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

POSTAL RATE AND FEE CHANGES Docket No. R2006-1

DIRECT TESTIMONY
OF
MARK WALLACE. WHITE
ON BEHALF OF
U.S. NEWS & WORLD REPORT, L.P.

SEPTEMBER 6, 2006

My name is Mark Wallace White, and my title is Vice President of Manufacturing for U.S. News & World Report, L.P., which publishes *U.S. News & World Report* magazine ("U.S. News"). My testimony will focus on my analysis of the impact that proposed Periodicals rates would have on U.S. News and explanations of discrepancies between that analysis and the Postal Service's statements regarding the proposed Periodicals rates.

Autobiographical Sketch

Prior to joining U.S. News in 1995 as Manufacturing Finance Manager, I worked in the newspaper industry as a journalist and manager. At U.S. News, I have worked in various roles in production and distribution management, serving both U.S. News and currently affiliated publications, which include the *New York Daily News*, and formerly affiliated publications, which include *Fast Company* magazine and *The Atlantic Monthly* magazine. From time to time, I also have provided consulting and other services to other publications, including but not limited to *Radar Magazine*. For most of those publications I analyzed and forecast distribution costs and was a key participant in the negotiation of printing-and-distribution contracts.

This is my first time testifying before the Postal Rate Commission, though I performed much of the financial analysis behind U.S. News' participation in Docket No. C2004-1 supporting the alignment of Periodicals postage rates with the Postal Service's costs.

I was graduated magna cum laude in 1979 from the University of Richmond with a bachelor's degree in history and journalism. I received a Master's of Business

Administration from the College of William and Mary (with the top grade-point average in the class of 1995).

Background on U.S. News

The primary business of our privately held company is publishing the weekly newsmagazine *U.S. News & World Report*, along with a related Web site. We mail more than 93 million copies annually via Periodicals Class. The Postal Service our largest vendor, though we also distribute copies via newsstand sales and an electronic edition.

U.S. News has responded to increases in postal rates over the past thirty years with such strategies as reducing our magazine's trim size and basis weight of paper. We have adjusted our mailing practices many times to take advantage of such rate incentives as low carrier-route piece rates, barcoding, the use of ADC entries, and palletization. In 1996, we were a pioneer in the use of poolshipping for weekly magazines to achieve more dropship discounts, which many in the industry thought was impossible for such a time-sensitive publication. The U.S. Postal Service has recognized U.S. News as a "poster child" for efficient mailing, as shown in the USPS brochure and poster entitled "The Perfect Bundle," both of which were part of Witness McCrery's response to MPA/USPS-T42-4c. The brochure includes two depictions and the poster one of a bundle of U.S. News copies.

Following the Postal Rate Commission's final order last year in Docket No. C2004-1, we redoubled our efforts to get our magazine involved in co-mail or other forms of co-palletization. As Michael J. Armstrong testified in Docket No. C2004-1, the current rate structure provides decreasing returns to scale for co-mailing such that there is relatively little incentive to co-mail a publication with more than 1,900,000 copies per

mailing. We interpreted the commission's order in Docket No. C2004-1 as an endorsement of the concept that Periodicals rates should encourage efficient bundling and containerization. That meant, we believed, that we needed to get ready for a future in which large Periodicals mailers would have sufficient incentives to engage in co-mailing and other forms of co-palletization.

Our efforts came to fruition in February of this year when Quad/Graphics, our printer, began co-binding the majority of our mailed copies with *Information Week*, a weekly magazine that mails more than 400,000 copies per issue. Almost every week since then, approximately 1.2 million copies of U.S. News printed in Quad's Saratoga Springs, NY and Hartford, WI plants have been co-bound with several hundred thousand copies of *Information Week*. Co-binding uses selective-binding technology to combine the assembling and mailing of two or more publications on the same binding line. The effect on postage is identical to co-mailing, with copies of the publications being mixed together in the same bundles as well as in the same containers. Although we have no direct knowledge of *Information Week*'s postal costs, our models indicate its postal savings from co-binding are far greater than ours. Nevertheless, we have eagerly worked with Quad/Graphics to make co-binding work because of the immediate net savings to us and because we thought it positioned us well for truly cost-based Periodicals rates. We have also worked with Quad/Graphics in publicizing to co-binding program in hopes it would inspire other mailers to make Periodicals Class mailing more efficient.

