all the mail entered there, not only the destinating within county mail, but his out of state mail.

Id. at 2033.

[243] Crews maintains that the use of tubs has also improved service, based on the publisher's representation that he has not had many complaints from his snowbirds since switching to tubs. *Id.* at 2033-34.

[244] *Odessa Odessan*. Crews says the publisher of this newspaper drives to Independence, about 30 miles from Odessa, where the newspaper is printed by an area daily newspaper company. The *Odessan* does not use any circulation software, but instead maintains a subscriber list and counts on the publisher in Independence to produce labels and sack tags. After the newspapers are bundled, Crews says the *Odessan's* publisher picks them up and takes them to various post offices. Bundles of in-county newspapers are dropped off at the Odessa post office, but the newspapers destined for two small towns cannot be entered in bundles, and are therefore entered in sacks. Crews says:

The copies in sacks leave Odessa and backtrack to Kansas City, another 20 miles east of Independence from where Joe [the publisher] just picked up the papers, to be processed and come back to the small towns. Would Joe use a container other than sacks? Sure, if he had an alternative, but none other has been authorized.

Id. at 2034.

[245] Crews says that another 500 copies are also in sacks, and that two-thirds of these go to readers in Missouri. The rest go outside the state, mostly to former residents and snowbirds. Id. at 2035. Subscription rates are \$34 for in-market copies; \$40 for copies to addresses in Missouri but outside the market; and \$45 for out-of-state copies. Ibid. Crews believes that this newspaper, like the Cameron newspaper, would face an extremely difficult set of choices if the use of sacking procedures to achieve service standard delivery resulted in sack charges. He also notes that the website is not a viable alternative, as it serves mainly as “a calling card.” Ibid.

D. U.S. News & World Report

1. Witness Armstrong (USNews-T-1)

[246] Witness Armstrong³⁰ notes that his testimony marks the first time U.S. News has filed testimony before the Commission, and indicates this decision is based on a firm belief that the Complainants' proposal would cause publishers to change their mailing behavior in ways that would make the Postal Service more effective and improve the efficiency of overall mailing operations, thereby minimizing future increases in Periodicals rates. *Id.* at 2115.

[247] He states that an analysis using the Complainants' model indicates that the rates associated with the proposed restructuring would reduce the magazine's postage by 10.4 percent with no change in current mailing practices. However, he says the proposed rates also would provide the incentive — in the form of an additional 3 percentage points in savings — to make a few simple changes that would reduce the Postal Service's costs. *Id.* at 2116. One involves presorting subscriber addresses in ways that would reduce by half the number of pallets and sacks the Postal Service handles. The other involves switching entry points for approximately 250,000 copies not currently eligible for destination discounts to destination bulk mail centers (BMCs). *Ibid.*

[248] With respect to new presorting practices, Armstrong states that the analysis indicates that the magazine could achieve a reduction in containers of at least 50 percent. He says his company has not undertaken necessary related changes because current Periodicals rates provide no incentive to undertake the requisite computer programming, testing and other measures. *Ibid.* As for entry points, he says the company already delivers copies to Periodicals facilities in the same cities as the BMCs, so it could easily add the BMCs as entries. He adds that current rates and regulations discourage entering Periodicals at BMCs. However, he thinks that the Postal Service should be well positioned to handle these sacks and pallets through the destination

³⁰ Witness Armstrong is Senior Vice President of Operations at U.S. News & World Report, L.P. (U.S. News). The company is privately held; its primary business is publishing the weekly newsmagazine *U.S. News & World Report*. It mails more than 92 million copies of the magazine annually to U.S. subscribers and identifies the Postal Service as its largest vendor. *Id.* at 2115.

BMCs at lower costs than today, and identifies this as another opportunity to increase the Postal Service's efficiency that is blocked by current Periodicals rates. Ibid.

[249] In addition to these changes, which Armstrong says that his company could make on its own, he believes that changes that could be made in conjunction with other publications are potentially more important. These include more dropshipping and co-mailing. Id. at 2116-17. With respect to co-mailing, he notes that the primary operational challenge is managing many different demographic versions, and adds:

For our printers, this means they would need to make a significant investment in large capacity multi-mailing equipment to combine many different publications and versions of publications. Because about three-quarters of our copies already qualify for carrier route sortation piece rates, there is virtually no incentive to co-mail them. As a result, our current co-mailing strategy focuses on those markets with relatively low carrier route percentages. The proposed rates would not only increase the savings from promoting five-digit pieces to carrier route, they would also provide incentives for consolidating various publishers' bundles and containers into fewer and larger bundles and containers. That would make co-mailing of *U.S. News & World Report* magazine with other publications economically attractive even in areas with high carrier route sortation.

Id. at 2117.

[250] Armstrong concludes by noting that his company supports this proposal even though it puts U.S. News at a competitive disadvantage, since the proposed rates favor *Time* and *Newsweek* more. However, he believes the proposal would help the Postal Service handle periodicals more efficiently and would therefore ultimately be good for the entire Periodicals class of mail. Ibid.

E. United States Postal Service

[251] The Postal Service submitted the testimonies of two witnesses, Michael W. Miller and Rachael Tang. Witness Miller discusses Periodicals costs drivers, current cost reduction efforts, and Stralberg's cost model. Witness Tang discusses the potential impacts of the proposed rate design and the policy implications of these proposed changes.

1. Michael W. Miller (USPS-RT-1)

[252] Witness Miller first reviews the cost reduction programs presented in Docket No. R2000-1. These programs included allowing barcoded and nonbarcoded bundles in sacks, a reduction in the number of "skin" sacks, the implementation of line-of-travel (LOT) sequencing, and the institution of the L001 labeling list.³¹ After the conclusion of the R2000-1 proceeding, the Postal Service began to deploy the Automated Flats Sorting Machine model 100 (AFSM-100). Miller believes that these cost reduction programs along with the new automated sorting equipment, have somewhat leveled off the rapidly increasing costs of Periodicals mail.

[253] Miller discusses the ongoing efforts of the Mailers' Technical Advisory Committee and Postal Service work groups to reduce Periodicals costs. He states that these groups have "evaluated issues relating to bundle breakage, alternative flats preparation methods, and a new flats container." *Id.* at 2155.

[254] Then Miller discusses USPS-LR-I-332, the library reference that forms the basis for Time Warner et al. witness Stralberg's modeling of costs presented in this docket.³² He testifies that it was developed solely to evaluate three specific Periodicals mail preparation changes.

[255] Third, Miller cites Postal Service attempts to control costs by proposing revisions to the existing rate structure. These changes include the per-piece pallet

³¹ L001 labeling is described in section L001 of the Domestic Mail Manual (DMM).

³² The three changes evaluated in USPS-LR-I-332 are "allowing barcoded and non-barcoded bundles in the same sack"; "elimination of CRRT skin sacks"; and "mandatory compliance with the L001 option." *Id.* at 2161-62; see also Docket No. R2000-1, Response of Postal Service Witness O'Tormey to Interrogatories of Magazine Publishers of America, MPA/USPS-ST42-4. March 9, 2000.

discount proposed in Docket No. R2001-1 and the two experimental co-palletization dropship discounts established in Docket Nos. MC2002-3 and MC2004-1. *Id.* at 2155.

[256] Witness Miller testifies that because the cost drivers associated with Periodicals mail are numerous and depend on a myriad of facility and equipment variations it is impossible to incorporate all of them into the rate structure. *Id.* at 2157. Miller lists the following influences on mail processing costs: the network configuration; building configurations; dock configurations; the mix of processing equipment available at different facilities; and the various processing methods used at different facilities. In addition, he cites: the transportation used to ship mail between postal facilities; destination entry; mailpiece dimensions; mailpiece weight; mailpiece volume or cube; container type; container size; container weight; bundling materials and the associated breakage rates; bundle size; bundle weight; mailpiece machinability; the presence of a barcode on the mailpiece; mailpiece address location; mailpiece return address location; mailpiece “noise”; the use of polywrap; and the frequency of distribution. *Ibid.* Miller does not elaborate on these differences in processing and transportation among facilities, but appears to believe they are somewhat responsible for cost behavior. *Ibid.*

[257] Miller criticizes witness Stralberg's adjustment of manual flats productivity because it “sharply” increases cost estimates. He suggests that a special study may be required to determine the actual productivities in question. *Id.* at 2158. Witness Stralberg's modeling has advanced the knowledge of cost behavior significantly; however, as Miller suggests, a Postal Service commitment to further study this issue would undoubtedly be helpful.

[258] Miller takes issue with witness Stralberg's cost estimates as bottom-up costs. *Id.* at 2158-59. He believes the goal of cost studies should be to calculate avoided or additional costs. He explains that for most classes, the current discounts are based on unit cost differences between the benchmark and the presort categories. Periodicals rates, however, traditionally have not been calculated in this manner. Rather, cost studies have been used. He argues that the flats cost studies used in Docket No. R2001-1 provided more reliable cost estimates than those calculated by witness

Stralberg. *Id.* at 2159-60. This criticism is difficult to understand given witness Stralberg's use of the R2001-1 flats studies as inputs to his updates. Miller also points out that the bundle studies relied upon by witness Stralberg were useful in cost models to isolate the cost impact of mailer presorting and prebarcoding efforts. He describes the use of these estimates in a bottom-up cost analysis as problematic. *Id.* at 2160.

[259] Witness Miller also argues that the basis for witness Stralberg's costs and witness Mitchell's rates, USPS-LR-I-332, was developed to measure broad savings associated with specific preparation changes and may not be valid for use at the rate category level. Without elaborating, Miller further states his belief that USPS-LR-I-332 was not designed to support a grid rate scheme. *Id.* at 2161-62.

[260] Witness Miller's testimony contains three additional criticisms directed at the Stralberg analysis. The first of these addresses witness Stralberg's use of piece distribution costs from the R2001-1 proceeding. Miller argues that these costs represent averages for all flats and should not be used to develop Periodicals costs. Next, he states that the use of bundle sorting cost studies by witness Stralberg is problematic because both studies suffer from several limitations. Finally, he cites examples intended to show that witness Stralberg is inconsistent in how he classifies costs as container related or weight related. *Id.* at 2162-65.

2. Rachel Tang (USPS-RT-2)

[261] Rachel Tang examined the effects of Complainants' proposal on publications of different sizes and densities. She grouped Periodicals by circulation into small (up to 15,000 copies per issue), medium (15,001 to 100,000 copies), and large (over 100,000 copies). Initially, her analysis was based on a random sample of 55 publications out of a population of 29,979 publications. *Id.* at 2222, *et seq.*

[262] Presiding Officer's Information Request No. 2 (POIR No. 2) requested further analysis of Tang's sample of 55 publications and analysis of a larger sample. In response to this request, Tang increased the sample size and provided the data in USPS-LR-1 under protective conditions. The number of publications receiving increases and decreases in postage in the larger sample is shown in Table 4-1 below:

Table 4- 1
Titles with Increases and Decreases at Proposed Rates

	Postage		Total
	Increase	Decrease	Sample
Large	5	46	51
Medium	66	33	99
Small	76	25	101
Total	147	104	251

Source: USPS-LR-1

[263] As shown on Table 4-2, USPS-LR-1 provides a great deal of information concerning the characteristics of publications in the sample grouped by per-issue circulation size. For example, the average number of bundles per container for large publications ranges from 3 to 177 while for small mailers the range is 1 to 26. The average pieces per sack, on the other hand, is similar for both the small publications in the sample and the large publications.

Table 4- 2
Selected Characteristics of Sample Publications

	Small	Medium	Large
Average Number of Sacks	114	2,320	10,292
Average Number of Pallets	1	450	7,800
Average Pieces per Bundle	11.2	11.0	14.2
Average Pieces per Sack	40	43	39

Source: USPS-LR-1

[264] Tang expresses the Postal Service view that a broader approach to considering changes in the Periodicals rate structure should be pursued. She cites impact on customers, operational readiness, and public policy goals as issues that should be considered. *Id.* at 2232. She also testifies that she believes a large number of small publications are not directly represented before the Commission. Response of United States Postal Service Witness Tang to Notice of Inquiry No. 1 Concerning Periodicals Data, December 1, 2004. Over 15,000 publications have per-issue circulation of less than 1,000.

[265] In response to questions from Magazine Publishers Association, Tang describes the experimental co-palletization discounts offered in Docket Nos. MC2002-3 and MC2004-1. *Id.* at 2169. She reports that as a result of these two experiments nearly 73 million pieces have been moved out of sacks and onto pallets as of the end of September 2004. *Id.* at 2171. She further states that the Postal Service believes that

these changes will “allow the Postal Service to process Periodicals mail more efficiently.”
Id. at 2169.

[266] The Commission is appreciative of the Postal Service efforts in response to both information requests and the Notice of Inquiry. These responses provided the most in-depth information on mailing patterns of Outside County regular rate Periodicals ever available.

III. COMPLAINANTS' REBUTTAL TESTIMONY

A. Witness O'Brien (TW et al.-RT-1)

[267] Witness O'Brien³³ responds to critics of the Complainants' proposal by addressing two main considerations. One is why the Complaint was filed; the other is how mailers can change their behavior in response to the incentives in the proposed structure. With respect to the second point, O'Brien asserts that the examples he provides show four things: that mailers are far more capable of changing their mailing practices than they would have the Commission believe; that there is more than adequate time to change mailing behavior prior to a 2006 rate increase; that the printing industry is actively developing the capability to help smaller publishers improve their mailing practices, and more change can be expected if the proposed rate structure is recommended; and that ABM witness Cavnar has presented a misleading view of the publishing industry. Tr. 5/1426.

[268] *Background on the filing of the Complaint.* O'Brien notes that the Complaint identifies a lack of congruity between the elements of the Periodicals rate structure and the actual cost causing characteristics of Periodicals mail, and maintains that this feature has become increasingly troubling — and increasingly well understood — during the nearly three decades of study and analysis since it was first identified. *Id.* at 1427. He emphasizes that improvements in cost analysis, along with advances in mechanization, have shown that costs are determined in meaningful and systematic ways by the makeup of bundles, sacks and pallets and associated interactions, including entry points. *Ibid.*

[269] O'Brien also raises two points about current mailing practices. One is that more than half of Periodicals mail processing costs in today's environment are incurred handling the bundles, sacks and pallets in which mail is entered, yet rates provide little information concerning what these costs might be and, accordingly, there is no way that mailers can make efficient decisions. *Ibid.* The other is that the Complainants allege that

³³ Witness O'Brien is Vice President of Distribution and Postal Affairs for Time Incorporated, a division of Time Warner Inc.

Periodicals mailers, large and small, engage in a widespread practice of sending skin sacks, with only one or two pieces, and maintained that these sacks would become rare if their rates reflected associated cost incurrence. *Ibid.*

[270] O'Brien states that dissatisfaction with the second-class rate structure's failure to reflect costs dates back to the earliest Commission proceedings, but contends that the distinctive "Periodicals cost problem" first came to light in Docket No. R90-1. *Id.* at 1428. He further notes that in Docket No. R97-1, a united magazine publishing industry presented the Commission with a plea for attention to the unresolved problem of Periodicals costs. He notes that the Commission lowered the Periodicals markup to 101 percent, which he characterizes as "the lowest level allowable under the Act." *Ibid.*

[271] O'Brien describes the creation and work of a joint industry/USPS Periodicals Operations Review Team following Docket No. R97-1. He notes, among other things, the team's report identified 15 issues that needed to be addressed, including the following two matters:

The Periodicals rate structure should be reviewed to ensure that it is consistent with the overall Periodicals processing strategy and induces appropriate mailer behavior; and

Consider matrix approach to rates to account for all cost causing characteristics.

Id. at 1429.

[272] O'Brien states that he created the initial draft of a cost-based rate grid in December 1998, with the assistance of Stralberg. He indicates that the rate grid was shared with Postal Service representatives, who acknowledged anomalies in the current structure, and expressed interest in the concept. *Ibid.* He also says that the rate grid and the concept of cost-based rates began to gain support in the mailing community and became one of the focal points for the Postal Service's product redesign effort, but claims

that the Postal Service has never filed its long-awaited case and the burden of advancing the cause of cost-based rates thus fell to the mailing community. *Id.* at 1429-30.

With respect to criticism of the Complainants' proposal, O'Brien claims that ABM, McGraw-Hill and NNA raise three main arguments in opposition to the requested relief:

- that some Periodicals mailers, "due to their size, their business models or other factors" will be unable to change their mailing practices in response to the incentives of a reformed rate structure;
- that "countless" such publications will suffer severe financial harm if the proposed changes are implemented; and
- that the proposed elimination of the unzoned editorial rate "would undermine maintenance of a broad, vibrant and diverse Periodicals class," presumably by driving some of the "countless" small publications out of business.

Id. at 1430 (internal citations omitted). However, he asserts that opposing witnesses have not demonstrated that a single publication, either of their own or among the "countless small and under-represented publications" they claim to represent, and whose identities they are unable to specify, would suffer the consequences they predict. *Ibid.* He therefore dismisses their testimony, claiming all they offer "are anecdotes, bald assertions and pleas for sympathy." *Id.* at 1431.

[273] *Mailers' ability to change.* O'Brien summarizes the opponents' contentions about publishers' ability to respond to the proposed structure as follows: the difficulty of making certain changes, such as altering the sack minimum, especially for small mailers; the infeasibility of, or lack of access to, co-mailing or co-palletizing for some publishers; loyalty to printers who do not offer such services, including contractual barriers to using the support services of a provider other than the printer; and an inadequate amount of time for the industry to adjust to the proposed incentives.

[274] On the issue of the difficulty of making changes, O'Brien presents an example of one decision mailers might face under the proposed structure, which is changing the minimum number of pieces in a sack. His position is that changing this parameter is something any publisher can do, with or without custom or off-the-shelf software. In support of this assertion, he states that he performed this change for *Cottage Living*

magazine in 21 seconds. He asserts that sources at fulfillment houses and software manufacturers have verified that this is an easy change to make. In addition, he asserts that a person doing a manual sort on a kitchen table would need even less than 21 seconds because he need only say to himself that he will not make any sacks with fewer than 24 copies. *Id.* at 1432.

[275] O'Brien maintains that if the proposed structure is approved, mailers will need to analyze their mail preparation practices to determine if operational or business changes are needed. He notes that his company is reviewing the preparation of *Time for Kids* and several small magazines published by Transworld³⁴ because, barring any change in preparation, these publications will experience rate increases under the proposed structure. He attributes the estimated 27% increase for *Time for Kids* to the fact that the proposed rates reflect the cost of firm bundles being processed as bundles, rather than pieces, as they now are. *Id.* at 1433. Thus, he says that the company is looking into mailing fewer, but larger, bundles of *Time for Kids*. O'Brien attributes the Transworld increases to lack of presort, and says co-mailing might allow a deeper presort level. However, he says they are not looking into co-palletizing, because this practice fails to improve presort level. *Id.* at 1435.

