Postal Rate Commission
Submitted 12/21/2006 4:01 pm
Filing ID: 55450
Accepted 12/21/2006

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

POSTAL RATE AND FEE CHANGES — Docket No. R2006-1

INITIAL BRIEF OF
U.S. NEWS & WORLD REPORT, L.P.

December 21, 2006

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

POSTAL RATE AND FEE CHANGES	Docket No. R2006-1

INITIAL BRIEF OF
U.S. NEWS & WORLD REPORT, L.P.

The Periodicals rate structure is clearly broken. With mailers lacking sufficient incentives to become more efficient postal customers, the costs and rates for the Periodicals class have been rising faster than those for most other classes of mail. The Postal Service apparently attempted to mend that structure in its current proposal but ended up with something that is in many ways worse than the current rates. The Commission does have before it, however, a proposal that would begin to fix most of what is wrong with Periodicals rates.

To understand Periodical rates and this rate case, it is necessary to explore – and explode – some myths. With apologies to David Letterman, then, here are the Top Ten Myths Regarding Periodicals Rates:

> ***Myth Number 10:*** *Time-sensitive publications cannot engage in such cooperative activities as co-mailing and pool shipping that could help them obtain more worksharing discounts.* **Reality: Oh yes they can – and do.** We have been pool shipping most copies of our weekly newsmagazine to

achieve greater dropship discounts since 1995 and have been co-binding most copies since early this year. Rather than delaying delivery, both moves on the whole have led to earlier home delivery for our magazines. The objection to co-mailing and pool shipping time-sensitive publications has to do with delaying dispatch from the printing plant so that they can be married up with other publications in the co-mail or shipping pool. The objection is irrelevant. What matters is not when publications leave a printing plant but when they are delivered to the subscriber. Pool shipping and the various types of co-palletization (including co-mail and co-bind) allow for more finely sorted bundles and containers that can be dropshipped more deeply into the postal system, meaning they can be dispatched later but still get delivered earlier than if the publication were mailed and shipped on a standalone basis. USNews-T-1 at 3.

Myth Number 9: *Co-mailing and similar activities are only for big publishers.* **Reality: Co-mailing is now available to publications that mail only a few thousand copies, while the largest mailers are generally excluded from co-mailing.** Co-mailing started with relatively large publications because it was pioneered by printers that focus mostly on long-run printing. But today co-mailing and co-palletization services are offered by such short-run printers as Publishers Press and Ovid Bell Press. Quebecor World's Express Collation Mailing System (ECMS), which is geared to mailings of 5,000 to 150,000 copies, is growing rapidly. Large mailers, however, face significantly declining economies of scale when examining co-mail, which is why printers typically exclude single-version publications mailing more than 500,000 pieces from their co-mail programs. U.S. News' research on a wide variety of Periodicals mailings indicates that the relationship between the number of pieces mailed and the cost per piece is logarithmic; specifically, for nationally distributed publications, every doubling of the number of pieces reduces the average piece cost by 0.82 cents. That means that putting 20 publications of 50,000 pieces each into a co-mail pool would reduce their piece costs by more than 3.5 cents per piece, as well as making possible more co-palletization, palletization, and dropship discounts. (With the Postal Service's proposed rates, the piece savings would rise somewhat, but most of the other discounts would disappear.) But adding another publication with 500,000 pieces to that pool of 1 million pieces would only create piece savings of 1.3 cents for that mailer and less than 0.5 cents for the rest of the pool, and it would hardly affect co-palletization, palletization, or dropship discounts for either the large mailer or the pool. Because savings in piece rates are virtually the only co-mail incentive available to large mailers, those that already mail a majority of their pieces in carrier-route bundles have difficulty getting co-mail to make economic sense.

Myth Number 8: *There is no sense in enhancing co-mail incentives because every publication that can co-mail is already doing so*. **Reality: More publications are making the move to co-mail, and many that could reduce the Postal Service's costs by co-mailing have insufficient incentive to do so.** In the past couple of months, for example, *Vibe* magazine announced that it was changing printers based largely on co-mailing capabilities, and Quebecor World announced expansion of its ECMS program for small mailers. New co-mailing incentives lead to gradual, not sudden, growth in co-mailing. A printer or other mail consolidator faces a chicken-and-egg problem when trying to develop co-mail pools. And they have to get their customers to think differently about who should presort mail files, the integration of production and distribution, and how to address the publications. Frankly, our industry seems to put more energy into developing excuses why it cannot co-mail than finding ways that it can co-mail.