Overall Impact on U.S. News

I modeled the impact of the proposed rates on the five issues of U.S. News published with May 2006 cover dates, making two simplifying assumptions that had no material effect on the results:

1) The model is based on a single version of each issue, whereas each actual issue had multiple versions with some variation in copy weights and advertising percentages. By using average advertising percentage and copy weight for each issue, the model calculated postage under current rates to within 0.1% accuracy.
2) Container charges under the new rates were based on the total number of pallets and sacks in each mailing. A small portion of these would presumably be charged to the smaller-circulation publication (*Information Week*) with which we co-bind most copies. But even with U.S. News bearing all of the container charges, such charges would not have totaled more than 0.3% of the total postage for any of the May issues.

The model calculated the rate increase for the five issues at 16.0%, with the amount per issue ranging from 14.6% to 19.2%. The major factors causing the variation from issue to issue were advertising percentage, copy weight, and the number of copies qualifying for experimental co-palletization discounts.

U.S. News has a long history of responding to the Postal Service's pricing signals by changing the way we mail – thereby minimizing our postage costs (and the Postal Service's costs as well). The rates proposed in Docket No. RC2006-1, however, provide no obvious new opportunities to make our mail more efficient for the Postal Service and may in fact result in mail that is less efficient for the Postal Service to handle.

***U.S. News*' Dropship Incentives**

The proposed rates would for the most part reduce our incentives to dropship. For example, the savings from moving one piece from Zone 1 or 2 to DADC would decrease by an average of 55.5%, with a range of 50.4% to 64.6% for the five issues. The savings from moving a piece from Zone 1 or 2 to DSCF would decrease an average of 24.1%, ranging from 18.1% to 35.1%. The savings from moving a piece from DADC to DSCF would increase by 47.4%, ranging from 40.6% to 59.0%. In summary, we would have less incentive to reach relatively small, out-of-the-way ADCs but somewhat more incentive to move DADC copies to DSCF.

Here are examples for three entries that we were able to open within the past two years as part of a change in printing locations:

- Macon, GA: Approximately 3,783 DSCF copies and 5,164 DADC copies. Current savings from using Macon instead of entering the copies in the Atlanta area is $200 per issue and would decline to $118 per issue with the proposed rates.
- Shreveport, LA: Approximately 2,396 DSCF copies and 3,678 DADC copies. Current savings from using Shreveport instead of a nearby entry (e.g. Dallas or Baton Rouge) is $134 per issue and would decline to $78 per issue with the proposed rates.
- Sioux Falls, SD: Approximately 2,352 DSCF copies, 4,589 DADC copies, and 6,290 zoned copies. Current savings from using Sioux Falls instead of entering the copies in St. Paul, MN is $182 per issue and would decline to $120 per issue with the proposed rates.

We have already had preliminary discussions with Quad/Graphics, our current printer/distributor, regarding whether the postal savings from such entries would justify the costs of serving those entries if the proposed rates were enacted. We have also pointed out the somewhat increased incentive to move copies from DSCF to DDDU. (Currently, less than 1% of our copies qualify for DDU discounts. All are entered at SCFs that serve as DDUs for some of their associated ZIP codes.) But Quad/Graphics' apparent reluctance to develop a DDU program was summed up by the following comment from Joseph E. Schick, Quad/Graphics' Director of Postal Affairs, in an article distributed to customers in June 2006 and posted on the company's Web site: "We question why that [enhanced DDU incentive for Periodicals] would happen now considering that if the Postal Service does deploy FSS technology (Spring 2008), DDU entry for flats would be eliminated except for Saturation Mail. We are also in the middle of a transportation environment that makes it extremely difficult to secure enough equipment and drivers to meet our current needs of delivering to hundreds of SCFs multiple times each week. What would happen if we needed drivers to make thousands of stops each week at DDUs around the country? Where would the drivers and equipment be found, and if found, what would it cost?"