[276] O'Brien counters statements that contractual obligations and lack of co-mailing or dropshipping capacity at current printers preclude some publishers from becoming more efficient with the assertion that his company's experience has been "the exact opposite." With respect to co-mailing, he explains:

The Transworld titles are printed at Brown Printing, which does not have its own co-mail program at this point. In addition, these titles have a multi-year agreement that does not expire until June, 2006. Transworld could easily make the assertions that our opponents make by saying that its

³⁴ The magazines O'Brien refers to are *Motocross* (circulation 43,896); *BMX* (circulation 18,336); *Skateboarding* (circulation 70,121); *Snowboarding* (circulation 85,537); and *Ride BMX* (circulation 21,855). *Id.* at 1435. O'Brien states that *BMX* is expected to cease publication after its January 2005 issue. *Ibid.*, n.6.

printer doesn't have the capability to co-mail and it is locked into a contract. But while it is true that Brown Printing doesn't have the ability to co-mail, other printers do and are willing to accept product from competing printing companies.

Id. at 1436 (footnote omitted).

[277] As to contractual obligations, O'Brien says he has more than 30 years in the publishing industry, and asserts that he has never seen a printing contract stipulating that the publisher must distribute its publications through the printer's network. Id. at 1437. In fact, he states that his company's "boilerplate" language reads as follows: "Printer shall prepare all copies of the Magazine for mailing or other shipment in accordance with the Publisher's instructions and all United States Postal laws and regulations applicable to the Magazine's postal classifications." Ibid. Thus, he says Transworld can simply ship unlabeled copies to Quebecor World's co-mail operation without any effect upon the contract with Brown Printing. Ibid. Thus, O'Brien considers the issue of contractual obligations a red herring and maintains that printing contracts do not dictate distribution methods. In particular, he says printers work very hard at being good business partners and do not want to lose their pre-press, press and bindery work over a distribution issue. Ibid.

[278] O'Brien also claims that lack of time to prepare for cost-based rates is also completely unfounded, as any resulting rates would not take effect for quite some time. Id. at 1438. He further notes that printers and suppliers are already positioning themselves to offer support services to mailers in anticipation of a more rational rate structure for Periodicals. Id. at 1439-40. He contends that these developments "run 180 degrees counter to witness Cavnar's statement that co-palletization and co-mailing 'will not be available to many periodicals for a number of reasons.'" Id. at 1440.

[279] *Perspective on witness Cavnar's view of the publishing industry.* O'Brien also disputes two other claims that witness Cavnar makes. One is that some publications will have no choice but to continue mailing in sacks because their mailing characteristics preclude doing otherwise; the other is that if a publication folds, a related website may

fold as well. O'Brien asserts that this is intended to have the Commission believe that some characteristics are completely static. *Id.* at 1441. He claims this is not the case, and points out that *Fortune* magazine has changed its trim size over the years in response to postage rate increases. *Ibid.* Thus, he says that contrary to Cavnar's claim, publishers do have a choice in determining their mailing characteristics, and maintains that if they choose to create pieces that must be manually processed, their rates should reflect the difference. *Ibid.*

[280] With respect to the website claim, O'Brien cites two examples. One is *Microsoft Certified Professional*, which has been reported as deriving 53% of sales from e-media. O'Brien suggests that this may mean that the electronic publication is the primary revenue driver and would succeed in the absence of its print component. *Ibid.* The second example is *Hope* magazine, which O'Brien says has been reported to be close to folding. If this occurs, O'Brien says the publisher, among other things, has stated that he intends to pursue publishing the content in another format, such as a newsletter or website. *Id.* at 1441-42.

[281] Finally, O'Brien notes that business-to-business publishers are aggressively pursuing digital alternatives to their print formats. He also points to differing views on the record, noting that one ABM member has said that she is surprised at the number of people who say they will take digital magazines, while Cavnar has said many readers simply will not accept the same information on a computer. *Id.* at 1442. His overall assessment is that business publishers appear to have a strategy of attempting to hold onto a favorable postage rate through the use of cost averaging, even as they develop an exit strategy from printed products. *Ibid.* O'Brien asserts that this raises the following question: "how long should we allow these publications to hold veto power over the balance of the publishing industry that is ready to roll up its sleeves and take action to drive costs out of the system in an effort to solidify our future?" *Ibid.*

B. Witness Stralberg (TW et al-RT-2)

[282] Stralberg's rebuttal testimony focuses mainly on rate impact arguments, which he generally considers exaggerated as they relate to small publications. *Id.* at 1540. In general, Stralberg testifies that the very high increases referred to on the record will not occur because they can be avoided by "the simple action" of using higher sack minimums, without the need for any capital investments or access to co-mailing/co-palletizing services. He believes that this likely would be done very quickly if the proposed rates were to become a reality. *Id.* at 1552. Stralberg also addresses the suggestion that fundamental changes should await changes in technology, a contention about the effect of previous large rate increases on mailers' behavior, service needs, and concerns that the proposed rate schedule is unduly complex. *Id.* at 1566-68.

[283] Stralberg develops a rate structure that retains all the features Mitchell presents, with the exception of the zoned editorial pound charge.³⁵ He then analyzes the impact of both the proposed rates and the modified schedule (using a new pound rate in the latter) in the context of three groups of publications.³⁶ *Id.* at 1544. These include the set of 251 publications of all sizes that witness Tang randomly selected from the universe of all outside county publications; 153 small and medium-sized publications belonging to five ABM member companies; and small newspapers, with the focus on a "typical" newspaper described by witness Crews. *Id.* at 1545.

[284] For the first group, Stralberg presents two tables that summarize key mailing characteristics for 51 low-density and 50 high-density publications, and asserts that both tables "tell similar stories."³⁷ *Id.* at 1547. In particular, he contends that the top rows in Table A-1 (which contain publications whose percent increases would be largest) show

³⁵ Stralberg uses an editorial pound rate of 12.95 cents in his modified schedule. See TW et al. LR-5.

³⁶ Stralberg describes his approach and results at Tr.5/1545-1562.

³⁷ Exhibit A, Table A-1 presents characteristics for small low-density publications; Table A-2 presents similar characteristics for small high-density publications. *Id.* at 1547.

that these publications tend to use sacks with few pieces and few bundles; in fact, he says that many have exactly one bundle per sack. *Id.* at 1548.

[285] Stralberg acknowledges that there are some exceptions to the trends he finds in both tables, but believes it is clear that the very high increases shown by Tang, like the similarly high increases cited by ABM witnesses, will not occur if publications, in response to more cost-based rates, stop using low-volume sacks and lower presort levels and, when faced with no palletization alternative, use fewer and fuller sacks with lower presort. He maintains that these sacks will be opened at an earlier stage, thereby allowing the mail to travel as bundles and loose pieces, which he contends the Postal Service can sort much more cheaply than sacks. *Id.* at 1549.

[286] *Publications studied by ABM members.* Stralberg also presents some of his analysis of the group of publications reviewed by ABM members in two tables.³⁸ Stralberg contends, among other things, that his Table B1 shows there is a very direct correlation between low sack minimums (a parameter which he maintains is set during the fulfillment process), low sack contents, and high postage increases under the proposed rates. *Id.* at 1551. He also points out that the five publications with low sack contents all are monthlies, and that the one weekly in the sample uses much fuller sacks (42 pieces). *Ibid.*

[287] Stralberg concludes that the very high potential postage increases for some publications referred to by Bradfield and other ABM witnesses are directly correlated with the practice of using skin sacks. Moreover, he maintains that the publications that engage in this practice, at least as far as his exhibits are concerned, are not particularly time sensitive. He therefore concludes that claims asserting that the use of skin sacks is necessary for service reasons have little or no merit. *Id.* at 1551-1552.

[288] Based on these observations, Stralberg claims it is easy to see the fallacy in witness Cavnar's claim that "many Periodicals mailers would see their rates increase above the Standard rates, creating it would seem, an ECSI penalty." *Id.* at 1552. In

³⁸ Exhibit B, Tables B1 and B2. Documentation for Stralberg's analysis of this group is contained, in part, in TW et al. LR-7.

particular, he says Cavnar failed to consider that skin sacks are not used for Standard flats, which instead are subject to a 125-piece requirement or 15-pound minimum. *Ibid.*

[289] *Small newspapers.* Stralberg's analysis of small newspapers focuses on the *Cameron Citizen Observer*, a western Missouri publication.³⁹ Based on certain information and assumptions, Stralberg estimates that total current postage for this newspaper's 81 copies is \$33.48 per issue, and that postage under the Complainants' proposed rates would be \$39.73, reflecting an increase of 18.7 percent. *Id.* at 1559. Stralberg believes the main reason these copies would cost more, even after eliminating unnecessary sacks, is that his calculation assumes they are nonmachinable. He notes, however, that if the copies were machinable, postage would be \$29.20, or a decrease of 12.8%. *Id.* at 1560.

[290] Stralberg also says he assumes that the 81 copies have no bundle presort beyond the mixed ADC level. However, he says that the newspaper's remote subscribers apparently live in clusters, which might make some bundle sorting to the ADC level feasible. In the event that the 81 copies can be divided among nine ADC bundles, but still be mailed in one mixed ADC sack, Stralberg says total postage would be \$32.45, or 3.1% lower than current postage, assuming nonmachinability. Under the same scenario, but assuming machinability, Stralberg says postage would be 14.19% less than under current rates. Thus, he says that even the portion of a local newspaper that would appear most vulnerable to cost-based rates would not have to pay significantly more than at present, and might even pay less, if the use of many low-volume sacks is avoided. *Ibid.*

[291] *Service.* Stralberg presents two main reasons why he does not believe the 81 copies would be delivered any faster if they were mailed in many low-volume sacks. First, he notes that NNA witness Crews says that the *Atchison County Mail* enters its copies in tubs, rather than sacks, and that there have been very few service complaints since this switch was made. *Id.* at 1560-61. Second, he contends the Service does "a

³⁹ TW et al. LR-11 contains Excel spreadsheets supporting Stralberg's estimates.

reasonably good job” these days of sorting flats and is improving its bundle handling capacity, but that sack sorting, at least outside of the BMCs, is a slower, costlier and more damage prone process. Id at 1561. He therefore contends that it makes more sense for a very small volume of flats and flats bundles, such as the non-local copies of the Cameron and Atchison County papers, to be entered with mixed ADC presort at the originating plant and to allow them to travel from that point as bundles or loose flats. Stralberg notes that this is how First-Class Mail flats travel through the system, and says there appear to be relatively few complaints about their service. Ibid.

[292] Stralberg also says that using tubs instead of sacks for such small volumes appears to make sense, at least when agreeable to management at the originating post office, and he suggests it might make sense for the Postal Service to codify such a methodology in its mail preparation regulations. In particular, he notes that dumping flats from a flats tub probably costs a lot less than dumping them from a sack. Id. at 1561-1562.

[293] Stralberg further observes that it is known that Periodicals that are entered far from the destination office occasionally incur very long delays, sometimes of several weeks, and acknowledges that he has experienced this on several occasions. Id. at 1562. He also says it is known that mailers as well as recipients of Periodicals often complain about service delays and that some postal managers, rather than address the underlying problems in postal operations that cause the delays, advise mailers to put their mail pieces in low-volume, high-presort sacks. However, he says “the inevitable result” is to cause more work for postal facilities, “which can only increase the chances of even more service delays as well as higher Periodicals costs.” Id. at 1563.

[294] As to concerns that container presort level could make a one or two-day difference in time to delivery, Stralberg presents an example that focuses on a small mailer that enters mail at the origin office for delivery at a remote location and that does not have the option of co-mailing or co-palletization.⁴⁰ Two key considerations are that:

- the mail will travel through the system first in sacks, then in bundles, and eventually as single pieces; and
- the presort level of the sack will determines how far into the system the mail will stay in the sack before it hits bundle and piece sorting operations.

[295] Stralberg says the three types of choices the mailer might have to make are: (1) whether to split a 3-digit/SCF sack into smaller 5-digit sacks; (2) whether to split an ADC sack into smaller 3-digit/SCF sacks; and (3) whether to split a mixed ADC sack into smaller ADC sacks. *Ibid.* He then reviews these situations and, among other things, acknowledges that in the 3-digit/SCF versus ADC sacks situation there may be some examples where mail in the 3-digit/SCF sacks could get faster delivery to some addresses under the present Postal Service sorting scheme. *Id.* at 1564. However, when a small mailer has a few ADC bundles and the choice is between ADC sacks and mixed ADC sacks, Stralberg contends it is hard to see how there could be any service advantage in using the smaller sacks. *Id.* at 1565. His reasoning is that if one mixed ADC sack is used, it will immediately be dumped at a belt in the originating facility, where the bundles are sorted and dispatched to each ADC, but if several ADC sacks are used, they must be sorted, most likely manually, at the originating facility. *Ibid.* Since there are over 90 ADCs, Stralberg says this sorting may require more than one iteration with probabilities of delay at least as large as for the bundles that were in the mixed ADC sack. He says that when they get to the destination ADC, the bundles that were sorted at the originating facility will go directly to the bundle sorting operation at the destination

⁴⁰ Stralberg contends that it is obvious that occasional very long service delays have nothing to do with container presort level, but stem from a breakdown in postal operations, such as mail getting stuck in a corner and not being moved for a long time. He maintains that avoiding these types of delays are the Service's responsibility. *Ibid.*

ADC, while the bundles that are still in ADC sacks must wait for those sacks to be sorted. Ibid.

[296] Thus, Stralberg concludes that mailers engage in the practice of using many small sacks for two reasons: because it is free under current rates and because they think it might reduce time to delivery. However, except possibly in the case of 3-digit versus ADC sacks, he believes there is no real reason to believe this practice will help delivery. Moreover, he says the only empirical “study” that anyone has referred to — the Carol Stream study — points in the opposite direction. Ibid. Stralberg maintains that once the use of “skin sacks” is no longer free, as with implementation of the type of rates the Complainants have proposed, he expects their use to drop dramatically, and he says this should lead lower Periodicals costs. Ibid.

[297] *Future automation.* Stralberg dismisses as irrelevant witness Bradfield’s suggestion that future automation, in the form of FSS or DPP, is a reason to forgo restructuring at this time. In particular, he notes that both automation concepts deal exclusively with what happens to the flats after they have arrived at the destinating SCF and have been sorted to the 5-digit ZIP Code level, while the Complainants’ proposal deals primarily with what happens before the destination SCF. Thus, he says that no matter how flats are eventually sequenced for delivery, they still need to get to the destination SCF as rapidly and inexpensively as possible.⁴¹ Id. at 1566-67.

[298] *Effect of past rate increases on mailer behavior.* In response to witness Bradfield, Stralberg says that Periodicals costs would be much higher than they are now, were it not for the very substantial changes that many Periodicals mailers have made, and that all mailers would be paying substantially higher rates. Id. at 1567. He also says that there are at least some segments of the industry (those whose postage would increase the most under the proposed rates) that can make more changes, such as using fuller sacks if palletization is not an alternative. Ibid.

⁴¹ Stralberg acknowledges that implementation of FSS or DPP may affect the value of carrier route presorting, but asserts that this case is not about that issue. Id. at 1567.

[299] *Complexity*. Stralberg notes that McGraw-Hill witness Schaefer expresses great concern about “unmanageably complex” price signals that will overwhelm most Periodicals mailers and that he indicates, among other things, that suitable software is not available. However, Stralberg asserts that Schaefer, like so many opponents, sees only the difficulties and not the tremendous opportunities that cost-based price signals open up. *Id.* at 1568. Stralberg maintains that the proposed rates will inform mailers what their mail costs as it is currently being prepared, and thus “will mobilize the ingenuity of small and large mailers as well as professional software developers to find ways to prepare a mailing so as to minimize the combined cost to the mailer and the Postal Service.” *Ibid.* Stralberg also points out that by 2006, when cost-based rates of the type proposed could go into effect, developers of Periodicals fulfillment software will have had time to modify their programs; however, even if this were not the case, he says existing software may already give reasonably good results by proper setting of user-defined parameters such as sack minimums. *Id.* at 1570.

[300] Stralberg testifies that he performed a separate analysis that addresses why some small publications would do quite well under the proposed rates, while others might have increases approaching 90%, and that the answer is simpler than anticipated: that it is really mostly about the use of skin sacks. He says that each data source indicated that the practice of using skin sacks extends far beyond the weekly and daily publications who might argue that they do it for the perceived service benefit. In fact, he says the practice is used by publications with as few as four issues per year. *Id.* at 1571.

[301] Stralberg says that another important characteristic that would affect postage under the proposed rates is mailpiece machinability. *Ibid.* He says that some publications may be able to change their mailpiece format to achieve machinability, and that others may be unable to do so or may have reasons for not wanting to. However, he believes, in any case, that it is fair and reasonable that the extra costs of handling odd-size pieces should be borne by those who put them in the mailstream. *Ibid.* At the same time, however, he believes the definition of machinability must be realistic, and he

says this probably includes expanding the current 20-ounce weight limit for flats that meet all other machinability criteria. Ibid. (n.31).

IV. POSITION OF OTHER PARTICIPANTS

A. American Postal Workers Union, AFL-CIO (APWU)

[302] The APWU argues three main points: that the Complainants are proposing a radical departure from the current rate methodology; that the proposed structure has cost-shifting potential, raising rates for many smaller publications while lowering them for larger ones; and that a complaint proceeding is not the vehicle for introducing radical changes. Its overall conclusion is that the Commission should not recommend any classification changes in Periodicals but, at most, share with the Postal Service any insight it has gained that might assist the Postal Service in its attempts to address Periodicals service and costs. Initial Brief of the American Postal Workers Union, AFL-CIO, December 27, 2004 (APWU Initial Brief) at 4-5.

[303] *Contentions regarding Complainants' methodology.* APWU notes that the Complainants' proposal entails de-averaging certain costs, and moves from a system based strictly on piece and pound charges, to one that includes additional charges for bundles, sacks and pallets. Based on these factors, it claims that the Complainants argue "for a completely different system" for Periodicals. *Id.* at 2. However, it asserts that cost averaging is used in every class of mail, and that any decision to reduce cost averaging in Periodicals has wider implications for rate setting. In particular, it claims that the Complainants' approach would depart from the Commission's practice of using a benchmark in setting discounts for certain mailer activities that reduce Postal Service costs. *Ibid.* In its view, use of a benchmark is preferable because it preserves much of the pre-discount cost sharing and averaging, so that the new discount does not result in a shifting of costs with an immediate higher rate to non-discount mailers. *Ibid.*

[304] *Cost-shifting and impact on the APWU Postal Worker.* APWU notes that based on a rate-calculation program provided by the Complainants, the *APWU Postal Worker* would pay higher rates under the proposal. *Ibid.* It says that in response to an inquiry about whether and how it could lower its postage costs, Complainants responded that since the publication was already heavily palletized, co-palletizing or co-mailing might be necessary. They also said that mailing from a central location would provide a

widely distributed publication with a lower average haul, but noted that the most important factor would likely be what the printer is able to offer in the way of coordinating with other mailings. *Id.* at 3.