Myth Number 7: *The pricing model presented by Witness Mitchell and endorsed by Time Warner is too complex.* **Reality: The Mitchell model is more straightforward than many aspects of current rates.** For those accustomed to the current rate structure, the Mitchell model would certainly require some new learning. But with some features that mimic the current rate structure (e.g. piece rates) and a logical structure throughout, it should be much easier to master than the current convoluted rate structure. For example, the experimental co-palletization discounts are notoriously complicated and administratively onerous.

Myth Number 6: *The Postal Service proposal would increase dropship incentives.* **Reality: The proposal would reduce incentives to dropship for many publications.** Witness White demonstrated that the incentives to switch zoned copies to DADC or DSCF would be greatly reduced not only for

U.S. News & World Report but for all twelve of the relatively small co-palletized publications studied by witness Tang. USNews-T-1 at 5, lines 1-7, and 10, lines 7-10. White explained that for “higher weight publications not involved in co-palletization” the dropship incentives would indeed be enhanced. Id. at 9, line 4. But the incentives would be greatly reduced for lighter-weight publications, especially those that are already extensively palletized or co-palletized. No other parties presented analyses of dropship incentives or rebutted this portion of White’s testimony.

Myth Number 5: *The Postal Service proposal would increase the incentives for co-mailing and other forms of co-palletization.* **Reality: The Postal Service proposal in many cases would reduce incentives for all forms of co-palletization.** A simplistic view of the Postal Service’s proposal is that it would enhance co-mailing incentives by increasing the differentials among piece rates. For example, the difference between the five-digit automated and carrier-route rates would increase from 6.6 cents to 6.9 cents. But the proposal would also eliminate such features as the experimental co-palletization discounts and the dropship-pallet discount, which are especially important for small mailers that are unable to create many dropship pallets on their own. See USNews-T-1 at 6, line 19, through 7, line 17. Co-mail and other forms of co-palletization are often what enable small mailers to dropship, and witness White demonstrated that 12 small- and medium-sized co-palletized publications analyzed by witness Tang would have significantly reduced dropship incentives. The savings from switching Zone 1 or 2 pieces to DADC, for example, would be reduced by an average of 41 percent. USNews-T-1 at 10, lines 7-9. White also demonstrated that the only analysis of co-palletization presented by the Postal Service was fundamentally flawed. USNews-T-1 at 11-13; response to USPS/USNews-T-1-3 (Tr. 30/10081-84). Neither the Postal Service nor any other party has rebutted any of these aspects of White's testimony or responses.

Myth Number 4: *Periodicals rates are a zero-sum game: Given a certain revenue requirement, the more Publisher A pays, the less Publisher B has to pay.* **Reality: Anything that incents a Periodicals mailer to reduce the Postal Service's costs reduces costs for the entire Periodicals class and therefore minimizes future rate increases.** On first blush, for example, U.S. News should not be very concerned about the proposed container charge, because it would represent only a fraction of 1 percent of our total postage. But in fact we are concerned about the perverse incentive it creates to eliminate dropshipped five-digit pallets, which reduce the Postal Service's Periodicals costs. Pitting one group of mailers against another – for example, efficient vs. inefficient, big vs. small, regional vs. national – hurts all of us, because it takes the focus off driving costs out of the Periodicals class. We're all in this class together.

Myth Number 3: *The Postal Service proposal would move Periodicals toward more cost-based rates.* **Reality: The Postal Service proposal is in many ways less cost-based than current rates.** A prime example is our own magazine, a literal poster child for efficient mailing and a pioneer in the use of pool shipping and co-palletization. A study of the five May 2006 issues showed that the Postal Service proposal would raise its rates an average of 16.0%, well above the average for outside-county Periodicals. USNews-T-1 at 4, line 15. Truly cost-based rates should result in such efficient mailers receiving lower-than-average increases. Despite our long history of responding to price signals in postal rates, the Postal Service proposal would give us little incentive to do anything except perhaps to <u>reduce</u> some worksharing. USNews-T-1 at 7, line 18, to 8, line 3. We note that the Postal Service's proposed dropship editorial discounts would probably make rates more cost-based for relatively heavy publications, especially those with low advertising percentages. But for lighter-weight publications, especially small- to medium-sized mailers involved in co-palletization, the loss of piece discounts without an overhaul of Periodicals rates in general would actually make rates less cost-based.