***U.S. News*' Co-Palletization Incentives**

The proposed rates would provide little additional incentive to expand our co-binding program and might actually make co-binding with *U.S. News* less attractive for other publishers. The proposed rates would slightly enhance the savings on piece costs for forms of co-palletization that entail complete commingling of mail, such as co-mailing and co-binding. The most relevant change for U.S. News is that the spread

between 5-digit automated and basic carrier-route piece rates would rise from 6.6 cents to 6.9 cents. But with approximately three-fourths of our pieces at the basic carrier-route rate without any form of co-palletization, the piece rates would still provide relatively little incentive for large mailers like U.S. News to co-palletize. The Postal Service has presented the proposed container rate as a significant incentive to co-palletize, but co-palletization would have an insignificant impact on container costs for a large efficient mailer like U.S. News.

For a smaller mailer like *Information Week*, lower piece costs are only part of the incentive to co-bind with U.S. News. Commingling with U.S. News enables a smaller mailer to piggyback on our extensive dropship program, which can mean fairly extensive co-palletization discounts under current rates. Although we have no information on *Information Week*'s mailing costs, we do know that for many of our postal entries *Information Week* typically does not have enough volume on its own to create a pallet. We assume that in those cases it receives co-palletization discounts when copies for that entry are co-bound with U.S. News. The proposed rates would eliminate the co-palletization discounts and, as shown above, generally reduce the dropship incentives for relatively lower weight publications like U.S. News and *Information Week*.

How would U.S. News Respond to the Rates?

U.S. News has a long history of changing our mailing practices in response to signals in postal rates. But we see almost nothing we could do to minimize the impact of the proposed rates. With more than 99 percent of our copies already palletized and an average of more than 2,000 pieces per container, there is little we could do in response to the proposed container rate. The proposal would not create much impetus to expand the

co-binding of U.S. News. And, as discussed above, it might actually give us incentives to increase our postage costs (and the Postal Service's costs) and reduce our freight costs by eliminating ADC entries.

Discrepancies with Witness Tang's Testimony

The above analyses are significantly at odds with the Postal Service's statements regarding the proposed rates. A comparison of the analysis with the testimony of Witness Tang raises three obvious questions:

1) How could the proposal weaken U.S. News' incentives to dropship if, as Witness Tang believes (USPS T-35 page 9, lines 17-18), "mailers, both large and small, would have the potential to move significant volume of mail to destinating facilities."
2) Given Witness Tang's expectation that "mailers would have comparable if not better incentives" to co-palletize (USPS T-35 page 11, line 12), how could the proposal have so little favorable impact on U.S News' co-palletization incentives and perhaps a negative impact on other mailers' incentives to co-palletize with U.S. News?
3) If the Postal Service's proposal complies with the Postal Rate Commission's encouragement to "'make progress toward a more cost-based [Periodicals rate] structure,'" as Witness Tang indicates (USPS T-35 page 4, lines 20-21), why would the rate increase for an efficient mailer like U.S. News be so much above the average for outside-county Periodicals?

The Dropship Discrepancy

Comparisons between dropship incentives under current and proposed rates would yield widely varied results, depending upon the publication. For some publications – especially high-volume, higher weight publications not involved in co-palletization – the dropship incentives would no doubt be significantly enhanced. But for a light publication like U.S. News that is extensively palletized and dropshipped, the new dropship editorial discounts and enhanced dropship piece discounts would not come close to making up for loss of the dropship-pallet discount.

The Postal Service's focus seems to be not on preserving dropship incentives for large mailers like U.S. News but enhancing dropship incentives for smaller mailers. (Unlike Witness Tang, I refer to "small mailers" and "large mailers" rather than "smaller-circulation publications" and "larger-circulation publications". "Circulation" refers to all forms of distribution, including newsstand sales and private delivery; Witness Tang's data apparently shows only the number of mailed copies, not total circulation. There are certainly many small mailers that have total circulation in the hundreds of thousands.)