[305] However, APWU asserts that the record “clearly shows that co-mailing and co-palletizing remedies touted are not available to all the periodicals mailers and may be particularly unavailable to small mailers.” *Ibid.* (footnote omitted). It further claims:

The Complainants seek periodical rates that help them lower their costs — in part by shifting additional burden for the inefficiencies inevitable with universal service to mailers that cannot duplicate the Complainants mailing practices. There are other ways to promote ‘efficient’ mailing practices that do not raise rates for small mailers. With a universal service we will have small mailers without the resources to provide low cost pieces to the Postal Service. Nonetheless, they are entitled to mail at reasonable rates. The Commission ought to consider long and hard before introducing a classification structure [that] would input higher rates for small mailers while lowering rates for many of the larger mailers.

Ibid.

[306] Moreover, APWU argues that the record does not provide the Commission with a good understanding of the potential impact of the Complainants’ proposal “on truly small mailers.” *Ibid.*

[307] *Use of the statutory complaint mechanism.* APWU also maintains that the Commission violated its own rules in accepting the Complaint, and should not now do more harm by making recommendations favorable to the Complainants. *Id.* at 4. It contends that the question of whether there are better ways to set rates — and a possible set of rates that are more consistent with rate setting criteria or fairer to all concerned — is a matter for a future omnibus rate case. It claims that the Commission should not have imposed upon interested parties the expense of participating in this proceeding and should do nothing that will invite more attempts to use the Complaint procedure as a substitute for mail classification and rate cases.

B. Magazine Publishers of America, Inc. (MPA)

[308] MPA supports the Complainants' proposal, and urges the Commission to 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. MPA Initial Brief at 3-4. It maintains that the importance and necessity of moving to postal classifications and rates that better reflect costs is well accepted, although opinions differ as to the pace of the move. *Id.* at 1. It also believes that cost-based rates would be beneficial to the Outside County Periodicals subclass as a whole, and that ample lead times can mitigate the higher rates that some publications would incur under the Complainants' proposal. *Id.* at 2. In support of its position, MPA identifies potential beneficial impacts of the proposal; addresses the consistency of cost-based rates with statutory provisions governing classifications and rates; suggests that an impact analysis is appropriate; and discusses ways to mitigate impact.

[309] *Potential benefits.* MPA contends that potential benefits include the possibility that many publications, including a large number of very small ones, such as those with circulations no greater than 1,000, may well experience rate decreases under the proposal. *Ibid.* In particular, it maintains that zoned editorial pound rates would provide a benefit to very small publications because many of them, such as local newspapers, church bulletins, and local interest group publications are distributed locally. *Ibid.* In addition, it says that many very small publications would benefit if they begin using higher-volume sacks. *Ibid.*

[310] *Consistency with the statutory framework for Periodicals.* MPA asserts that the Complainants' Memorandum thoroughly describes the history of rate preferences for magazines and newspapers, and notes that it fully supports the continuation of these preferences. *Id.* at 4. Moreover, MPA claims that 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. *Id.* at 5. It

notes, for example, that while the Postal Service can deliver a newspaper or magazine to any address it serves, 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. *Ibid.* It also points out that even for those with access to the Internet, not all of the content of hard-copy magazines is available on the web. *Ibid.* However, MPA argues that the continuation of a preferred status for magazines and newspapers need not deter the adoption of classification proposals (such as those presented here) which will result in better cost-based rates, nor does it require the continuation of an unzoned editorial pound charge. *Ibid.*

[311] MPA asserts that the Complainants' Memorandum discusses in detail why neither 39 U.S.C. § 101(a) nor 39 U.S.C. § 3622(b)(8), the two statutory provisions that support the historical preference for magazines and newspapers, precludes recommendation of cost-based classifications and rates. *Id.* at 5-6. In addition, it says that it believes that measuring whether cost-based rates and classifications are consistent with section 101(a) requires examining whether the adverse impact, if any, is severe, and if so whether it can be reasonably mitigated. *Id.* at 6. It suggests:

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.

Ibid. (footnote omitted).

[312] MPA believes that the statutory requirement that rates and classifications be fair and equitable is not inconsistent with cost-based rates. *Id.* at 7.

[313] *Impact.* MPA asserts that in analyzing impact, it is important for the Commission to keep three points in mind: that impact estimates on the record assume that publishers do not change their mailing practices in response to a new set of rates; that no particular set of rates will be recommended in this docket; and that if the Commission recommends classification changes in this docket, no rate changes will occur until calendar year 2006 at the earliest, and then only following extensive review in an omnibus rate case. *Ibid.* It says this means that the Periodicals industry will have substantial “lead” time to adjust as necessary to a new classification structure and to any resulting rate changes. It also says that the Commission could mitigate impact by recommending less-than-100% passthroughs, as it often does when new discounts are introduced, suggesting that this approach could be applied to the sack charges applied to users of small sacks. *Id.* at 7-8. Similarly, it says the Commission could initially base zoned editorial pound rates on less than the full cost avoidance. *Id.* at 8.

[314] MPA points out that impact can be beneficial as well as adverse, and asserts that establishing a “fair and equitable” classification schedule “requires balancing the good with the not so good.” *Ibid.* In particular, it argues that the Commission should not make its recommendation in this case based solely upon potential negative impact, and notes that some responses to Notice of Inquiry No. 1 show that many small publications (such as newspapers, church bulletins, and interest group publications) are distributed locally and would benefit from the proposed zoned editorial pound charge, as well as the Complainants’ proposal considered in its entirety. *Ibid.*

[315] One of the benefits MPA sees in the proposal is a reduction in 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. Another benefit is that more 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, thereby allowing the Postal Service to process Periodicals mail more efficiently. It notes, in connection with these benefits, that reducing combined costs is essential to maintaining a healthy Periodicals industry and that

increasing efficiency is critical to controlling Periodicals rates over the long run. *Id.* at 9. It claims that there is no question that the rates suggested by Complainants 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. *Ibid.*

[316] *Mitigation.* MPA acknowledges that there are potential adverse rate consequences for some mailers, including its members, from classifications such as those proposed by the Complainants if they do not act to mitigate those effects. However, it believes that the record shows that publishers can act to mitigate adverse effects by co-palletizing, co-mailing, dropshipping and increasing sack size. *Ibid.* It notes the significant amount of dropshipping that currently occurs indicates that dropshipping services are widely available, but says that appropriate discounts are needed to make the practice cost effective for more publishers. If an incentive to dropship editorial pounds were provided, MPA believes many of the publishers who cannot cost effectively dropship now would immediately begin doing so, thereby mitigating any adverse impact and potentially benefiting from cost-based rates. *Id.* at 10.

[317] MPA also contends that the record shows that more printers and third-party vendors are offering co-mailing and co-palletizing services than in the past. It cites witness O'Brien's testimony about the increased availability of co-mailing and co-palletizing services, printers' and vendors' willingness to accept publications from other printers into their worksharing programs, and about the absence of any terms in printing contracts which would operate as impediments to improved mail preparation. *Ibid.* MPA says witness 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. *Ibid.* However, it says this success is limited because increased discounts are necessary to make co-mailing and co-palletizing services attractive to more mailers. *Ibid.* It adds that 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 through September 2004, an amount it refers to as "a very small fraction of the

billions of sacked Periodicals Outside County flats mailed each year.” Id. at 10-11 (footnote omitted).

[318] *Sacks*. MPA says that under the Complainants’ proposals, the most significant adverse impact would accrue to publishers that mail in “small” sacks, or those containing fewer than — and often many fewer than — 24 mailpieces. Id. at 11. It notes that while no empirical data has been presented to support the perception, the record shows that the primary concern preventing mailers from putting more pieces in sacks is the perception that doing so could adversely affect delivery service. Id. at 12. However, it says that there is ample opportunity to address this issue before the next omnibus rate case. In the interim, it says that it 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. Ibid. It contends that 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. It says this will allow mailers to substantially mitigate rate impact (and at the same time reduce Postal Service costs) with no adverse effect on service. Ibid.

[319] *Responses*. The Postal Service takes issue with MPA’s claim that adverse rate impacts from the Complainants’ proposed rate structure could be mitigated by “basing sack charges on less-than-100% passthrough.” Postal Service Reply Brief at 7. It asserts that sack prices are not designed using passthroughs under Complainants’ proposal; instead, they directly match the “bottom-up” sack costs provided by witness Stralberg, and do not reflect a cost differential or any passthrough. Id. at 7-8. Thus, the Postal Service says that rate mitigation would not be merely a matter of adjusting a passthrough, but would be much more complex because the rate design process would involve determining which costs should be fully covered and marked up, and which would not, with rationales that explain the different treatment. Thus, it says that the process is not nearly as simple as MPA states. Id. at 8.

C. Office of the Consumer Advocate (OCA)

[320] The OCA contends that the chief policy issue in this case should be articulated as follows: “Should cost efficiencies of the type proposed by the Complainants outweigh the Congressional policy of favoring particular mail matter that has educational, cultural, scientific, and informational value to the recipient?” It does not challenge the Complainants’ implication that the proposed rate structure may result in a total increase in the volume of Periodicals mail, coming primarily from high-volume publications with the ability to presort finely large volumes of mail that can be entered at downstream facilities. However, it claims that this would result in “the likely demise” of many small publications that could not achieve the efficiencies, and therefore would be faced with devastating price increases. OCA Brief at 2 (emphasis omitted). The OCA warns of media concentration, asserting that the need to preserve diverse points of view is more, rather than less, pressing today than at the time of postal reorganization. *Id.* at 3.

[321] The OCA states that the Complainants’ attempt to weaken the geographic basis for the Commission’s policy, particularly with witness Gordon’s testimony that the Internet allows even low-volume, financially weak purveyors of information and opinion the opportunity to reach a wide audience at low cost. *Id.* at 8. It notes that witness Gordon, among other things, claims: “There is no longer the slightest chance that setting postal rates for editorial content in Periodicals class mail by zones to reflect actual costs would cause the country to be divided by these zones.” *Id.* at 9. However, the OCA claims that witness Gordon’s conclusions were eroded through cross-examination and the testimony of other intervenors. *Id.* at 9-12. One alleged concession in the course of cross-examination is witness Gordon’s agreement that ‘it is often difficult to assess the timeliness and accuracy of information found in any medium, including websites.’ *Id.* at 9, citing Tr. 3/651. Another is his acknowledgement that television programming is not an adequate substitute for many business publications. *Ibid.*, citing Tr. 3/665. In addition, the OCA claims that witness Gordon was unable to cite any Internet news group that furnished depth of coverage equivalent to that supplied by a long list of ABM

member publications. *Ibid.*, citing Tr. 3/679. In terms of the testimony of other witnesses, the OCA cites ABM witness Cavnar’s statement that revenue from hard-copy sales are generally the platform atop which Internet access is added incrementally. *Id.* at 10, citing ABM-T-1 at 17.

[322] *OCA’s recommendation.* The OCA’s position is that the specific social policies articulated in § 3622(8) and the more general authority to apply “other factors as the Commission may deem appropriate” in § 3622(9) and § 3623(6) should be used to preserve a Periodicals rate structure that promotes the wide dissemination of diverse ideas, information, and opinion by small, nationwide publications that might be driven out of business by the strictly cost-based pricing scheme proposed by the Complainants. *Id.* at 12. It contends that rejecting the Complainants’ proposed rate structure is a sound, defensible course of action for the Commission, and urges the Commission to do so.

[323] As an alternative, OCA suggests what it describes as the “Alaska air” approach. It reasons:

The parallel that the Commission faced for parcel post — recovery of destructively high Alaska air transportation costs solely from other parcel post mailers — and the current dilemma — recovery of above-average processing and transportation costs allegedly caused by inefficient low-volume Periodicals mailers solely from other Periodicals mailers — should lead to a parallel costing approach.

Id. at 12-13.

[324] The OCA cites Dr. Haldi’s testimony (in Docket No. R90-1) stating that costs that cannot be recovered through pricing nor reduced by abandoning particular services are “inescapable” and therefore must be subsidized by taxpayers or other parts of the enterprise. *Id.* at 13 (footnote omitted). It also states that Haldi has testified that there are good reasons for not charging the entire amount of an inherent subsidy to a relatively narrow subclass. *Ibid.*

[325] The OCA recognizes that while the concern with parcel post rates was that the Postal Service would lose significant volume to competitors, the concern here is different and, as expressed by the *MOAA* court,⁴² is that the overall level of Periodicals mailed is depressed by charging high-volume Periodicals postage that is higher than their marginal costs. *Id.* at 13-14. Thus, it says the question is why the Commission long favored an unzoned editorial rate and eschewed wholly bottom-line oriented rates. It claims the answer is that Congress's policy, as articulated in the Postal Reorganization Act, is to favor ECSI value mail matter, as well as to bind the nation together. It says the Commission interprets these dual objectives as a policy that favors the broad dissemination of printed publications to all areas of the nation, whether they are far apart, or rural in character.

[326] The OCA claims that the Complainants have not proven that viable alternatives exist to the distribution of low-volume publications under a subsidized rate structure, but asserts that this does not necessarily lead to the conclusion that responsibility for the desirable social policy goal of broad dissemination of ideas should rest solely with high-volume publications. It says that if important social policies prevent structuring the Periodicals subclass along the lines of strict economic efficiency, the Commission should consider identifying that portion of Periodicals costs that results from satisfying that social imperative. It suggests the Commission might wish to approach the costing exercise in a manner similar to its estimates for Alaska air costs: charge low volume publications rates that economically efficient publications pay, and costs above that — which might drive small publications entirely out of circulation — should be viewed as institutional costs to be borne by all classes of mail, not just from other Periodicals. *Id.* at 14-15.

[327] The likely consequences of adopting such an approach, in the OCA's view, include having more high-volume publications in circulation, avoiding driving low-volume Periodicals out of business, and placing the Commission in the position of not favoring

⁴² *Mail Order Assoc. of America*, 2 F.3d 408, 436 (D.C. Cir. 1993) (*MOAA*).

any particular Periodicals, which it claims is a consideration the *MOAA* court cautioned against. *Id.* at 15. In addition, the OCA says the welfare of *all* ECSI mail matter would be preserved and enhanced by contributions from the widest group of mailers over which the Commission has authority — the entire mailing community. It says:

As Dr. Haldi pointed out in Docket No. R90-1, taxpayers, more than ratepayers should properly bear the excess costs produced by preservation of diverse, independent points of view. Naturally, this is outside of the powers delegated to the Commission by Congress under the PRA. The next best alternative is to charge excess costs to the broadest community over which the Commission does exercise authority — postal ratepayers. If the Commission has the power to shield parcel post ratepayers from the excess cost of Alaska air, it surely can exercise its powers similarly for the benefit of recipients of ECSI mail matter and the broad, democratic ideals of the nation as a whole.

Id. at 15-16.

[328] The OCA notes that the Commission found that the Postal Service's universal service obligation was the root cause of the Alaska air costs. It says that likewise, the special value Congress placed on ECSI mail matter is the root cause of maintaining an unzonned editorial rate and extended averaging in the Periodicals class. *Id.* at 16.

[329] The OCA says that although the total amount of excess cost has not been calculated in this proceeding, it believes that incorporating that amount into the institutional cost pool will have a *de minimis* effect on the rates of other postal ratepayers, including First-Class. It therefore recommends that the Commission instruct the Postal Service to submit testimony in the next rate case that estimates the amount of extra cost that is generated in the processing and transportation of low-volume Periodicals. Once this has been estimated, the OCA recommends shifting that amount out of the attributable costs to be recovered from Periodicals and into the institutional cost pool recovered from all ratepayers. *Id.* at 16-17.

[330] *Responses to OCA's arguments.* The Postal Service argues that the OCA's proposed extension of "Alaska air" treatment to Periodicals should be rejected out of hand due to procedural and substantive deficiencies. One alleged defect is the OCA's failure to raise this suggestion in testimony. The Service notes "... by waiting to advance this proposal until the briefing stage of this proceeding, the OCA has guaranteed that there is absolutely nothing in the evidentiary record to support it." Postal Service Reply Brief at 2. Another claimed deficiency is the OCA's failure to cite any basis to conclude that the complaint has been justified. Therefore, the Postal Service says that like the Complainants, the OCA has failed to identify any means by which the Commission can do other than terminate the proceeding as unjustified. *Id.* at 2-3. A third procedural problem the Postal Service raises is that even if the Commission were to find the complaint to be justified, the sole remedy under section 3662 would be to issue a recommended decision to the Governors. *Id.* at 3. In particular, the Postal Service asserts that there is no statutory authority for the Commission to issue instructions to the Postal Service to submit testimony in the next rate case containing estimates of the amount of costs that would be shifted from attributable to institutional. *Ibid.*

[331] As a substantive matter, the Postal Service says the OCA's proposal is equally flawed. First, it claims that the alleged similarities between the Alaska air costs and "excess" Periodicals costs are illusory. It explains:

In the Alaska situation, geographic and climatic conditions cause infrastructure deficiencies (i.e., the lack of roads) which require the Postal Service to provide a higher level of transportation, and thereby incur additional costs not required to deliver similar mail elsewhere. With respect to Periodicals mail, however, there are no service distinctions or operational factors which result in the Postal Service handling any category of Periodicals mail differently. In other words, in Alaska, operational and other factors cause the creation of a distinct pool of costs (air costs) that would not have been incurred absent those operational limitations, and the premium adjustment is limited to the treatment of that well-defined cost pool. For Periodicals, however, there is no

difference in cost incurrence and no operationally-defined cost pool to be reallocated.

Id. at 3-4.

[332] Moreover, the Postal Service claims that while the OCA bases its cost shifting proposal on “high-volume” publications versus “low-volume” publications, both types of publications use the same operations, but to different degrees. It says that without an operations-based cost pool or service distinctions, the treatment of costs would become merely a function of the identity of the mailer and, as a practical matter, that parties would continually be trying to shift the line between subsidized and non-subsidized publications to suit their own interests. Id. at 4 (footnotes omitted).

[333] Another criticism is that the OCA’s suggestion embodies the view that it is possible to maintain low rates for low cost Periodicals and low rates for high cost Periodicals, and that it is unnecessary to attempt to use the rate structure to encourage all Periodical mailers to take whatever steps they reasonably can to minimize the costs incurred by the Postal Service to handle their publications. Id. at 4-5. The Postal Service asserts that the OCA seems “willing to abandon completely” any notion that high cost Periodicals could ever alter any of their cost causing characteristics, and thereby reduce the amount of postal resources required to deliver them. Instead, it says the OCA proposes a regime in which portions of Periodicals costs are, in effect, perpetually subsidized by all mailers. Id. at 5 (footnote omitted). The Postal Service claims that while this result may appear to advance the goal of widespread dissemination of information, it conflicts with the more fundamental statutory objective that all subclasses of mail cover their own costs. Ibid., citing 39 U.S.C. § 3622(b)(3).