Myth Number 2: *A proposal that increases rates significantly more for one publisher than for another is inherently unfair.* **Reality: Correction of the current intra-class cross-subsidization necessarily means larger rate increases for inefficient mailers than for efficient mailers.** Periodicals rates are already unfair because of the huge discrepancy between the Postal Service's costs for handling various publications and what it charges those publications. By not recognizing the cost of handling sacks, for example, current Periodicals rates cause mailers of heavily palletized publications to subsidize mailers of sacked publications. This is not just big companies subsidizing smaller companies, as it is often mis-characterized. We note that a majority of the main-run copies of two Time Warner publications are mailed in sacks (response to ABM/TW-T1-8), meaning that U.S. News is subsidizing Time Warner. Many relatively small publications are efficient mailers, either because they are regionally focused publications mailed near their subscribers or because they are using such tools as co-mailing and dropshipping. A move toward fairness should mean those mailers would get lower-than-average rate increases, while the inefficient (sometimes larger) mailers they are subsidizing would get larger-than-average increases.

And the Number 1 Myth Regarding Periodicals Rates: *Cost-based rates would help large-circulation publications and hurt small-circulation publications.* **Reality: No credible study comparing mailing costs by circulation has been presented, and many small-circulation mailers would in fact benefit from cost-based rates.** Postal Service references to publications as having "small circulation" or "large circulation" are extremely misleading. Those size designations are based on the number of copies mailed, not the total number of paid copies. Thus *U.S. News & World Report* is considered a very large-circulation publication and our sister publication, the *New York Daily News*, is a very small- circulation publication – even though the *Daily News* sells far more copies annually (mostly through home delivery and newsstand sales) than does *U.S. News*. The *Daily News* is by no means the only large-circulation publication mis-characterized as small by

> the Postal Service. We question whether discriminating against large-circulation publications in setting postal rates is good public policy. And we have heard no one explain why an independent, medium-sized company like U.S. News should subsidize giant newspaper corporations simply because we distribute our publication mostly through the Postal Service. It is true that cost-based rates would help efficient mailers more than inefficient ones, but we have seen plenty of inefficient large mailers and efficient small mailers. And by giving all publications incentives to become more profitable for the Postal Service, cost-based rates would ultimately help the entire Periodicals class.

The fundamental problem with Periodicals rates is what Witness Buc (PB-T-3) refers to as a steak-and-hamburger issue: "If you have a restaurant where you sell steak and hamburgers for the same price, you sell a whole lot more steaks." Tr. 30/ 10137. For too many Periodicals mailers, the pricing differentials between "hamburger" and "steak" service are so small that mailers are choosing the "steak" service – forcing the Postal Service to bear the costs of shipping, handling inefficient containers, etc. Until Periodicals rates are more closely tied to the Postal Service's costs, mailers will not receive appropriate pricing signals that would cause maximization of such worksharing activities as co-palletization and dropshipping.

The Commission has stated clearly the need for Periodicals rates to be more cost-based, most recently in its final order in C2004-1, the Time Warner et al. complaint case:

> 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.

Docket No. C2004-1, Order No. 1446, Order Addressing Complaint of Time Warner Et Al., issued October 21, 2005, p. 45, ¶ 5001.

The Commission goes on to state,

> It is clear 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 proposal is a more cost-based 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.

Id., pp. 45-46, ¶ 5003.

The Postal Service proposal largely ignores "the new insights … into the costs of bundles, sacks, and pallets." Nothing in the new rates recognizes bundle costs. In fact, elimination of the co-palletization discount would give mailers less incentive to engage in co-mailing and other activities that lead to fewer and larger bundles. The proposed container rate addresses sack and pallet costs clumsily, ignoring the Postal Service's widely varying costs for handling containers depending upon such factors as type and point of entry. The most positive feature of the Postal Service proposal is the dropship discounts for editorial pounds.

(Unfortunately, however, the requirement that publications be dropshipped at least to the ADC level, rather than to BMCs or Zone 1, to get any discount may limit the benefits for publications in small freight pools.) Despite these new discounts and the enhanced dropship piece discounts, however, the Postal Service proposal would actually reduce the incentive to dropship for many mailers. The best features of the Postal Service proposal amount to putting a few more lifeboats on the Titanic; they would not keep the ship from sinking. The worst features amount to drilling holes in the ship's hull to let the water out.

Magazine Publishers of America has put forth a proposal that would correct some of the worst features of the Postal Service proposal. For example, it would restore and actually enhance co-mail incentives. And it would encourage creation of dropshipped five-digit pallets, which are efficient for the Postal Service to handle, rather than discouraging them. For U.S. News, the resulting increase would be about 3 percentage points lower than with the Postal Service proposal. And, unlike the Postal Service proposal, it would offer options for minimizing the increase even further by doing more worksharing. But with apologies for taking an analogy a bit too far, the MPA proposal would be like pumps on the Titanic, keeping it afloat a bit longer but not changing the fact that it is doomed. We need a new ship.