Having little data ourselves on small Periodicals mailings, we turned to data provided by Witness Tang regarding twelve co-palletized publications in response to an interrogatory from the Magazine Publishers of America, Inc. (MPA/USPS-T35-17). The "Tang Twelve" publications' mailings range from 9,620 copies to 36,663 copies each. Modeling a publication's dropship incentives under current and proposed rates requires only a few data points – copy weight, advertising percentage, and the proportion of co-palletized, dropshipped copies that are eligible for experimental co-palletization

discounts. Witness Tang's data show copy weight and advertising percentage and indicate that no copies would be dropshipped if they were not co-palletized.

The spreadsheet "R2006-1 Tang12 Dropship.xls" shows the results of the analysis. In the model for each publication, "Dropship Pallet" is shown as 1.1 cents per copy, which is the difference between the dropship-pallet discount and the other-pallet discount. For the sake of simplicity, the model assumes one copy per piece, though most of the Tang Twelve have a minimal number of multi-copy pieces. The "Summary" sheet demonstrates that, for all twelve publications, the incentive to move copies from Zone 1 or 2 to DADC or DSCF would be significantly reduced, by an average of 41 percent and 21 percent, respectively. For most, the incentive to move copies from DADC to DSCF would be slightly enhanced, by an average of 13 percent. Given Witness Tang's statement that "over 64 percent of the co-palletized Periodicals pieces were dropshipped to the DADC and over 25 percent to the DSCF" (Tang response to ABM/USPS-T35-16b), the most significant issue for these publications is the incentive to move pieces from zoned to DADC.

Admittedly, the proposed container charge would give these publications a new incentive to co-palletize. But the significant reduction of dropship incentives might mean that some co-palletized copies would not be dropshipped. The Postal Service's goal was "to offer price signals to change the behavior of those not dropshipping" and not "to deny discounts to those that are already reducing the Postal Service costs [sic] by dropshipping" (Tang response to MH/USPS-T35-10). But for small mailers that have responded to the price signals in current rates by co-palletizing and dropshipping, the

proposed Periodicals rates would in fact deny discounts and offer price signals to discourage dropshipping.

The Co-Palletization Discrepancy

Witness Tang has acknowledged that her initial analysis of co-palletization incentives with the proposed rates was flawed (response to MPA/USPS-T35-28c). But even her corrected testimony and responses indicate several misunderstandings regarding how mailers are co-palletizing.

- Witness Tang makes a false distinction between co-palletization and co-mailing. Note her response to MPA/USPS-T35-17j, where she states, "The impact on co-mailed publications is expected to be similar to that on co-palletized ones, in terms of palletization and dropshipping." She indicates that her co-palletization analysis focused only on situations where bundles of different publications are put onto the same pallets, not on co-mailing and other strategies that commingle publications within bundles. But the Postal Service's regulations for the experimental co-palletization discounts describe co-palletization as any process that involves the presorting together of "at least two different Periodicals publications or two different editions, segments, or versions of a Periodicals publication." (Domestic Mail Manual, Section 709-3.1.3a.) Co-mailing, co-binding, and selective binding are among the techniques for commingling different publications or versions within bundles and that qualify for the experimental co-palletization discounts.
- Witness Tang assumes that co-palletization incentives for co-mailed publications are similar to those of the co-palletized publications she studied (that is, the Tang

Twelve). But co-mail often involves larger mailers and larger total mailstreams, meaning that the co-palletization incentives for co-mailed publications are often quite different than those of the Tang Twelve. (For example, in Exhibit A of his testimony in C2004-1, Witness Schick detailed a co-mailing in which twelve of the thirteen publications had more copies than did any of the Tang Twelve.) One significant difference is that larger mailers tend to have fewer copies per container than do smaller mailers, which means larger mailers would have less incentive than smaller mailers to use co-palletization as a means of minimizing the proposed container rate. That means that the twelve publications Witness Tang chose for her co-palletization analysis are by no means a representative sample of the universe of publications involved in co-palletization.