[334] The Postal Service observes that establishing the best possible postal rates requires that hard choices must be made, and notes that the OCA’s suggestion may seem like an attractive option to avoid having to make hard choices. However, it asserts that its adoption would constitute neither good policy nor good economics, and argues that it should have no bearing on the Commission’s resolution of the complaint. Ibid.

D. National Newspaper Association (NNA)

[335] NNA addresses four main points in its initial brief: impact on member publications; use of the statutory complaint mechanism; the policy of “binding the nation together” and opposition to a sack charge, which it characterizes as a “penalty” in the absence of a viable alternative.

[336] With respect to impact, NNA contends that the “cost-based rates” that the Complainants are urging upon the Commission would force many small publications to make stark and equally unwelcome choices. It summarizes the scenario low-volume periodical publishers would face as follows:

Either they could jettison local and regional printers they presumably are using today and find large national printers to amass their mail into greater and more ‘efficient’ volumes on pallets or in co-mailings. Or they could stuff all of their mail into a few large sacks and pray the Postal Service delivered their issues quickly enough that all of their subscribers would not cancel in anger.

NNA Initial Brief at 4.

[337] NNA emphasizes that its members use sacks for their newspapers because they have been the only officially permitted containers for this type of mail. It notes that NNA witnesses Heath and Crews explained that pallets cannot be used for small mail volumes, and that this volume cannot be combined with the copies of another newspaper at a central plant. *Id.* at 7.

[338] NNA argues that this Complainants’ witnesses are all magazine experts, and claims that newspapers do not have the same flexibility that even some small magazine titles may have to avoid the consequences of service problems. *Id.* at 9-10. It also maintains that newspapers do not create mail.dat files, which impedes an impact analysis, and notes that newspapers are not permitted to use the automated sorting machines which will provide some mailers with an opportunity to further reduce their

rates under the Complainants' proposed introduction of recognition of machinability. *Id.* at 11.

[339] NNA acknowledges that Stralberg discounts its witnesses' claims that skin sacks are needed to ensure adequate service, but claims that whether or not Complainants believe the small volume sacking practice really does work for achieving promised service, "it is a given" that the mailers are the ones with the daily, weekly and monthly obligation to get their products to subscribers, and who have the experience to know what works and what does not. It argues:

It makes sense to lend some credence to their beliefs. Until meaningful alternatives that achieve necessary service levels are developed, attaching a price penalty to the mailers' only viable means of using the system and staying in business is unfair to the mailers, and punitive to the mailstream as well as the owners of the mail.

Id. at 14.

[340] As to the use of the complaint mechanism, NNA claims that this case is somewhat reminiscent of other cases, citing the "Red Tag" case of 1981 and the 1995 reclassification case. *Id.* at 14-15. With respect to the former, it notes that the Commission was admonished to be cautious in using its classification, and not to intrude into the rate arena of the Postal Service. *Id.* at 15. As to the latter, NNA asserts that the Commission "wisely declined to take the path the larger publications hoped for, and instead gave the mailstream some breathing room to develop such new practices as the copalletization discounts that arose in late dockets." *Id.* at 15-16.

[341] On the issue of "binding the nation together," NNA takes particular issue with witness Gordon's testimony. It claims, among other things, that Gordon does not "squarely address what happens if small periodicals could not survive the hearty new price signals that would force them to cease to design their mail for timely delivery" and does not know what role postage plays in small publications. *Id.* at 17-18.

[342] On the sack charge, NNA claims that Complainants acknowledge that in many cases, viable alternatives to sacks are not yet available. It further argues that witness Heath has worked for years to create alternatives to sacks, has been involved in encouraging experiments with tubs, and even with dropping bundles directly on local loading docks, thereby eliminating containers altogether. *Id.* at 20. However, it contends that these alternatives are barely beginning to enter the mailers' world, and says that even if the Postal Service were to initiate changes immediately, Heath predicts that more than a year would be required to convert publishers to the new practices. Thus, NNA contends that in the short term, the penalties for sacks would simply punish newspapers for circumstances they cannot help — and that in the short term, these newspapers are stuck with sacks. *Ibid.*

[343] *Responses.* The Postal Service, responding to NNA's argument that there cannot be a penalty for using sacks until a meaningful alternative exists, asserts that it is trying to address service concerns of newspapers and small publications and would like to investigate whether the use of low-volume sacks improves service performance. Postal Service Reply Brief at 5-6. It adds: "Simply stated, handling extremely small amounts of mail in the Periodicals mailstream may be both time consuming and costly." *Id.* at 6. The Postal Service also says it is working on alternatives to sacking small volumes of Periodicals mail, including some that would move newspapers, particularly in-county publications, from sacks into tubs, or out of containers altogether. *Ibid.* It claims that the resolution needs to be one that considers the impact on the small volume user, in terms of postage increases, and the impact on other customers, who may be compelled to recover an additional cost burden. *Ibid.*

E. Other Considerations

[344] Participants also comment on the validity of witness Mitchell's comparison of the CPIU index to a Periodicals rates markup index; his contention that the Periodicals rate structure lags behind other classes in terms of the adoption of efficient elements; and his analysis of a publisher's decision to retain or drop subscribers in more distant zones. Given the disposition of this case, the Commission does not address all of these points, but does acknowledge the Postal Service's position on the CPIU comparison. It also comments on Mitchell's identification of several workpaper errors, and comments that the proposal reflects "radical de-averaging" and is unduly complex.

[345] *CPIU comparison.* With respect to the CPIU comparison, witness Tang expresses doubt that Mitchell's comparison contributes usefully to the Periodicals pricing discussion. Her reasoning is that his comparison relies on assumptions that are not necessarily realistic or appropriate, and that these assumptions render that comparison not meaningful for pricing Periodicals. She elaborates:

Implicit in Mitchell's comparison presented in Graph 1 of his testimony is the idea that Periodicals subclasses either would or should have maintained the same markup index over approximately a two-decade period. These assumptions are flawed. They inappropriately expand the role of the markup index from being a useful tool for describing relatively contemporaneous rate changes to being a long-run normative pricing rule.

Maintaining a constant markup index over time violates reasonable commonsense pricing principles. This is especially true over long periods of time when significant structural changes are occurring in rate designs and mail mixes.

[346] Tang pursues this point using an example (with three tables) which she maintains illustrates the problems inherent in assuming a constant markup index. *Ibid.* She acknowledges that she has simplified products and pricing, but contends that the conclusions drawn from her tables do not depend on using only two products or starting with equal markups for both products (as shown in Table 1). Instead, she says:

As a general principle the Postal Service seeks over time to develop rates for products that are fair and equitable when all relevant factors are taken into account, including unit contributions. As seen in my illustrative example, obliging any one product's markup index to hold constant over time can lead to obviously inappropriate outcomes. It is wholly unrealistic to assume — even for the purposes of analysis and exposition as witness Mitchell has done — that the Postal Service would have sought to maintain Periodicals' markup index constant in light of the massive changes in worksharing opportunities and productivity investments that have occurred throughout the Postal Service over the past two decades.

Id. at 2189.

[347] Tang claims that Mitchell's testimony implies that his constant markup index Periodicals rate index somehow reflects the "correct" or "natural" price path for Periodicals prices over the last two decades, and says she disagrees. *Ibid.* Instead, she claims that where there have been massive changes in relative costs, it is more appropriate to examine how unit contribution, as well as markup or cost coverage, has tracked over time. Including unit contribution for this kind of analysis does not mean that the Postal Service believes that the markup index has no value as a descriptive tool, nor that it believes that other percentage-based or relative markup measures should be neglected, and that unit cost contribution be the only guiding pricing strategy or the primary focus. *Id.* at 2190. Tang says the Postal Service is fully aware that focusing solely or primarily on unit contributions can also lead to inappropriate pricing policy. *Ibid.* However, she also states that the Postal Service does believe that looking at unit

contribution may provide additional insights beyond those obtained looking only at cost coverages or percentage markups. *Ibid.*

[348] *Mitchell's correction of several workpaper errors (existing rates).* Witness Mitchell testifies that he has identified three errors in the Periodicals Outside County rate design sheets in Docket No. 2001-1. Tr. 3/825. These worksheets were used as the basis for the Commission PRC-LR-9. In particular, Mitchell notes that when developing rates in Docket No. R2001-1, Postal Service witness Taufique divided transportation costs by 75 percent of the weight of Science of Agriculture publications. Mitchell changes this to 100 percent based on his belief that "transportation costs are caused by the full weight carried." *Id.* at 831. Mitchell also asserts that Taufique distributed 50 percent of the distance-related transportation cost on 44 percent of the weight. Mitchell adjusts the distribution so that 40.47 percent (which is the percent of weight entered at distribution ADC and above facilities) of distance-related transportation costs are distributed on 44 percent of the weight. Mitchell contends that this preserves the differences among the zones in per pound costs and alleviates the problem of inflated pound rates for higher zoned mail. *Ibid.* at 830. Finally, Mitchell says that Taufique withheld a portion (0.4 cents per piece) of the DSCF pound rate from DSCF-entered mail. Taufique did this by subtracting the DADC discount from the DSCF discount. Mitchell changes the discount calculation to remove the subtraction. *Ibid.*

[349] Based on Mitchell's representations in response to POIR No. 1, question 4 concerning the impact of these changes, none of these three adjustments affects the revenue obtained from the Outside County subclass, and none affects the piece rates or any of the associated piece discounts. However, pound rates are affected as shown in Mitchell's response. *Id.* at 1113-4.

[350] *De-averaging and complexity.* Some of the criticism of the Complainants' proposal focuses on the de-averaging associated with the proposed recognition of bundles, sacks and pallets as discrete elements in the fundamental Periodicals rate structure. While the impact of this recognition may result in rate increases that are objectionable if mailers have no practical way at this time to alter their mailing practices,

the concept of recognizing these elements is not radical in itself. Instead, it reflects studied observation of the way mailings are prepared and handled in today's environment. In essence, the effect under the costs and assumptions in the Complainants' proposal is to shift about 10 percent of costs away from pounds and about the same amount from pieces. This is not, in itself, a radical departure from the current approach, although the consequences in terms of rate impact are more severe than can be accepted at this time.

[351] Similarly, given that the proposal closely follows real-world mailing practices, there is validity to the Complainants' contention it is conceptually simple. Also, to the extent that complexities are entailed in its execution, it also appears that many, although not all, mailers have access to computer programs that can effortlessly evaluate available options. The Commission acknowledges that this is not the case for some mailers of Outside County Periodicals — notably NNA members — but in general does not find the arguments against the proposal on grounds of complexity to be persuasive.

APPENDIX B

APPENDIX A: RECOGNITION OF 39 U.S.C. 3622(B)(8) IN PERIODICALS RATES

I. THE LEGISLATION HISTORY OF SECTION 3622(b)(8)

[1] The legislative history of what is now section 3622(b)(8) is sparse, but is instructive in this respect — that Congress intended it as a new factor for the Commission to consider in recommending rates.

[2] Section 3622(b)(8) was first proposed in 1975 as part of H.R. 2445, the successor to H.R. 15511, which dealt with, among other things, increased appropriations for the Postal Service. In July 1975, the Subcommittee on Postal Service adopted several amendments to H.R. 2445 and ordered it reported as a clean bill, H.R. 8603. The latter became the basis for the "Postal Reorganization Act Amendments of 1976," Pub. L. 94-421, which included new section 3622(b)(8).

[3] This legislation was developed at a time of uncertainty regarding the future of the Postal Service and the Commission. The Postal Service was experiencing financial difficulties; the regulatory framework created by the Postal Reorganization Act was being challenged as unworkable or at least flawed; and there was considerable debate over methods (and amounts) used to finance postal operations. Moreover, the transition from the Post Office Department to the Postal Service as mandated by the Postal Reorganization Act was in its relative infancy. The first omnibus rate proceeding, Docket No. R71-1 was decided June 5, 1972, with increased rates becoming effective July 6, 1972. The second omnibus rate case, Docket No. R74-1, was pending before the Commission.¹ Furthermore, the Postal Service's well-publicized deteriorating financial condition made likely that it would require additional rate relief in the near term.

[4] Against this backdrop, section 3622(b)(8) was intended to address claims that neither the Postal Service in proposing nor the Commission in recommending rates adequately recognized the educational, cultural, scientific, and informational (ECSI)

¹ The Commission's Recommended Decision was issued August 28, 1975. Increased rates became effective September 14, 1975. Decision of the Governors of the United States Postal Service on Rates of Postage and Fees for Postal Services, September 4, 1975.

value of mail to the recipient. In hearings on these bills, publishers (as well as various other mailer interests) sought to mitigate future rate increases directly through subsidies (public service appropriations) as well as by endorsing a new provision in the ratemaking section of the Act directing the Commission to consider separately the ECSI value of mail to the recipient. To that end, numerous witnesses discussed the preferential rate treatment historically accorded periodicals to foster, among other things, diversity of views and nationwide availability, *i.e.*, the widespread dissemination of information.² To be sure, such statements reflect self-interests; nonetheless, their substance is historically valid.

[5] Comments by Rep. Ford, a principal proponent of section (b)(8), emphasize both that ECSI value be considered and its harmony with the historic purpose of the post.³

[T]he reason for this amendment is to make it abundantly clear that it is the intent of the Congress that that kind of a factor should be taken into account. And I don't suppose I have to remind you that a very quick study of the origins and development of the Postal Service in this country would indicate that that was always a primary consideration of the people who believe that we needed a postal service, *vis-à-vis* a primary way for our people to communicate and thereby become educated.

² Illustrative is the statement of the publisher of the *New Republic*, "The value of a wide diversity of the press hardly needs additional debate in this forum, although reminding everyone of the need for easy dissemination of information is a daily requirement. It is a strong argument indeed for including such values in rate making decisions as the bill recommends." Hearings on H.R. 2445 Before the Subcomm. on Postal Service of the House Comm. On Post Office and Civil Service, 94th Cong., 1st Sess., Serial No. 94-4 (1975) at 135. *See also id.* at 305, statement on behalf of the National Rural Electric Cooperative Association. ("Congress, in establishing the second-class category and its special rate, recognized clearly the need for all citizens—urban and rural—to have access to printed information at reasonable costs. It was the deliberate intent of Congress to foster a wide variety of publications and to assure their availability throughout the nation—at a subsidy, if necessary. We believe that the Postal Service, in its zeal to increase revenues, has ignored this intent of Congress and is likewise ignoring the need for economical distribution of information.")

³ *Id.* at 255.

[6] Section (b)(8) was introduced to address what was perceived to be a shortcoming of section 3622 of the Postal Reorganization Act, namely, that it did not require the Commission to consider the content value of the mails in recommending rates. At the time, that issue became more pressing because of mounting concern over the run-up of rates during the five to six year period following passage of the Postal Reorganization Act. That is, absent section (b)(8), the fear was that rates would be set without appropriate consideration of the value of the content of the mails. Additional comments by Rep. Ford capture these twin legislative concerns:⁴

Existing law does not require the Postal Rate Commission to consider the subjective values of the various kinds of mail in recommending postal rates. The law is designed to accomplish that in mail classification proceedings, but those proceedings have progressed so very slowly that postal rates may go through the roof before the Postal Rate Commission ever gets around to deciding that a book, a magazine, or a newspaper has more intrinsic value to the public than a brick. They may all have the same shape, size, and weight, but they are not all the 'same.' The conference report includes a new criterion which requires that the Postal Rate Commission take into account the 'educational, cultural, scientific, and information value' of mail matter in fixing postal rates.

⁴ House Comm. on Post Office and Civil Service, 94th Cong., 2d Sess., H.R. 8603, Postal Reorganization Act Amendments of 1976, Pub. L. 94-421, Legislative History, Committee Print 94-20, October 1976, at 551.

II. CONSIDERATION OF NON-COST FACTORS IN DESIGNING RATES

[7] The non-cost ratemaking criteria of section 3622(b) are used initially for purposes of assigning the institutional cost burden among the various classes and types of mail. These non-cost factors, however, may also be appropriately considered by the Commission in designing rates that satisfy the myriad and sometimes-conflicting statutory directives. Thus, considerations that may support a higher (or lower) cost coverage for a class or type of mail may need to be weighed during the rate design process to achieve the desired result. Mail preparation, criterion 6, is fundamental to the rate design process. Rate impact, criterion 4, may be employed in determining cost coverage as well as, where appropriate, the design of rates within a class, *e.g.*, where, without adjustments, rates would increase disproportionately across zones, rate cells, or weight. Criterion 7 is inherently related to rate design, directing the Commission to consider "the simplicity of structure of the entire schedule[.]" Likewise, criterion 8 may be appropriately considered during the rate design process for those classes or types of mail evincing ECSI value, including Periodicals.

[8] MPA argues that criterion 8 should be applied only to determine the cost coverage for Outside County Periodicals and should not "be viewed as justification for not basing . . . rates on costs."⁵ This position is unsupportable for at least two reasons. First, criterion 8's role is broader than merely determining cost coverage. The Commission has been directed to consider the ECSI value of mail matter to the recipient. Editorial matter satisfies this criterion, whereas advertising matter does not. While the ECSI value of Periodicals as a whole may be reflected in cost coverage, any distinction between editorial and advertising matter can only occur during the rate design process. Suggestions that criterion 8 only be used for determining cost coverage for Periodicals fail to recognize that the rate design process necessarily involves balancing all of the sometimes-competing ratemaking factors of the Act.

⁵ MPA Initial Brief at 6.

[9] Second, implicit in the statement that criterion 8 not be used to justify not basing rates on costs is the premise that an unzoned editorial pound charge (EPC) violates criterion 3, *i.e.*, because it does not precisely mirror costs. That conclusion is erroneous. Cost averaging, such as an unzoned rate for editorial materials, is an accepted rate design alternative, particularly, when, as here, it accomplishes a specific statutory directive, namely binding the nation together through the widespread dissemination of the educational and informational value of Periodicals.⁶ In the same vein, the vast majority of mailpieces is not subject to zoned rates.

⁶ Moreover, the requirement that “each class of mail or type of mail service bear the direct and indirect postal costs attributable to that class or type” is not directly applicable to the editorial portion of Periodicals, as this matter is neither a class, type, nor even subclass of mail. See *Mail Order Association of America v. U.S. Postal Service*, 2 F.3d 408, 435 (D.C. Cir. 1993) (MOAA).

III. REFLECTING ECSI VALUES IN PERIODICALS RATES

[10] While Congress directed the Commission to consider ECSI values in recommending rates, how that should be accomplished was left to the Commission's discretion. The current rate design, employing zoned rates for advertising combined with an unzoned editorial rate, was established in 1917 when Congress rejected zoned pound charges based on the total weight of the publication.⁷ Congress refused to alter this structure repeatedly in the succeeding half century. The Commission has on several occasions considered proposals to alter the treatment of editorial pounds and, on each occasion, has rejected those proposals as contrary to the long-standing policy favoring the widespread dissemination of information.⁸

[11] Complainants contend that current Outside County rates "could be brought into closer conformity with the requirements of the [Act]" by revising the rate structure to "bring about efficient changes on the part of mailers," including eliminating the unzoned EPC, which is characterized as "a substantial impediment to the development of a more efficient Periodicals rate structure[.]"⁹ The latter is the focus of Complainants' legal memorandum in which they argue that changed circumstances since Docket No. R90-1 cast doubt on the continuing efficacy of an unzoned EPC.¹⁰ Before turning to those arguments, three preliminary observations are in order.¹¹

⁷ See Tentative Decision Concerning Officer of the Commission's Proposal to Eliminate the Distinction Between Rates for Advertising and Editorial Matter, Docket No. MC76-2, September 30, 1977, Appendix D at 8-9.