Though we are reluctant to praise a competitor, we see the rates and pricing model presented by witness Mitchell on behalf of Time Warner as the only proposal that would move the Periodicals class in the right direction – toward cost-based rates. (We note that the rates proposed by Mitchell would cause a slightly smaller increase for *U.S. News* than the MPA proposal, amounting to a 12.2-percent rather than a 13.1-percent increase.) We encourage the Commission to view the Time Warner proposal as really two proposals that contain the germ of a third proposal. In addition to a specific rate proposal, Mitchell is also offering a general approach to Periodicals rates. For those who accept the Mitchell approach but object to specific rates or outcomes, he has provided the ingredients for a make-your-own-sundae rate structure.

On its surface, the Mitchell model in this case is a watered-down version of what the Docket No. C2004-1 complainants proposed. Rather than zoned editorial-pound rates, for example, Mitchell would retain unzoned rates but add dropship editorial discounts (as would the Postal Service proposal). And only 60 percent, rather than 100 percent, of bundle and container costs would be reflected in Mitchell's new pricing model. Though a half-a-loaf solution, this proposal would incent more publishers to engage in the kind of worksharing practices that minimize the Postal Service's costs of handling and delivering Periodicals.

More fundamentally, however, the Mitchell proposal sets forth a logical approach to Periodicals rates. The logic is really quite simple: Identify the Postal Service's major cost drivers for handling and delivering Periodicals mail, then create rates that are based on those cost drivers. It would mean no longer pretending that the Postal Service incurs no costs from handling bundles or that its cost to transport a pound of editorial matter is the same regardless of whether the distance is 30 miles or 3,000 miles.

Parties have complained about various impacts of the Mitchell model, but none in either C2004-1 or this case have challenged his assessment of the major cost drivers or the basic logic of tying rates to those cost drivers. The Commission's only criticism of the original Mitchell model in C2004-1 is that it would lead to inordinately high rate increases for some small mailers. Mitchell's current proposal incorporates those concerns, following the same logic as before but softening the impact on certain mailers (and necessarily balancing that by making worksharing incentives less than they were in the C2004-1 proposal). These efforts to "limit disproportionate effects on what have traditionally been called small mailers" (TW-T-1 at 23, lines 1-2) are reasonable, and U.S. News endorses the specific rate structure he has proposed. But if the Commission disagrees, we urge it not to throw out the baby with the bath water.

Because the Mitchell model in this case is so malleable, U.S. News urges the Commission to consider the Mitchell logic and approach in general separately from its impact. Would the proposed bundle and container charges cause inordinately high rate increases for certain mailers? Then the Commission could dial back the impact by changing "60%" to a lower number on the spreadsheet model Mitchell provides. Does the Mitchell proposal overweight a particular cost driver? The rates can be tweaked to bring them into line with what the Commission believes to be more accurate cost estimates.

The Postal Service has indicated that it intends to send clear, consistent price signals to Periodicals mailers, but instead what we are getting these days is mostly static. We hear the Postal Service talk about discounts that have led to more co-mailing and dropshipping, then see it propose to remove those discounts without replacing them with other incentives. It has praised co-mail and other forms of co-palletization but inadvertently proposed a rate structure in this case that would provide reduced incentives for such worksharing activities. Flats automation and network redesign are praiseworthy efforts that should minimize Periodicals costs, but the Postal Service is still wrestling with exactly how they will work – much less communicating clearly to mailers what the impact on them will be.

Adoption of Periodicals rates based on the Mitchell approach would clear up much of the static, even if the specific rates differ from what he proposes in this case. Even watered-down Mitchell rates would send the message that Periodicals are moving toward cost-based rates, though we would not necessarily know how quickly or whether Periodicals rates would ever be truly cost based. Periodicals rates would no longer include such bizarre features as the experimental co-palletization discounts or the proposed container charges that cry out to be eliminated in the next rate case (though both are or would be favorable to U.S. News). Once adopted, the Mitchell approach would have staying power, though no doubt there would be arguments about underlying cost assumptions and whether to move further along the cost-based road. Our vendors could continue to invest in co-mailing, pool shipping, and other efforts that reduce the Postal Service's costs – knowing that our incentives to do so might grow but certainly would not shrink. We could align our production and distribution to take advantage of such incentives without wondering whether they would disappear next year. We could look ahead to see, and prepare for, what would happen if today's "partial recognition" of certain costs becomes tomorrow's fuller or complete recognition. And we would have a rate structure that could easily be adjusted for a future world of postal reform, flats automation, and network redesign.

Respectfully submitted,

s/____________________________

Peter Dwoskin
General Counsel
U.S. News & World Report, L.P.

450 West 33rd Street, 3rd Floor
New York, New York 10001
(212) 210-6390 (Telephone)
(212) 210-6313 (Facsimile)
pdwoskin@nydailynews.com