- Witness Tang states that "it is likely that a co-palletization program achieving a pallet size of around 1,600 pieces will involve co-palletizing more than two publications" (response to ABM/USPS-T35-12). The U.S. News-*Information Week* co-binding program, in fact, typically creates pallets averaging more than 3,000 pieces.
- Witness Tang's analysis is based on the assumption that the Postal Service has data showing how co-palletized publications would be mailed if they were not co-palletized. In response to a question from Commissioner Hammond, she states, "when I assess the impact on the currently co-palletized mail, the way to look at the absolute incentives, relative incentives, is actually to look at what if they don't co-pal under the proposed rate, take the differential from the one if they co-pal using the same set of rates which was under the proposed rates and compare the

incentives they are getting under the proposed rates with the incentive they are getting now and you can clearly see that the incentives are at least comparable" (transcript page 1877, lines 13-22). Witness Tang cannot possibly know what mailers would pay "if they don't co-pal under the proposed rates" because she does not know how they would mail if they did not co-palletize. Mailers themselves often do not have that information. Take, for example, a supplemental mailing of 12,400 copies of *Radar Magazine* that the printer of that magazine included in a large co-mail run last year. If Witness Tang had studied that mailing, she would have seen that 97 percent of the copies were dropshipped to hundreds of SCFs and that 56% of the copies were eligible for an experimental co-palletization discount. She could also have seen data supporting those co-palletization discounts, which would have shown how the mailing would have looked if it had not been co-mailed <u>but had still gone to all of the same entries</u>, with of course at least one container per entry. But that data in no way describes how *Radar Magazine* would have been mailed without co-palletization. The printer would not have transported a mailstream of less than 7000 pounds to 200 or more entries. Without co-mail, most of the copies would have been origin entered -- but there is no way for the Postal Service to see that from the reports submitted for *Radar Magazine*. With the proposed charge of 85 cents per container, there would be even more incentive to origin-enter mail in mixed-ADC containers rather than in dropshipped sacks.

The Cost-Based Discrepancy

As Michael J. Armstrong testified in Docket No. C2004-1, U.S. News is such an efficient mailer that a move to true cost-based Periodicals rates would reduce our postage costs by more than 10 percent. The Postal Service indicates that its proposed Periodicals rates are more cost-based than are current rates. But the proposed rates would increase U.S. News' postage costs far more than the average for outside-county Periodicals. The Postal Service's intent may well have been to move Periodicals toward more cost-based rates, but the analyses I presented above demonstrate a disconnect between the Postal Service's intent and its proposal.

The plaintiffs in the Docket No. C2004-1 case effectively demonstrated the poor relationship between the Postal Service's costs and Periodicals postal rates. They showed that the Postal Service's major cost drivers for handling Periodicals are related to pieces, bundles, containers, and weight. The current Periodicals rate structure virtually ignores bundles and containers and inadequately reflects the Postal Service's weight-based transportation costs. The Postal Service in essence uses revenue from piece and weight charges to cover its costs of handling Periodicals bundles and containers. As a result, it has to overcharge for pieces (especially efficiently sorted pieces) and for the weight of dropshipped mail. In an attempt to send price signals that encourage more efficient mailing, it has in recent years introduced such features as the dropship-pallet discount and the experimental co-palletization discounts. Those admittedly imperfect discounts did not cure the underlying problem – the mismatch of rates to cost drivers – but they at least act as bandages.

Now the Postal Service proposes to rip the bandages off without healing the wound. The proposed rates would still overcharge for pieces, especially efficiently presorted pieces, but there would no longer be such incentives as the dropship-pallet discount to soften that overcharge. The new dropship-editorial rates are certainly a positive move and may serve to create a more cost-based rate structure for relatively heavy publications. But for a light, efficiently presorted, and extensively dropshipped publication like U.S. News, no amount of tinkering with weight rates can overcome the overcharges for efficient pieces.