⁸ See *ibid*; PRC Op R77-1, May 12, 1978, at 348-351; PRC Op. R90-1, January 4, 1991, paras. 5274-5280; PRC Op. MC91-3, July 17, 1992, paras. 1009-1015.

⁹ Complainants' Memorandum of Law and Policy Relating to the Editorial Pound Charge for Periodicals, Docket No. C2004-1, December 1, 2004, at 1-2 (Complainants' Memorandum).

¹⁰ *Id.* at 3.

¹¹ Consistently throughout this proceeding, the Complainants have submitted exemplary pleadings, thoughtful, well-researched, and well-written. The Commission appreciates these efforts, even if it declines, for purposes of this proceeding, to jettison the unzoned EPC, as they illuminate important issues affecting Periodicals.

[12] First, Complainants' pleadings, including the Complaint, their briefs, and legal memorandum, are significant for what they do *not* say. They make no claim that the current rates are unlawful. Second, Complainants' challenge to the unzoned EPC is complicated by their proposed restructuring of Outside County rates. The effects of that change are not isolated and thus are subsumed within the overall impact of Complainants' proposal. Third, the Postal Service, which opposes the Complaint, "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."¹²

[13] Mailers' frustration with what appear to be delayed efforts to reform Periodicals rate design is understandable, although perhaps somewhat overstated.¹³ The Commission urges the Postal Service to proceed forthwith to develop a rate design for Periodicals that better serves the needs of all interested stakeholders and thereafter file a request for a recommended decision with the Commission.¹⁴ It is hoped that this Order will further inform the Postal Service and spark prompt action. Nonetheless, at this juncture the Commission does not find the rate design suggested by Complainants superior, or that the existing rate design can be found not to conform with the policies of Title 39.

[14] In their legal memorandum, Complainants cite three things as evidence of changed circumstances since Docket No. R90-1 that, they contend, cast doubt on the continuing validity of the rationale supporting an unzoned EPC, *i.e.*, the widespread dissemination of information. These are: (1) the DC Circuit's opinion in *MOAA*; (2) changes in technology affecting communications, principally the Internet; and

¹² Brief of the United States Postal Service, Docket No. C2004-1, December 23, 2004, at 2.

¹³ See Reply Brief of the United States Postal Service, Docket No. C2004-1, January 10, 2005, at 8-9.

¹⁴ As the Complainants note, "economic efficiency and cost recognition are not the only statutory ratemaking policies that the Commission must take into account[.]" Initial Brief of Time Warner *et al.*, Docket No. C2004-1, December 23, 2004, at 72. Nonetheless, all participants appear to recognize the need to encourage efficiency in Periodicals rate design.

(3) periodicals' mailers access to transportation alternatives other than the Postal Service.¹⁵ Having carefully considered Complainants' arguments, the Commission is unpersuaded that an unzoned EPC has outlived its usefulness.¹⁶

[15] *The MOAA Opinion*. The Court in *MOAA* upheld the Commission's decision to retain the unzoned EPC based on section 101(a) of the Act, which identifies as the "basic function" of the Postal Service the "obligation to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people."¹⁷ In addressing the Commission's reliance on criterion 8 for rejecting a zoned EPC, the Court focused on the Commission's statement that (b)(8) "reinforces the special nature of editorial content of second-class mail and requires special treatment of such."¹⁸ The Court correctly noted "that both the advantaged and the *disadvantaged* publications supply these informational benefits."¹⁹ The Court concluded that criterion 8, by itself, did not support the rationale for rejecting a zoned EPC, *i.e.*, the widespread dissemination of information. But it found that the Congressional mandate that the Postal Service "bind the Nation together" supported the Commission's rationale in terms of "the *nationwide* distribution of units of information."²⁰

[16] The Court's finding sustains ECSI as a rate design tool in conjunction with section 101(a) of the Act. In discussing section 101, Complainants argue:²¹

¹⁵ Complainants' Memorandum at 3.

¹⁶ As a point of clarification, the Commission is not of the view, contrary to implications in Complainants' legal memorandum (at 47), that its discretion to consider rate designs is limited either by the longevity of the flat EPC or that that rate structure pre-dated the passage of the Postal Reorganization Act.

¹⁷ 39 U.S.C. § 101(a).

¹⁸ *MOAA*, *supra*, 2 F.3d at 436.

¹⁹ *Ibid.* (emphasis in original).

²⁰ *Id.* at 436-37 (emphasis in original).

²¹ Complainants' Memorandum at 44-45.

The inclusion of personal and business correspondence in [section 101] hardly suggests a preference for magazines in particular, much less a preference for long-haul rather than short-haul magazines. That is, the language is so general that it might equally well be used to support the widespread dissemination of almost any kind of mail.

Complainants' interpretation of section 101 ignores the existence of (b)(8), negating it as a rate design tool. Section 101(a) directs nationwide distribution of information while section 3622(b)(8) identifies ECSI as particularly favored types of information. Thus, the *MOAA* court affirmed the Commission's rate distinctions between editorial and advertising matter as consistent with the policies of the Act.²²

[17] The rationale behind the existing unzoned EPC is similar to that supporting the uniform book rate, section 3683. During the debate on the Postal Reorganization Act, Senator Mansfield spoke in favor of a uniform book rate: "[T]hese uniform rates serve important educational and cultural purposes, insuring that all citizens, libraries, and educational institutions have the same access to these materials, no matter where they may be located."²³ The same principle applies to the unzoned EPC. It provides a rate design simultaneously recognizing both ECSI values and section 101(a) considerations. In contrast, Complainants' proposed rate design gives effect to only one of those policies.

[18] During the debates on H.R. 8603, which became the Postal Reorganization Act Amendments of 1976, Senator Matthias discussed the policy underlying section 101 of the Act. His remarks are relevant to the foregoing discussion because they make it clear that service is the preeminent goal, particularly as it relates to the nation as a whole.

After quoting sections 101(a) and (b), he observed:²⁴

²² The Commission thus rejects Complainants' contention that "the ECSI provision is *irrelevant* to the policy of maintaining an unzoned editorial rate." Complainants' Initial Brief, *supra*, at 54; (emphasis in original). The *MOAA* court did *not* decide all information was equally valuable, in which case it would have rejected favoring editorial over advertising matter.

²³ 116 Cong. Rec. 22300-01 (1970).

²⁴ House Committee on Post Office and Civil Service, *supra*, at 484.

We knew what we were saying when we in Congress stated that policy. We wanted to insure that 'service' would be the foremost goal and that the geographically remote sections of our country would not be disadvantaged—left out of the mainstream of our national communications system—in order to achieve some operating efficiencies. There are some services, such as rural mail delivery, whose benefits far outweigh the 'costs' which may be attributed to them.

[19] *Technological Changes*. On behalf of the Complainants, witness Gordon provides a brief history of communications technology since 1917 in an effort to demonstrate that an unzoned EPC is unnecessary to bind the nation together through the widespread dissemination of information.²⁵ To that end, he touches on several notable technological changes affecting communications including radio, television, and the rise of the computer, which affected telephony, and, more significantly, gave birth to the Internet.²⁶ He also cites “a revolution in printing technology” enabling newspapers and magazines to be printed in multiple locations.²⁷ He concludes his testimony with observations about how the country is “smaller” than it was in 1917 due to technological changes, such as air travel, reduced telephony costs, television as a news medium, and the Internet, cited, in particular, as a source for new developments on virtually any topic.²⁸ Characterizing the United States as “one vast neighborhood,” he contends that “[t]here is no longer the slightest chance that the setting of postal rates for editorial content in Periodicals class mail by zones to reflect actual costs would cause the country to be divided by these zones.”²⁹

[20] Certainly, the country is different today than it was in 1917, or even in 1970. While zoned EPCs may not cause the country to be divided into zones, they,

²⁵ Tr. 3/701; see Direct Testimony of John Steele Gordon, TW et al.-T-3, Tr. 3/610 *et seq.*

²⁶ *Id.* at 618-24.

²⁷ *Id.* at 622.

²⁸ *Id.* at 626-27.

²⁹ *Id.* at 627.

nonetheless, may impair the widespread dissemination of information. Changes in communications media notwithstanding, none is a perfect substitute for the print media. As a mass communications medium, television is unparalleled. It does not, as a general rule, yet provide programming designed to address myriad specific industries or areas of interest, often arcane, specialized, or unconventional.³⁰ Nor does the Internet, a wondrous utilitarian tool, fully supplant the role served by the print media to educate and inform. Not all material available in print is readily accessible on the web.³¹ Some publications provide editorial content on publicly available web sites, while access to others is available to subscribers only;³² the information available online may not, in many cases, mirror that available in print.³³ The Postal Service's universal service obligation requires that it deliver to every mailing address. Access to the Internet is generally available on a fee-paid basis only;³⁴ a substantial portion of the population, perhaps as much as 30 percent, is not online.³⁵

[21] Undeniably, the Internet represents an important technological change affecting communications. But this does not mean it has supplanted the print media anymore than television supplanted radio. The advent of television was not the demise of radio. Rather it caused radio to evolve so that "[t]oday the radio business in the United States is far larger than it was in 1946 before television began to compete with it."³⁶ Witness Gordon acknowledges that the Internet "has not yet reached maturity or

³⁰ *Id.* at 665-66, 705-06, 723-24.

³¹ *Id.* at 716, 733-35; Tr. 6/1736.

³² Tr. 6/1923; Tr. 3/706-07. Web sites associated with publications offer readers and advertisers multi-media exposure. Witness Caver contends that incremental revenues generated by associated web sites are insufficient to replace print advertising and that such web sites would likely disappear entirely if the periodicals were to cease publication. Tr. 6/1736-37.

³³ Tr. 3/716; Tr. 6/1736.

³⁴ Some libraries provide public access to the Internet. This service is often subject to filters limiting access to certain information.

³⁵ Tr. 3/783-84.

³⁶ *Id.* at 763.

saturation, although the latter is happening rapidly.”³⁷ As the communications media evolves, it may be that, like television’s affect on radio, the Internet will spur the print media to new growth. It is too soon to speculate on that. The point is that these media options supplement one another.

[22] A recent report by the PEW Internet and American Life Project confirms that the majority of Internet users continue to rely on offline sources for communicating, conducting their affairs, and obtaining information.³⁸ The report, entitled, *The Internet and Daily Life*, concludes: “The integration of the Internet into everyday life doesn’t match its popular appeal. Most Internet users still default to the traditional offline ways of communicating, transacting affairs, getting information, and entertaining themselves.”³⁹

[23] To be sure, changes in technology have had a profound effect on the ways in which Americans communicate and receive news and information. To that extent, the nation-binding influence of postal services may be diminished, as witness Gordon suggests.⁴⁰ It has not, however, been eliminated. More significantly, the Complainants have not demonstrated that the availability of the Internet makes Periodicals redundant for purposes of the widespread dissemination of information. As the prior discussion establishes, the Internet, as marvelous as it may be, does not yet (and perhaps never will) satisfy the needs of mailers and users alike currently met via the print media. Furthermore, the law and the policy it embodies remain unchanged. The Postal Service’s “basic function” continues to be the “obligation to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people.” The Commission finds, based on this record, that an unzoned EPC remains consistent with that policy.

³⁷ *Id.* at 691.

³⁸ Tr. 6/1951.

³⁹ *Ibid.*

⁴⁰ Tr. 3/714.

[24] *Alternate Transportation*. The third indication of changed circumstances cited by Complainants is the opportunity to access private sources for the long-haul transportation of magazines in lieu of the Postal Service.⁴¹ In essence, they are referring to dropshipping, and to a lesser degree altered mailing practices involving co-mailing, co-palletization, and pool dropshipping. Complainants' position is somewhat problematic.

[25] Mailers utilize dropshipping to realize savings, improve service or both. Presumptively, any Periodicals mailer realizing one or more of these benefits is currently dropshipping. However, it does not follow that those currently not dropshipping would be able to do so if a modified rate design was available. Many publications are presumptively unable to do so due to lack of volumes, density, or both. Small nationwide circulation publications typically lack the density and volumes needed to dropship. As Complainants acknowledge: “[t]here clearly are many small nationally distributed publications with high editorial contents that initially would pay higher postage under zoned editorial pound rates,”⁴²

[26] Witness Tang indicates that there are 29,979 periodicals, of which 25,234 (or 84.3 percent) are classified as small.⁴³ The Commission is concerned with the impact of Complainants' proposal on small circulation publications.

[27] Dropshipping may benefit some mailers; however, it cannot simply be assumed that small publishers will be able to avail themselves of that option. In addition to proposing to zone the rate for editorial materials, Complainants also propose reducing total per pound charges. The net result of these two changes might make dropshipping

⁴¹ Complaint at 10; see *also* Complainants' Memorandum at 3.

⁴² Complainants' Initial Brief at 55. Complainants argue (at 56) that under the current rate structure, these publications are unable “to take advantage of the rapidly increasing availability of pooled dropshipping as well as comailing and co-palletization services.” It is more a leap of faith than statement of fact that such publications will be able to utilize these options. “The growing availability of comailing, co-palletization and pool dropshipping . . . *should eventually* also extend to such [printing] plants, or these Periodicals will inevitably have the option of switching to plants that do provide such services.” *Id.* at 57 (emphasis added).

⁴³ Tr. 6/2232; see *also* Appendix D at 1-2.

less attractive for many publications. The data in this proceeding are too uncertain to permit any reasonable estimate.

[28] In sum, the choice of a rate design entails tradeoffs among various competing factors of the Act, including, for example, costs, impact on mailers, and policy concerns. In this proceeding, Complainants have proposed a revised Periodicals rate design in lieu of the current one. While the Commission is not adopting Complainants' proposal in this proceeding, this result should not be read as a ringing endorsement of the status quo. Rather, it largely reflects concerns over the impact on mailers and the policy implications that flow from the Complainants' proposal.

IV. COMPLAINANTS' USE OF IMPLICIT COST COVERAGES AS A PROXY FOR ECSI VALUES

[29] Witness Mitchell states that “reduced cost coverages may be the best way to recognize ECSI values in a balanced and fair way that does not cause other problems.”⁴⁴ A lower cost coverage for the Outside County Periodicals subclass (than otherwise might be the case) reflects ECSI value. By itself, however, a lower cost coverage for the subclass as a whole does not distinguish between editorial and advertising content. That distinction occurs during the rate design process. And where lower rates are developed for editorial matter, the result will be different content-based implicit cost coverages. Accordingly, distinctions between editorial and advertising matter resulting in lower rates for the former may appropriately reflect ECSI value subject to an important caveat — that they are otherwise consistent with the Act. In this regard, the Commission has serious reservations about the Complainants’ proposed flat editorial discount.

[30] The Complainants’ proposed restructuring of Periodicals rates is based principally on notions of efficiency, that is, rates designed “to recognize costs efficiently and give appropriate signals to mailers.”⁴⁵ The unzoned EPC in particular is singled out as an anathema to this objective.⁴⁶ In its place, witness Mitchell proposes a flat editorial discount of \$.101 per pound. He contends that substantial deference is provided to ECSI value of Periodicals since his proposed rates maintain the implicit cost coverages derived from current editorial and advertising rates.⁴⁷ On brief, Complainants rephrase this, arguing that “[w]e believe that the ECSI provision justifies providing no less benefit to editorial matter than it now receives, which is what our proposed rates would do.”⁴⁸

⁴⁴ Tr. 3/1064.

⁴⁵ Direct Testimony of Robert W. Mitchell, TW et al.-T-1, at Tr. 3/802.

⁴⁶ *Id.* at 801.

⁴⁷ *Id.* at 834. Witness Mitchell states that ECSI value is reflected in the Periodicals subclass in two ways—a low cost coverage, 101.3 percent, for the subclass and different implicit cost coverages on editorial and advertising matter, 84.7 and 129.5 percent, respectively. He implies that his proposed rates likewise reflect ECSI value because “it is not proposed that [these coverages] be changed.” *Id.* at 856.

⁴⁸ Complainants’ Initial Brief at 54.

Designing revised rates based on preexisting implicit coverages may produce “no less benefit to editorial matter.” This yardstick, however, is essentially meaningless since not only would the “benefit” be redistributed among effected mailers, but also there has been no showing that the result satisfies the criteria of the Act.

[31] The implicit cost coverages reflect, among other things, current editorial/advertising rate differences, justified, first, on the basis that ECSI values may warrant *some* rate distinction, and, second, on the basis that a flat EPC is consistent with the underlying policies of the Act. The Complainants’ proposed rates, however, are markedly different from the current rates notwithstanding using implicit cost coverages. Plainly, these rates, including in particular the proposals to zone editorial matter and the editorial pound discount, redistribute the “editorial benefit” in a manner entirely different from that of the current rate design. Complainants have not demonstrated that their proposed rate design with its resulting restructured editorial benefit is appropriate. The editorial benefit associated with the current rates was developed following the two-step process noted above. In contrast, under Complainants’ proposal, ECSI values were considered only derivatively, *i.e.*, as reflected in the cost coverage of current rates. Thus, the proposed flat editorial pound discount appears to be a fallout from current rates, rather than an independent assessment of ECSI values coupled with support that the resulting rate design is consistent with the policies of the Act.

[32] Like the current unzoned EPC, the proposed flat editorial benefit, \$0.101 per pound, treats all editorial pounds equally.⁴⁹ Unlike the current EPC, which favors nationwide dissemination of editorial matter, the proposed editorial pound discount favors short-haul mailers because it represents a decreasing percentage of the pound rate in each succeeding zone. As a percentage of the pound rate, witness Mitchell’s proposed editorial discount ranges from 69.7% for deliveries to a DDU to 20.3% for

⁴⁹ As Complainants note, this is not the same thing as treating all periodicals equally. Complainants’ Memorandum, *supra*, at 44, n.39. That result, however, is simply an inescapable consequence of any rate design.

deliveries in zone 8.⁵⁰ Thus, this structure operates inversely to the manner in which pound costs are incurred, *i.e.*, the shorter the haul the greater the percentage discount notwithstanding that pound costs increase with distance of haul. Furthermore, the zoned EPC, and even more so, the flat editorial pound discount, turns the longstanding policy underlying an unzoned EPC, *i.e.*, to bind the nation together, on its head. On this record, the Commission is not prepared to do so.⁵¹

⁵⁰ Tr. 6/840.

⁵¹ Complainants' proposals to zone EPC and to implement a flat editorial pound discount have ECSI value implications. In contrast, their proposed container rates do not. These rates concern processing matters that are unrelated to content. In that regard, witness Stralberg's contention that focusing on eliminating costs that result from inefficient use of mail containers merits more serious consideration. See, *e.g.*, Stralberg surrebuttal, TW et al.-RT-1, at 12-13, 30-31.

V. POLICY IMPLICATIONS OF THE COMPLAINANTS' PROPOSAL

[33] Section 101(a) of the Act mandates that the “Postal Service shall have as its basic function the obligation to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people.” In prior decisions rejecting proposals to zone the EPC, the Commission has endorsed the long-standing policy in favor of the widespread dissemination of information.⁵² It has found that a zoned EPC would discourage the broadest geographic distribution of informational material, while the policy of binding the nation together is fostered by the unzoned EPC.⁵³ This is not to suggest that other rate designs might not also be suitable. On this record, however, Complainants have not demonstrated that the current rate design has outlived its usefulness or that their proposed restructuring of Periodicals rates better satisfies the criteria of the Act.

[34] In retaining the unzoned EPC, for purposes of this proceeding, the Commission has carefully considered the Complainants' proposal and, on balance, concludes that the status quo is preferable to the alternative. Complainants' proposal entails more than simply eliminating the unzoned EPC in favor of zoned charges. It also includes container charges and a flat editorial discount. In combination, these various elements disproportionately benefit a few publications with reduced rates at the expense of the vast majority of publications, those with circulations below 15,000.

[35] The potential and disproportionately large adverse impact of Complainants' proposal on most publications could have a permanently disruptive effect on the Periodicals subclass.⁵⁴ Witness Tang notes that small publishers account for only 12

⁵² See, e.g., PRC Op. MC76-2, September 30, 1977, at 8; PRC Op. R77-1, May 12, 1978, at 350; PRC Op. R90-1, January 4, 1991, at ¶ 5279.

⁵³ PRC Op. MC76-2, September 30, 1977, at 10.

⁵⁴ Of the 29,979 periodicals, approximately 97 percent are small or medium-sized publications. Only 929 publications (or 3.1 percent) are considered large publications, with circulations above 100,000. Among the small publications, the vast majority, 21,973 or 87 percent, have a circulation of less than 5,000 per issue. Witness Tang's analyses demonstrate that 76 percent of small publishers and 66 percent of medium publishers would be subject to increased rates under the Complainants' proposal. See Appendix D at 1-2.

percent of total Periodicals' volume but 84 percent of the titles; in contrast, large publishers represent only three percent of the titles, but 68 percent of total volume.⁵⁵ She cautions that even if the impact affected only 10 percent of the total volume, "that 10 percent could represent more than 20,000 small Periodicals publications, and a large proportion of the editorial content in Periodicals."⁵⁶

[36] Testimony by witness Schaefer, appearing on behalf of The McGraw-Hill Companies, Inc., confirms the uneven impact of Complainants' proposal.⁵⁷ McGraw-Hill publishes 84 Periodicals in diverse fields such as finance, business, healthcare, and construction.⁵⁸ Its largest publication, *Business Week*, has nearly one million subscribers; its smallest has only a handful. Witness Schaefer estimates that under the proposed rates McGraw-Hill could realize annual savings of about \$300,000, primarily due to *Business Week*. Nonetheless, witness Schaefer reports that all but three of McGraw-Hill's publications would incur substantial increases under the Complainants' proposal, most "well into double digits."⁵⁹ Notwithstanding the savings, McGraw-Hill opposes the Complainants' proposal out of concern for the adverse impact on smaller publications, and "maintenance of a broad, vibrant and diverse Periodicals class as a whole."⁶⁰ The Commission shares this concern.

[37] Maintaining diversity within the Periodicals subclass is in the public interest and consistent with the policy of binding the nation together. Diversity among Periodicals promotes debate and a well-informed citizenry, attributes of a vibrant and robust democracy. Witness Schaefer underscores the critical role played by small circulation magazines in binding the nation together "by meeting diverse informational needs that

⁵⁵ Tr. 6/2231.

⁵⁶ *Ibid.*

⁵⁷ Direct Testimony of David Schaefer, MH-T-1, September 9, 2004, Tr. 6/1916 *et seq.*

⁵⁸ *Id.* at 1922.

⁵⁹ *Id.* at 1924.

⁶⁰ *Id.* at 1920; 1924-25.

may not otherwise be served, and forming and sustaining distinct communities defined by common interests rather than geographic proximity.”⁶¹

[38] Complainants, with commendable effort, have raised important issues affecting Periodicals as a whole. Their proposed restructuring is based principally on notions of efficiency, a goal, while laudable, that cannot be assessed in a vacuum. Witness Tang correctly observes that factors in addition to efficiency must be addressed before major classification changes can be adopted. These would include impact on mailers, operational readiness, public policy goals for Periodicals, and the need to account for revenue leakage, particularly given Periodicals’ lean cost coverage.⁶² Witness Tang believes that a more balanced approach “can enhance efficiency without sacrificing the broad diversity of editorial content in Periodicals.”⁶³

[39] As discussed above, the Commission has on numerous occasions recognized the competing considerations regarding proposals to eliminate the unzoned EPC. In balancing the tradeoffs between economics on the one hand and policy concerns on the other, the Commission concludes that on this record Complainants have not demonstrated that the rationale supporting the unzoned EPC — binding the nation together and the widespread dissemination of information — no longer applies. In the final analysis, Complainants’ proposal is tailored to the mailing requirements of a few publishers, without a complete understanding of the impact of their proposal on other publishers. Under the circumstances, and in light of the potential dire consequences for many publishers suggested by this record, the Commission will not recommend abandoning the current unzoned EPC policy.

⁶¹ *Id.* at 1952; *see also* Joint Reply Brief of American Business Media and The McGraw-Hill Companies, Inc., *supra*, at 20.

⁶² Tr. 6/2232.

⁶³ *Id.* at 2233.

APPENDIX C

THE OPT-IN RATE STRUCTURE

Introduction

[1] In this Order, the Commission suggests alternative ways that the Postal Service might improve the rate structure for the Outside County Periodicals subclass.¹ Among the suggested alternatives is the opt-in approach whereby the subclass would be separated into two groups of mailers. One group would be subject to a new rate structure reflecting a more cost-based system, such as the Time Warner et al. proposal, and the other group would be subject to the current rate structure. In the sections below, the Commission begins by describing the opt-in approach. Because calculation of the applicable revenue target and the rate design process varies according to the type of case and because selection of the circulation threshold to distinguish the two groups is critical to the rate design process, the Commission then discusses each of these in order.

Description of the Opt-In Approach

[2] Under this approach, Outside County Periodicals would continue to be one subclass, but there would be two rate structures. One would be more cost based, such as along the lines of the Time Warner et al. proposal, and the other would be the current rate structure. The applicable rate schedule for a publication would in part be determined by a circulation threshold. Circulation is defined as mailed copies per issue. Only flat-shaped mail would be subject to the new rate structure. Mailers below the threshold and all mailers of letter-shaped mail would continue to be subject to the current rate structure.

[3] Mailers of flat-shaped mail above the threshold would be subject to a new rate structure which might incorporate concepts such as:

- (1) Altering the proportion of revenue that would be obtained from piece rates and pound rates compared with the current rate structure;

¹ In the context of this Complaint, improving the rate structure means making it more cost based.

- (2) full weight of the publication would be zoned;
- (3) container charges for bundles, sacks and pallets;
- (4) machinable and nonmachinable piece rates;
- (5) a flat editorial discount per pound; and
- (6) a per-piece editorial discount as currently constructed.

[4] Mailers below the circulation threshold would continue to pay postage in accordance with the current rate structure unless they choose to voluntarily opt in to the new rate structure. Mailers likely to opt in would include mailers whose rates will be lower under the new rate schedule either because they already use efficient containerization and dropship distribution patterns or because they are willing and able to change to more efficient containerization and dropship patterns. Mailers above the threshold would not be eligible to use the current rate structure.

[5] The rate design process for the opt-in approach would require the Postal Service to separate base year (BY) billing determinants into the two groups. The process would require the Postal Service to select a circulation threshold thereby requiring a bifurcation of the billing determinants, and it would initially have to estimate the billing determinants for the mailers it considers likely to opt in to the new rate structure. Further, as discussed in the next section, the choice of case type for requesting classification changes can also affect the rate design process.

The Choice of Case Type for Proposing Rate Restructuring

[6] The rate design process is partly dependent on the type of case the Postal Service selects for proposing a new rate structure. There are three ways the Postal Service can request changes in a rate structure. First, it could choose to request only a rate restructuring. An example of this approach is Docket No. MC95-1. Second, the Postal Service could request a rate restructuring and additional revenues using a classification case. An example of this approach is Docket No. MC96-3. Third, the Postal Service can use an omnibus rate case. This is the type of proceeding the Postal Service most frequently uses for requesting additional revenues. From a classification

perspective, the first approach is distinguished from the second and third approaches by its revenue target.

[7] The revenue target in Docket No. MC95-1 was the Test Year After Rates (TYAR) subclass contribution from the Commission's decision in Docket No. 94-1 plus the corresponding attributable cost. This was referred to as a contribution neutral approach.² PRC Op. MC95-1, para. 1028. Rate changes resulted only from classification changes, not from a general increase in rates. Thus, the Postal Service proposed rate changes to existing rate categories and new rates for new categories, but the rates were designed to obtain the same subclass contribution to institutional cost established in Docket No. R94-1.

[8] The Postal Service's approach in Docket No. MC96-3, which focused on selected special services, differed from its approach in Docket No. MC95-1 because proposed classification changes were accompanied by a request for additional revenues. This approach precluded the use of TYAR revenues or contribution from Docket No. R94-1 because the Postal Service was asking for more revenue and more contribution. The rate changes were the product of two sources: (1) classification changes and (2) increased contribution. Any increase in rates associated with a classification change was likely amplified by additional increased contribution. So, instead of using Docket No. R94-1 as a basis for a revenue target, the Postal Service used the most recently available base year data projected to test year 1996. This process is used in omnibus rate cases, during which rate changes can be a function of both classification changes and a general rate level increase.

² In Docket No. MC95-1, the Postal Service used the principle of contribution neutrality when it proposed to separate then Third-Class Bulk Rate Regular Subclass into three subclasses. Contribution neutrality rather than revenue neutrality was required because the proposed rate restructuring was expected to induce mailers to increase the amount of worksharing by causing a migration to deeper presort levels and to automation categories. This, in turn, was expected to lower both revenues and attributable costs which meant that TYAR revenues expected from Docket No. R94-1, the basis for Docket No. MC95-1, would not be achieved. Thus, the Postal Service proposed to design rates that would obtain the same amount of contribution in aggregate from the three proposed subclasses that Third-Class Bulk Rate Regular Subclass was expected to achieve in the test year after rates in Docket No. R94-1. This constituted contribution neutrality, i.e., the contribution before and after rates was the same.

[9] In the instant proposal, Time Warner et al. use the test year data for Outside County Periodicals from Docket No. R2001-1 as the basis for their rate restructuring proposal. TW et al. expand the TYAR billing determinants, representing a projected FY 2003, to include the number of bundles by presort level, and the number of sacks and pallets by presort and entry level. TW et al.-T-2 at 12. The proposed rates yield the same revenues expected to be produced in test year after rates from the Commission decision in Docket No. R2001-1. Thus, the proposal is intended to be revenue neutral.

The Rate Design Process

[10] There are six general steps to the rate design process for the opt-in approach, but the choice of case type affects the revenue target and the application of a revenue neutral approach:

- (1) Develop base year billing determinants and revenues;
- (2) Separate the base year billing determinants and revenues into two groups, i.e., mailers above the circulation threshold and those likely to opt in, and all other Periodicals mailers;³
- (3) Project the base year billing determinants for each group to the test year;
- (4) Select a revenue target for each group of mailers;
- (5) Reconfigure the base year billing determinants for the group of mailers above the threshold (including opt-ins) to reflect new billing determinant components like number and type of container by presort and entry level, etc.; and
- (6) Redesign rates for mailers above the threshold (including volunteers) to reflect new rate structure and to generate the revenue target.

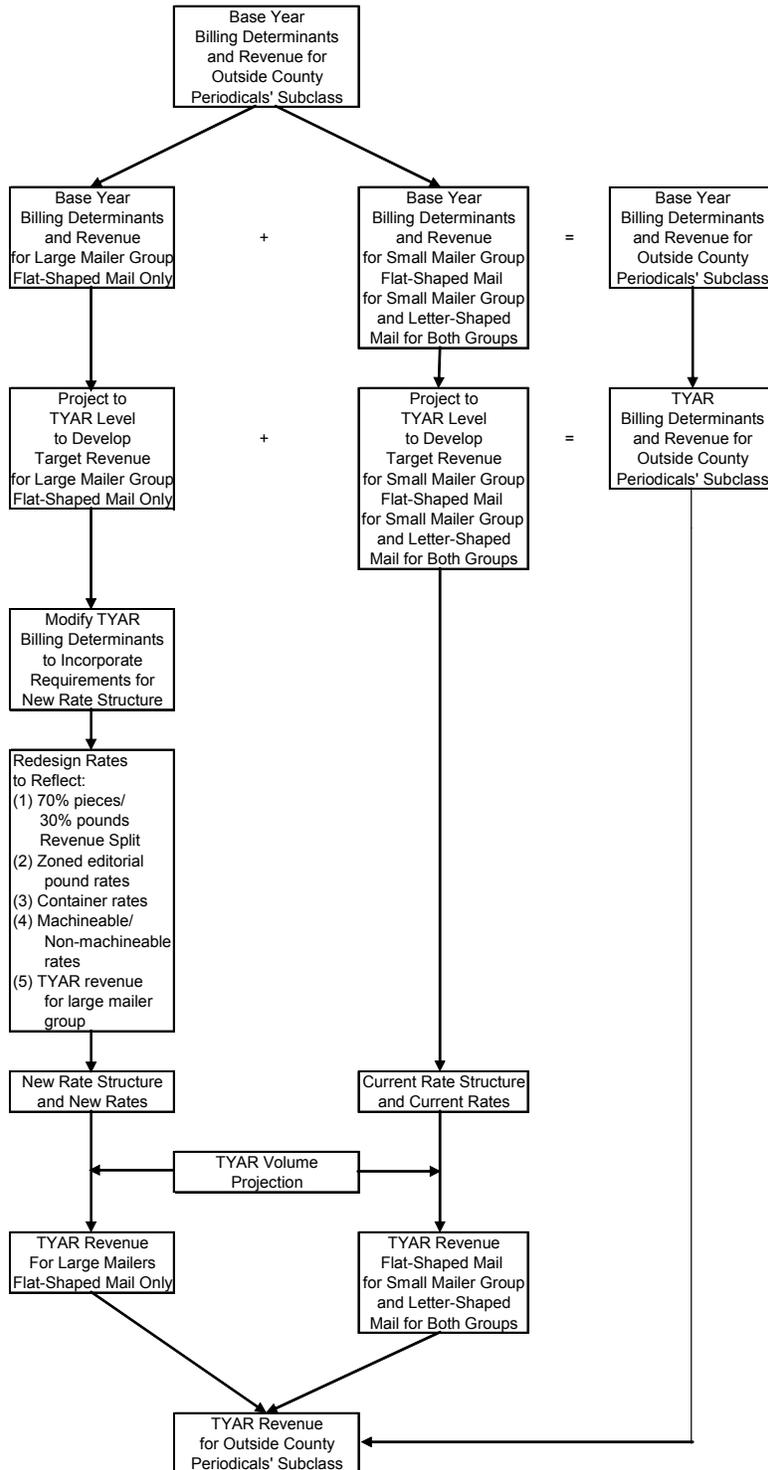
[11] For a classification case involving only a rate restructuring, there are two revenue targets for the opt-in approach. The first target is the test year after rates

³ The billing determinants for the mailers in the group below the threshold must also include the billing determinants for letter-shaped mail for all mailers. However, for ease in presentation, this will not be mentioned further.

subclass revenue for Outside County Periodicals from the Commission's decision in the most recent omnibus rate case. This subclass revenue target must then be divided between the two groups of mailers. The only way this can be done is to separate the base year billing determinant data from the last rate case between the two groups and then project the data for each group to the TYAR level using the applicable TYAR/BY volume ratios.⁴ Multiplying the individual TYAR billing determinants for each group by the applicable current rates and the billing determinant adjustment factor should yield revenue products that when summed equal the TYAR subclass revenues from the last case. See Flow Diagram 1 below.

⁴ The TYAR billing determinants and revenues for any subclass in a rate case are based on projecting base year billing determinants to the TYAR level. The projection will also include estimated billing determinants for new rate categories if there are recommended classification changes. If the most recent available actual billing determinants were used to separate the projected TYAR billing determinants in a rate case, because the piece distribution by rate category and pound distribution by zone would likely be different, a different average revenue and total revenue would be obtained. Accordingly, the starting point has to be the base year data which can be bifurcated and then each group's data can be projected to the TYAR level using the same procedure applied to the subclass data in the rate case. This will ensure that the sum of the bifurcated billing determinants and revenues will equal the subclass totals.

FLOW DIAGRAM 1
RATE DESIGN PROCESS FOR OPT-IN APPROACH
ASSUMING RATE RESTRUCTURING ONLY

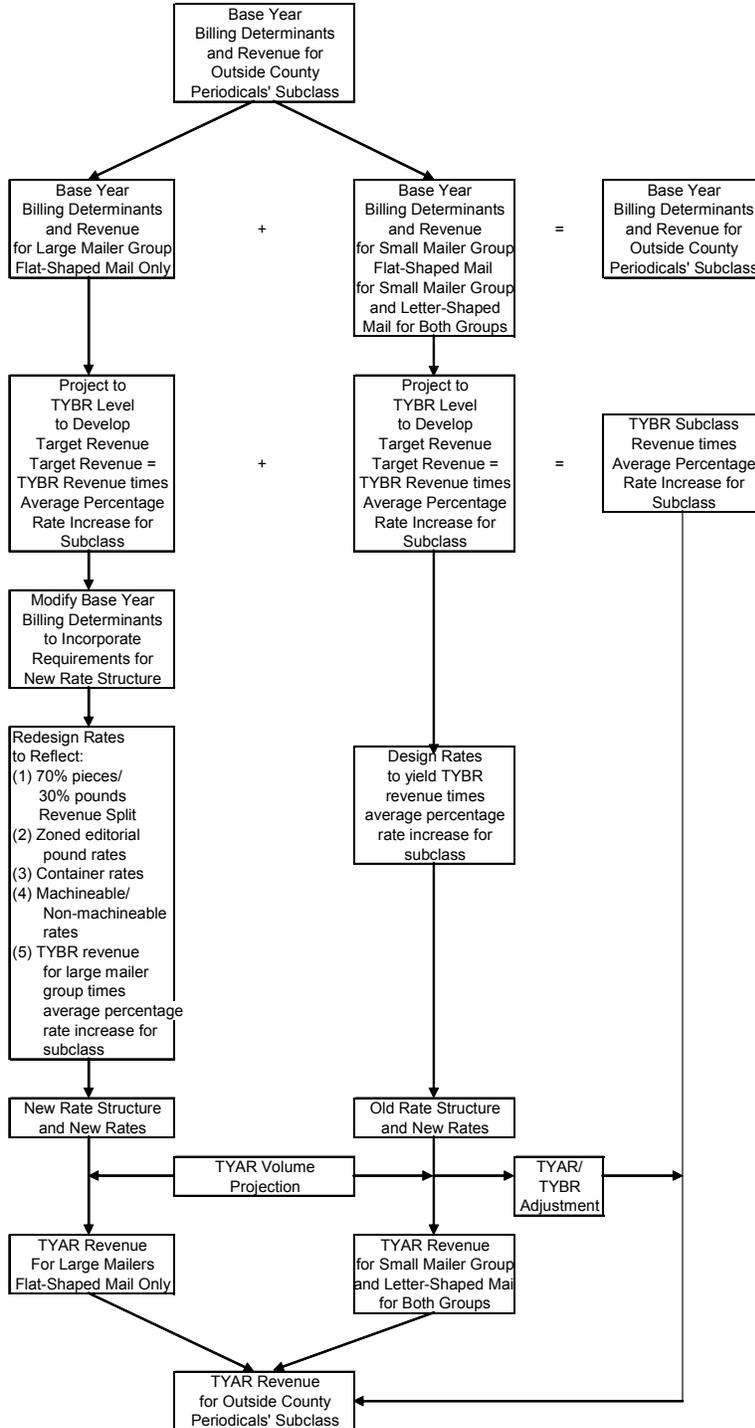


[12] Applying this approach to the Time Warner et al. proposal would result in no rate changes for small publications and therefore no losers because of rate changes. The rate changes for publications above the threshold would be smaller in terms of absolute value compared with the percentage rate changes shown in witness Tang's rebuttal testimony. There would be winners and losers resulting from rate changes in this group because TYAR group revenues would be redistributed among publications in accordance with the revised rate structure.

[13] For a combined general rate increase and classification change, the revenue generated by each group after the rate structure change and general rate increase must be equal to the revenue generated by each group before the changes increased by the average percentage increase for the subclass. Thus, if the proposed subclass rate increase is 10 percent, then each group's after rate revenues must equal Test Year Before Rates (TYBR) revenues increased by 10 percent (e.g., TYBR revenue for mailers above the threshold times 1.1). In addition, TYBR figures must be adjusted to the TYAR level. See Flow Diagram 2.

FLOW DIAGRAM 2

RATE DESIGN PROCESS FOR OPT-IN APPROACH
ASSUMING RATE RESTRUCTURING AND A GENERAL RATE INCREASE



[14] The rate design process described above assumes that a circulation threshold has been selected and that the billing determinants for mailers below the threshold likely to opt in to the new rate structure have been identified and added to the billing determinants for the group of mailers above the threshold. This process will be somewhat difficult, but as discussed below, it is quite feasible.

Selecting the Circulation Threshold and Grouping Mailers

[15] Selecting the threshold is critical to the opt-in approach. Because minimizing the adverse impact of rate increases on mailers who cannot engage in more efficient mailing practices is the rationale for the opt-in approach, rate impact must be factored into the selection process. However, it enters this process in two ways. First, the threshold should be selected with recognition of the number of mailers who would suffer adverse rate impacts. Second, some mailers who fall below the threshold may already containerize mail in a way that would produce lower postage under the proposed restructured rates than under the current structure. In both instances, the Postal Service must identify the billing determinants for each publication on both a current and restructured basis so that it can compute postage for each publication under current rates and restructured rates. This will help the Postal Service to select a circulation threshold by quantifying the number of publications that would experience rate changes under the proposed rate restructuring. Identifying mailers of publications likely to opt in is critical because failure to include their billing determinants in the billing determinants for the group above the threshold would result in reduced aggregate contribution.

[16] The makeup of the group of mailers below the threshold must be considered in the rate design process. This group of mailers can be separated further into three subsets: (1) mailers who will respond to the rate incentives inherent in the Time Warner et al. proposed rate structure by adopting lower cost mailing practices; (2) mailers who will not change or cannot change their mailing practices; and (3) mailers who have already adopted lower cost mailing practices and who will benefit from reduced postage by opting in to the new rate structure.

[17] The appropriate basis for analyzing each of these subsets of mailers is the expected subclass revenues and attributable costs. Assuming that the opt-in rate schedule has been created, mailers who change their mailing practices to take advantage of the new rate structure (*i.e.*, the first subset) will reduce their unit attributable cost and their postage bill. Thus, both subclass revenues and attributable costs will be reduced. However, assuming that the rate design reflects the principles of efficient component pricing, the reduction in revenues will be equal to the reduction in attributable cost and the aggregate subclass contribution will be the same before and after the mailer shifts to the lower set of rates. This will also be the case for mailers in the second subset that will not or cannot modify their mailing practices to take advantage of the new rate structure. Expected aggregate subclass contribution from them will be unchanged. However, the third subset of mailers is problematic. These mailers already use efficient mailing practices, so when they opt in to the new rate structure, their postage bill will be reduced, but there will be no corresponding reduction in unit attributable cost. They already operate efficiently; therefore, the subclass attributable costs already reflect the costs these mailers impose on the Postal Service. Thus, when they opt in to the new rate structure, subclass revenues will be reduced without a corresponding reduction in attributable cost and this will directly reduce expected aggregate subclass contribution. The only way to prevent this from happening is to identify these mailers and their billing determinants so that they can be added to the billing determinants of the group of mailers above the threshold. The criterion for identifying these mailers is conceptually simple. Mailers below the threshold who would receive a postage reduction by shifting to the new rate structure could reasonably be expected to do so. If, for some reason, they do not, actual subclass contribution will be greater than expected. The Commission believes that it is feasible for the Postal Service to identify these mailers.

[18] The Postal Service has the data by which it can determine what a reasonable threshold would be as evidenced by witness Tang's rebuttal testimony (USPS-RT-2) and her response to Presiding Officer's Information Request No. 2. Using data from the PostalOne Electronic Verification system and business mail entry units to support her

rebuttal testimony, witness Tang collected data for a random sample of 55 publications. She separated the publications into three groups based on circulation size: (1) large – more than 100,000 copies per issue; (2) medium – between 15, 001 and 100,000- copies per issue; and (3) small – up to 15,000 copies per issue.

[19] For each sampled publication, witness Tang calculated postage under current rates and proposed rates. The sample included 11 large publications. Of these, two, or 18 percent, would experience postage increases under Time Warner et al. proposed rates with the largest increase being 2.48 percent. Ten of the 20 medium-sized publications, or 50 percent, would experience postage increases with the largest increase being 23.66 percent. Of the 20 small publications, 16, or 83 percent, would experience postage increases with the highest being 80 percent.

[20] In response to Presiding Officer's Information Request No. 2, witness Tang expanded her original sample of publications from 55 to 251 providing selected data and calculating postage rate changes for all the publications under current and proposed rates. Although this effort required additional Postal Service resources, it is clear that the Postal Service has the capability of identifying the billing determinants for each of the 29,979 publications and calculating before and after rates postage changes. The Postal Service could begin to create an environment for Periodicals that would encourage more efficient mailing practices by conducting the study required to implement the opt-in system.

APPENDIX D

POSTAL SERVICE DATA CONCERNING SMALLEST PUBLICATIONS

In response to the Commission's Notice of Inquiry No. 1 Concerning Periodicals Data, November 19, 2004 (NOI No. 1), the Postal Service provided information on the smallest publications in the Outside County subclass. These publications have per-issue circulation of 15,000 or less. Witness Tang testifies that there are 25,234 publications in this category, and that in FY 2003 they mailed 1.1 billion pieces, or 12.3 percent of total Outside County pieces. Table 1 summarizes witness Tang's data for all Outside County publications. The information in this table prompted NOI No. 1, which contained specific questions about the smallest periodicals.

Table 1
Mailed Publications
Titles and Mailed Annual Volume
(FY 2003)

<u>Size</u>	<u>Circulation per Issue</u>	<u>Mailed Publications</u>		<u>Total Mailed Annual Volume</u>		<u>Average Mailed Annual Volume</u>
		<u>Titles</u>	<u>Percent of Total</u>	<u>Pieces (Thousands)</u>	<u>Percent of Total</u>	
Small	0 to 15,000	25,234	84.2%	1,145,512	12.3%	45,396
Medium	15,001 to 100,000	3,816	12.7%	1,871,811	20.1%	490,516
Large	More than 100,000	929	3.1%	6,313,662	67.7%	6,796,191
Total		29,979	100.0%	9,330,984	100.0%	311,251

Note: This table excludes publications with only within county volume or no reported frequency of issuance.

Source: PERMIT System data. Adapted from USPS-RT-2 at 8.

Table 2 shows the total, mean, and median circulation for small publications. The publications in Table 2 are further broken down into four groups by circulation per issue. Thus, the mean circulation for publications with mailed circulation per issue of 1,000 or less is 307 and the median is 224. This circulation group contains the largest number of titles, 60.1 percent, but the smallest share of total circulation, 9.4 percent. By contrast, the largest circulation group has a mean of 12,277 and a median of 12,135. Circulation per issue is inversely related to the number of publications in these groups.

Table 2
Small Publications
Total, Mean and Median of Mailed Circulation per Issue
(FY 2003)

Circulation per Issue	Small Publications		Total Circulation		Mean Circulation	Median Circulation
	Titles	Percent of Total	Pieces (Thousands)	Percent of Total		
0 to 1,000	15,152	60.1%	4,652	9.4%	307	224
1,001 to 5,000	6,821	27.1%	16,186	32.8%	2,373	2,081
5,001 to 10,000	2,114	8.4%	15,028	30.4%	7,109	6,984
10,001 to 15,000	1,104	4.4%	13,554	27.4%	12,277	12,135
Total	25,191	100.0%	49,420	100.0%	1,962	608

Note: The number of 25,191 small publications, analyzed in this appendix, does not include 43 publications. The PERMIT System shows zero piece weight for these 43 publications. This can happen when piece weight is rounded to the nearest pound on the postage statement.

Source: PERMIT System, Periodicals Postage Statement Form 3541.
 See Response of USPS witness Tang to NOI No. 1 at 3.

Table 3 divides low circulation publications into commercial publications and nonprofit publications. Commercial publications comprise 69.1 percent of the titles in this group. The largest percentage of nonprofit publications, 35 percent, is in the highest circulation category, yet this represents the smallest number of nonprofit titles.

Table 3
Small Publications
Commercial and Nonprofit Publications
(FY 2003)

Circulation per Issue	Commercial Publications		Nonprofit Publications		All Small Publications
	Titles	Percent	Titles	Percent	
0 to 1,000	10,736	70.9%	4,416	29.1%	15,152
1,001 to 5,000	4,519	66.3%	2,302	33.7%	6,821
5,001 to 10,000	1,435	67.9%	679	32.1%	2,114
10,001 to 15,000	718	65.0%	386	35.0%	1,104
Total	17,408	69.1%	7,783	30.9%	25,191

Source: PERMIT System, Periodicals Postage Statement Form 3541.
See Response of USPS witness Tang to NOI No. 1 at 4.

Table 4 contains a breakdown of small publications by frequency of publication. Almost one quarter of these small publications are published weekly or more often. Service concerns could be expected to be more acute for periodicals published more frequently. The percentage is slightly higher, 27.4 percent, for the smallest publications.

Table 4
Small Publications
Weekly or More Frequent Publications
(FY 2003)

Circulation per Issue	Weekly or More Frequent Publication		All Other	
	<u>Titles</u>	<u>Percent</u>	<u>Titles</u>	<u>Percent</u>
0 to 1,000	4,149	27.4%	11,003	72.6%
1,001 to 5,000	1,558	22.8%	5,263	77.2%
5,001 to 10,000	280	13.2%	1,834	86.8%
10,001 to 15,000	85	7.7%	1,019	92.3%
Total	6,072	24.1%	19,119	75.9%

Source: PERMIT System, Periodicals Postage Statement Form 3541.
See Response of USPS witness Tang to NOI No. 1 at 4.

The data in Table 5 show the percent of publications containing 10 percent or less advertising. These publications are treated as 100 percent editorial. Response of Witness Tang to NOI No. 1 at 6. Titles containing more than 10 percent advertising make up 42.7 percent of the smallest publications, gradually increasing to 69.1 percent for the largest publications.



Table 5
Small Publications
Containing More than Ten Percent Advertising Material
(FY 2003)

<u>Circulation per Issue</u>	<u>More than 10% Advertising</u>		<u>10% or Less Advertising</u>	
	<u>Titles</u>	<u>Percent</u>	<u>Titles</u>	<u>Percent</u>
0 to 1,000	6,475	42.7%	8,677	57.3%
1,001 to 5,000	3,726	54.6%	3,095	45.4%
5,001 to 10,000	1,410	66.7%	704	33.3%
10,001 to 15,000	763	69.1%	341	30.9%
Total	12,374	49.1%	12,817	50.9%

Source: PERMIT System, Periodicals Postage Statement Form 3541.
See Response of USPS witness Tang to NOI No. 1 at 4.



Tables 6 and 6A show the breakdown of copies for basic, 3-digit, 5-digit, and carrier route categories. Basic presort accounts for 24.5 percent of the copies for these small publications. For the smallest publications, however, basic accounts for 42.9 percent of copies. Only 5.7 percent of copies are presorted to carrier route level by the smallest publications. This figure grows to 21.8 percent for the largest per-issue circulation group.

Table 6
Small Publications
Distribution of Mailed Circulation per Issue by Presort Category
(FY 2003, Percent of Pieces)

<u>Circulation per Issue</u>	<u>Basic</u>	<u>3-Digit</u>	<u>5-Digit</u>	<u>Carrier Route</u>	<u>Total</u>
0 to 1,000	42.9%	28.1%	23.3%	5.7%	100.0%
1,001 to 5,000	26.8%	30.5%	24.4%	18.3%	100.0%
5,001 to 10,000	16.9%	36.4%	27.1%	19.6%	100.0%
10,001 to 15,000	11.5%	35.8%	30.9%	21.8%	100.0%
All Publications	24.5%	32.5%	26.2%	16.8%	100.0%

Source: PERMIT System, Periodicals Postage Statement Form 3541.
See Response of USPS witness Tang to NOI No. 1 at 5.

Table 6A
Small Publications
Distribution of Mailed Circulation per Issue by Presort Category
(FY 2003, Pieces in Thousands)

<u>Circulation per Issue</u>	<u>Basic</u>	<u>3-Digit</u>	<u>5-Digit</u>	<u>Carrier Route</u>	<u>Total</u>
0 to 1,000	1,996	1,307	1,084	265	4,652
1,001 to 5,000	4,338	4,937	3,949	2,962	16,186
5,001 to 10,000	2,540	5,470	4,073	2,946	15,028
10,001 to 15,000	1,559	4,852	4,188	2,955	13,554
All Publications	10,432	16,567	13,294	9,128	49,420

Tables 7 and 7A show the distribution of mailed circulation by weight for small publications. These publications appear to be predominantly under 12 ounces in weight. This is true for all of the circulation categories.

Table 7
Small Publications
Distribution of Mailed Circulation per Issue by Weight
(FY 2003, Percent of Pieces)

Weight (Ounces)	Circulation per Issue				All Small Publications
	0 to 1,000	1,001 to 5,000	5,001 to 10,000	10,001 to 15,000	
0 to 1	9.9%	8.5%	10.3%	14.4%	10.5%
1 to 2	3.9%	9.6%	13.9%	11.1%	9.9%
2 to 3	6.4%	8.1%	12.4%	10.9%	9.5%
3 to 4	7.3%	9.1%	11.0%	14.3%	10.4%
4 to 5	9.3%	10.7%	9.2%	9.8%	9.9%
5 to 6	8.5%	7.5%	10.2%	10.6%	9.0%
6 to 7	8.9%	9.1%	8.1%	6.7%	8.3%
7 to 8	6.1%	7.5%	6.5%	9.0%	7.3%
8 to 9	18.4%	10.0%	3.7%	3.1%	8.5%
9 to 10	3.7%	4.5%	3.6%	3.1%	3.8%
10 to 11	2.6%	4.0%	2.4%	1.8%	2.9%
11 to 12	2.8%	2.4%	2.2%	1.2%	2.1%
12 to 13	1.7%	1.7%	1.2%	0.6%	1.4%
13 to 14	1.4%	1.2%	1.3%	0.8%	1.2%
14 to 15	1.4%	0.8%	0.7%	0.7%	0.9%
15 to 16	0.6%	1.1%	0.3%	0.3%	0.6%
16 to 17	0.8%	0.3%	0.5%	0.2%	0.4%
17 to 18	0.8%	0.3%	0.4%	0.1%	0.4%
18 to 19	0.7%	0.6%	0.0%	0.1%	0.4%
19 to 20	1.1%	0.2%	0.1%	0.2%	0.4%
20 to 21	0.3%	0.5%	0.1%	0.0%	0.3%
21 to 22	0.8%	0.5%	0.0%	0.1%	0.4%
22 to 23	0.4%	0.2%	0.1%	0.0%	0.2%
23 to 24	0.2%	0.1%	0.1%	0.0%	0.1%
Over 24	2.2%	1.5%	1.5%	0.8%	1.5%
Total	100.0%	100.0%	100.0%	100.0%	100.0%

Source: PERMIT System, Periodicals Postage Statement Form 3541.
See Response of USPS witness Tang to NOI No. 1 at 5.

Table 7A
Small Publications
Distribution of Mailed Circulation per Issue by Weight
(FY 2003, Pieces in Thousands)

Weight (Ounces)	Circulation per Issue				All Small Publications
	0 to 1,000	1,001 to 5,000	5,001 to 10,000	10,001 to 15,000	
0 to 1	460	1,376	1,549	1,953	5,338
1 to 2	181	1,554	2,090	1,506	5,331
2 to 3	297	1,311	1,865	1,479	4,952
3 to 4	339	1,473	1,655	1,940	5,406
4 to 5	432	1,732	1,384	1,330	4,878
5 to 6	395	1,214	1,534	1,438	4,581
6 to 7	414	1,473	1,219	909	4,015
7 to 8	283	1,214	978	1,221	3,697
8 to 9	855	1,619	558	422	3,453
9 to 10	172	728	543	422	1,864
10 to 11	120	647	362	244	1,374
11 to 12	130	388	332	163	1,013
12 to 13	79	275	182	81	617
13 to 14	65	194	197	108	564
14 to 15	65	129	107	95	396
15 to 16	27	178	47	41	293
16 to 17	37	49	77	27	189
17 to 18	37	49	62	14	160
18 to 19	32	97	0	14	143
19 to 20	51	32	17	27	127
20 to 21	14	81	17	0	111
21 to 22	37	81	0	14	132
22 to 23	19	32	15	0	66
23 to 24	9	16	15	0	41
Over 24	102	243	225	108	679
Total	4,652	16,186	15,028	13,554	49,420

Source: PERMIT System, Periodicals Postage Statement Form 3541.
Adapted from Response of USPS witness Tang to NOI No. 1 at 5.

Zone distribution for small publications is displayed in Tables 8 and 8A. For these publications, zone 1 and 2 account for 19 percent of the pieces. The next highest number of pieces, 15 percent, is entered at the destination SCF.

Table 8
Small Publications
Distribution of Mailed Circulation per Issue by Entry and Zone
(FY 2003, Percent of Pieces)

Circulation per Issue	Dropshipped Pieces				Zoned (Nondroshipped) Pieces								100% Editorial \1	Total
	DDU	DSCF	DADC	Subtotal	Zone 1&2	Zone 3	Zone 4	Zone 5	Zone 6	Zone 7	Zone 8	Subtotal		
0 to 1,000	1%	24%	1%	26%	31%	7%	5%	6%	3%	2%	3%	56%	18%	100%
1,001 to 5,000	3%	16%	1%	20%	25%	8%	7%	7%	4%	2%	4%	58%	22%	100%
5,001 to 10,000	3%	10%	2%	15%	18%	8%	9%	9%	4%	3%	4%	56%	29%	100%
10,001 to 15,000	3%	11%	2%	16%	18%	7%	10%	10%	5%	3%	4%	56%	28%	100%
All Publications	2%	15%	2%	19%	23%	7%	8%	8%	4%	2%	4%	56%	24%	99.5%

1/ Entry and zone piece distribution is not available for publications with 100% editorial.

Source: PERMIT System, Periodicals Postage Statement Form 3541.

See Response of USPS witness Tang to NOI No. 1 at 6.

Table 8A
Small Publications
Distribution of Mailed Circulation per Issue by Entry and Zone
(FY 2003, Pieces in Thousands)

Circulation per Issue	Dropshipped Pieces				Zoned (Nondroshipped) Pieces								100% Editorial \1	Total
	DDU	DSCF	DADC	Subtotal	Zone 1&2	Zone 3	Zone 4	Zone 5	Zone 6	Zone 7	Zone 8	Subtotal		
0 to 1,000	44	1,112	44	1,200	1,435	321	228	274	135	91	135	2,619	833	4,652
1,001 to 5,000	502	2,606	162	3,270	4,063	1,311	1,149	1,149	664	324	664	9,323	3,593	16,186
5,001 to 10,000	466	1,518	301	2,284	2,720	1,217	1,368	1,368	616	466	616	8,371	4,373	15,028
10,001 to 15,000	393	1,477	271	2,142	2,426	935	1,342	1,342	664	393	529	7,631	3,782	13,554
All Publications	1,405	6,713	778	8,896	10,644	3,785	4,087	4,133	2,079	1,273	1,943	27,944	12,581	49,420

1/ Entry and zone piece distribution is not available for publications with 100% editorial.

Source: PERMIT System, Periodicals Postage Statement Form 3541.

Adapted from Response of USPS witness Tang to NOI No. 1 at 6.

Tables 9 and 9A show the percentage and pieces, respectively, by container type. Overall 92.3 percent of small publication volume is in sacks. For the smallest publications, 99.1 percent of pieces are in sacks. These results appear to indicate that smaller publications find palletization less feasible than do larger publications.

Table 9
Small Publications
Distribution of Mailed Circulation per Issue by Container Type
(FY 2003, Percent of Pieces)

<u>Circulation per Issue</u>	<u>Pallet</u>	<u>Sack</u>	<u>Total</u>
0 to 1,000	0.9%	99.1%	100%
1,001 to 5,000	3.1%	96.9%	100%
5,001 to 10,000	11.7%	88.3%	100%
10,001 to 15,000	17.4%	82.6%	100%
All Publications	7.7%	92.3%	100%

Source: PERMIT System, Periodicals Postage Statement Form 3541.
See Response of USPS witness Tang to NOI No. 1 at 6.

Table 9A
Small Publications
Distribution of Mailed Circulation per Issue by Container Type
(FY 2003, Pieces in Thousands)

<u>Circulation per Issue</u>	<u>Pallet</u>	<u>Sack</u>	<u>Total</u>
0 to 1,000	42	4,610	4,652
1,001 to 5,000	502	15,684	16,186
5,001 to 10,000	1,758	13,270	15,028
10,001 to 15,000	2,358	11,195	13,554
All Publications	4,660	44,760	49,420

Source: PERMIT System, Periodicals Postage Statement Form 3541.
Adapted from Response of USPS witness Tang to NOI No. 1 at 6.

APPENDIX E

GUIDE TO SOURCES OF PUBLICATIONS' MAILING PROFILES AND CHARACTERISTICS

Several participants have filed data on the mailing profiles of their publications with the Commission in the course of this proceeding. The Commission is extremely appreciative of the cooperation of the parties in providing data quantifying the impacts of the proposed rate structure. These data have been useful in improving the Commission's understanding of the characteristics of Periodicals as well as in evaluating potential impacts. This appendix is a guide to the data and information that have been filed.

Complainants. In response to ABM/TW et al.-T1-3, witness Stralberg provided data on "a single recent issue of each publication" for Complainants' publications, including data for supplemental mailings. The data include frequency; weight per piece; percentage mailed to zone 3 or higher; editorial content; whether co-palletized or co-mailed; pallet weight; pieces per sack; pieces per bundle; current postage; and postage under the proposed rates.

ABM. Exhibit LB-1 of ABM witness Bradfield's testimony contains data on 141 ABM publications. The information includes circulation; average weight; percent sacked; percent palletized; current postage per issue; postage per issue under proposed rates; and percent change.

NNA. In response to TW et al./NNA-1, NNA filed NNA-LR-1. This category 4 library reference contains a listing of NNA members as of June 30, 2004. Tr. 6/2080. NNA also provided a response to Notice of Inquiry No. 1 Concerning Periodicals Data, November 19, 2004 (NOI No. 1) consisting of estimates of mean and median circulation; percent nonprofit; percent weekly or more frequent; and volume distribution by processing category. In addition, NNA provided some data for non-members.

Postal Service. USPS-RT-2 contains a series of tables summarizing the impacts of the proposed rates on a sample of 55 publications. The data include publication size;

percent postage change; percent editorial; and piece weight. In addition, Table 5 contains the universe of titles by size and total pieces.

POIR No. 2 requested that the Postal Service enlarge the sample and provide further regression analyses designed to explore the relationship between the proposed rate structure and certain publication characteristics, such as editorial content, circulation size, and presentation.

In response to this request and to TW et al./USPS-RT2-13, the Postal Service filed USPS-LR-1. This category 5 library reference contains a database of publication-specific material that witness Tang relied on to respond to POIR NO. 2. These data, contained in an Excel spreadsheet, were filed subject to protective conditions established in Presiding Officer's Ruling No. C2004-1/11 (October 14, 2004).

Data provided by the Postal Service in response to NOI No. 1 include mean and median circulation; percent nonprofit; percent weekly or more frequent; distribution by zone; distribution by presort category; and distribution by container type for publications with circulation 15,000 or less.¹

McGraw-Hill. In response to TW et al./MH-4(c)(3), McGraw Hill filed MH-LR-1. This library reference consists of 11 Excel spreadsheets used to calculate the change in postage for 11 McGraw-Hill publications under the proposed rates and a summary spreadsheet.

¹ The Postal Service data are discussed in detail in Appendix D.

APPENDIX F

[1] The existing Postal Service tariff for Periodicals is a complex structure of rates and discounts based on mailer categories; numbers of pieces; weights; editorial content; dropship locations; transportation zones traversed; palletization; presortation; and other factors. The rates and discounts proposed by Time Warner et al. involve changes in fees for many of the existing categories, abolition of some categories, and proposed fees for several new categories. Separately determining the effects on mailers of the various attributes of the Time Warner et al. proposal by directly comparing the proposed rates with those rates currently in effect proved to be a difficult exercise. In an effort to address this technical problem (which arises in some form whenever changes are proposed in any complex system of postal rates) the Commission has experimented with a method for econometrically estimating the impact of the Time Warner et al. proposal on Periodicals mailings by current mailers.

[2] The method employs four general steps: (1) collection of a representative sample of mailings by affected mailers; (2) calculation of the postage paid by the mailers at the pre-existing rates and at the proposed rates; (3) the assembly of data for a list of variables serving as descriptors; and (4) econometric estimation of an equation relating the difference in postage resulting from the proposal to the descriptors. The desired end result of the process is an equation that generically identifies the impact of the proposed rates on mailings as described by the set of variable characteristics such as size and percentage of editorial content.

[3] Step 1 was performed by Postal Service witness Tang in two stages. In her initial testimony [USPS-RT-2], witness Tang provides a sample of 55 observations. This was expanded to a list of 251 observations in her response to POIR No. 2. The sample was also made more representative of small and medium circulation publications. The original sample of 55 Periodicals is heavily weighted towards large circulation publications. The sample of 251 observations eventually obtained is more balanced in its composition and included many mailers of all sizes.

[4] Steps 2 and 3 were performed using Excel worksheets supplied in the library references sponsored by witness Tang. Initially, witness Tang's worksheet calculated the postage for the original 55 observations at the pre-existing Postal Service rates and at the new rates and discounts proposed by Time Warner et al. This required a record of certain characteristics of the mailings that the Postal Service derived from mailing certificates submitted by the mailers and other data recorded at the time the mailings were made. POIR No. 2 asked the Postal Service to provide some additional information about the original 55 mailings and to extend the sample with a more complete list of descriptors. This was done promptly in a revised worksheet from witness Tang.

[5] An effort was made to further enlarge witness Tang's sample by combining it with samples provided by witnesses Bradfield and McGarvey. However, these additions proved to be problematic because they did not include all of the descriptors and because the average postage rates were estimated somewhat differently from the rates from the observations in witness Tang's sample.

[6] On the whole, it appears to the Commission that the time and trouble taken by the Postal Service to assemble this sample is justified by the analysis it allows. In the future, developing analyses based on a representative sample of this type should be a part of the evaluation process whenever possible when changes are contemplated in a complex structure of pre-existing rates and discounts.

[7] An example of how the Commission or a party might use a sample to perform step 4 is shown in Table F-1 for the sample of 251 observations. An equation was fit in a form that would allow a Periodicals mailer who knew the general characteristics of his mailings to predict the relative change that Time Warner et al.'s proposal would have on the average postage per piece of his mailings. The dependent variable (Y) is the natural logarithm of the ratio of postage per piece at current Postal Service rates to the postage per piece for the mailing calculated using the rates and discounts proposed by Time Warner et al. The regressors X(1) to X(18) comprise a list of general descriptors of a Periodicals mailing in a form that is suitable for a log-linear regression.

Table F-1

Regression Output:		TW Case								
Constant		1.4192								
Std Err of Y Est		0.1084								
R Squared		0.6792								
No. of Observations		251								
Degrees of Freedom		231								
X Coefficient(s)	ln(Issue Size)	ln(1+Density)	Ln(Editorial)	Ln(Weight)	Ln(Postage)	DDU	DSCF	DADC	Zone 1&2	
	-0.0295	0.2752	0.1102	0.2334	0.3710	1.9246	-0.3328	-0.2126	-0.2383	
Std Err of Coef.	0.0055	0.0658	0.0321	0.0456	0.0927	3.5378	0.0817	0.1038	0.0832	
t-value	-5.3762	4.1800	3.4327	5.1173	4.0006	0.5440	-4.0747	-2.0479	-2.8645	
	Zone 3	Zone 4	Zone 5	Zone 6	Zone 7	Palletized	3-Digit	5-Digit	CR	Weight
	-0.2921	-0.2429	-0.1591	-0.1117	-0.2308	-0.0046	0.4297	0.3413	0.5289	-1.7660
	0.1069	0.0972	0.0868	0.0987	0.1433	0.0234	0.0581	0.0842	0.1285	0.2755
	-2.7332	-2.4986	-1.8320	-1.1318	-1.6103	-0.1947	7.3997	4.0534	4.1175	-6.4103

Y - ln(Postage per piece at Time-Warner Rates/Postage per piece at Current USPS Rates)

X(1) - ln(Single Issue Size)

X(2) - ln(1 + Density Fraction)

X(3) - ln(Editorial Content Fraction)

X(4) - ln(Average Weight per Piece)

X(5) - ln(Postage per piece at Current USPS Rates)

X(6-8) - Fraction of Weight by DDU, DSCF and DADC

X(9-14) - Fraction of Weight by Zone (Zone 8 and Other Omitted)

X(15) - Fraction Palletized

X(16-18) - Fraction Presorted to 3-Digit, 5-Digit and Carrier-Route (Basic Presort Omitted)

X(19) - Percent Current USPS Postage Based on Weight

[8] An effort was made to find a list of regressors that is both simple and serviceable. Simplicity is necessary if the regression co-efficients are to have straight-forward interpretations that are broadly applicable as descriptions of how the proposed changes in rates will impact mailers. "Serviceable" means that the statistical quality of the fitted equation is good enough to allow the Commission to identify the impacts that are both important and unimportant. The list of descriptors used to obtain the estimates displayed in Table F-1 was settled upon after a small amount of experimentation. It is not necessarily the best set of regressors that might be selected for the sample of 251 mailings supplied by witness Tang. However, it is inclusive in the sense that all of the characteristics of a mailing that generally affect existing rates and discounts are included in some form as a regressor.

[9] The specific definitions of the dependent (Y) variable and the regressors X(1) to X(18) are shown listed below the least-squares fit of the regression equation in Table F-1. The R-Squared statistic for the fit shows that only about 68 percent of the variation in the dependent variable is explained by the regressors despite the effort to define an inclusive set. This means that the Time Warner et al. proposal has effects on mailers that cannot be predicted using just the listed predictors. These unexplained effects would appear to be somewhat idiosyncratic or random to mailers relying on this list of descriptors.

[10] The t-values of the co-efficient estimates generally show that Time Warner et al.'s proposal will have effects on postage that are significantly related to all but one of the descriptors. The exception to the general pattern of statistically significant co-efficients is the proportion of palletized mail. Knowing that a Periodicals mailer palletizes its mailings does not appreciably help to predict how its postage will change with the Time Warner et al. rates. It is only marginally useful to know the distribution of the mailing by the dropship category or transportation zones traversed. Some of the co-efficients for these variables, X(6) through X(14), are statistically significant while others are not. All of the other co-efficients have t-values that reveal relationships that are highly significant. For example, we can see that the proposed rates favor large mailings but disfavor mailers who presort. The t-value for X(1), ln(Issue Size), is -5.3762 while the t-values for the presort fractions for 3-Digit, 5-Digit and Carrier-Route are 7.3997, 4.0534 and 4.1175.¹

[11] The utility of an equation such as that shown in Table F-1 is that it provides a means to ascertain how postal customers would be affected by changes in a complex postal tariff. Often the proposed changes in a complex tariff have multiple effects that are offsetting. The fitted equations disclose which of the multiple possible effects

¹ A useful rule-of-thumb for examining t-values for an equation fit to a large sample is that the co-efficient estimate is significantly different from zero if the t-value is larger in absolute value than 1.96. This is the critical value for a 95% two-tail test with a normal distribution.

predominate and which are relatively unimportant, thus enabling the analyst to accurately predict how postal customers will be affected by the proposed changes.

[12] As an example, the estimates in Table F-1 may be applied to show that Time Warner et al.'s proposal would generally increase the progressiveness of the rate schedule. By this we mean that the differences between high and low rate payers would tend to be accentuated by the Time Warner et al. proposal even though there may be no differences between the publications mailings as measured by the other variables of the model. To derive this result, one can apply the estimates in Table F-1 to compute the elasticity of postage per piece under the Time Warner et al. rates, P_{TW} , with respect to postage per piece under the current rates, P_{USPS} . This elasticity is derived from the coefficient β_5 for the variable X(5) as follows:

$$\ln(P_{TW} / P_{USPS}) = \beta_5 \ln(P_{USPS}) + \text{other terms}$$

$$\ln(P_{TW}) = (1 + \beta_5) \ln(P_{USPS}) + \text{other terms}$$

$$\frac{\partial P_{TW}}{\partial P_{USPS}} \frac{P_{USPS}}{P_{TW}} = \frac{\partial \ln(P_{TW})}{\partial \ln(P_{USPS})} = 1 + \beta_5 = 1.3710$$

The point estimate of $1 + \beta_5$ is 1.3710, moreover, one can be fairly confident that

$1 + \beta_5$ is greater than 1 because the standard error of β_5 is only 0.0927.

[13] To illustrate how the estimate of $1 + \beta_5 = 1.3710$ makes the rate schedule more progressive, consider the example of two mailers with different current rates but otherwise-identical mailings. Suppose that one mailer's postage per piece is 2.000 times that of the other mailer at the current USPS rates. Under the proposed Time Warner et al. rates this ratio of postage rates will increase to $2.000^{1+\beta_5} = 2.000^{1.371} = 2.5865$ even

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though there are no differences between the mailings except the initial difference in the current USPS rates.

APPENDIX G

PARTICIPANTS AND COUNSEL OR REPRESENTATIVE

ALLIANCE OF NONPROFIT MAILERS (ANM)
David M. Levy

AMERICAN BUSINESS MEDIA (ABM)
David R. Straus

AMERICAN POSTAL WORKERS UNION, AFL-CIO (APWU)
Darryl J. Anderson

ASSOCIATION OF AMERICAN PUBLISHERS (AAP)
John R. Przepyszny

CONDÉ NAST PUBLICATIONS INC., A DIVISION OF ADVANCE
MAGAZINE PUBLISHERS INC. (CONDÉ NAST)**
Barry Steiner

DOW JONES & COMPANY, INC. (DOW JONES)
Michael F. McBride
Bruce W. Neely

HEARST COMMUNICATIONS, INC. (HEARST)*
Thomas A. Bisdale

MAGAZINE PUBLISHERS OF AMERICA, INC. (MPA)
James Pierce Myers

MAIL ORDER ASSOCIATION OF AMERICA (MOAA)
David C. Todd

MCGRAW-HILL COMPANIES, THE (MCGRAW-HILL)
Timothy W. Bergin

NATIONAL NEWSPAPER ASSOCIATION (NNA)
Tonda F. Rush

* Limited Participator

** Complainant

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NEWSPAPER ASSOCIATION OF AMERICA (NAA)

William B. Baker

NEWSWEEK, INC. (NEWSWEEK)**

Jack Widener

OFFICE OF THE CONSUMER ADVOCATE (OCA)

Shelley Dreifuss

Emmett Rand Costich

PITNEY BOWES INC. (PITNEY BOWES)

John Longstreth

DAVID B. POPKIN (POPKIN)*

David B. Popkin

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William J. Olson

John S. Miles

VALPAK DIRECT MARKETING SYSTEMS, INC. (VDMS)

William J. Olson

John S. Miles

* Limited Participator

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