

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

POSTAL RATE AND FEE CHANGES)
_____) Docket No. R2006-1

INITIAL BRIEF
OF
THE McGRAW-HILL COMPANIES, INC.

Timothy W. Bergin, Esq.
Hall, Estill, Hardwick, Gable, Golden & Nelson, P.C.
1120 20th Street, N.W.
Suite 700, North Building
Washington, D.C. 20036-3406
(202) 973-1224

Attorney for The McGraw-Hill Companies, Inc.

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The McGraw-Hill Companies, Inc. ("McGraw-Hill"), through its undersigned counsel, respectfully submits this initial brief supporting generally the rate design proposed by the Postal Service for Outside-Country Periodicals mail (with the exception of the level of the unzoned editorial pound charge) as opposed to the two alternative rate designs, one proposed by Time Warner Inc. ("Time Warner") and another proposed by Magazine Publishers of America and Alliance of Nonprofit Mailers jointly ("MPA/ANM").

OVERVIEW

In Docket No. C2004-1, the Time Warner et al. complaint case, the Commission recognized that choice of a rate design for Periodicals mail under the Postal Reorganization Act ("the Act") involves tradeoffs between economic efficiency, adverse rate impact, and the statutory policy of promoting wide diversity and dissemination of editorial content. The latter two factors led the Commission to resolve that case by embracing an incremental approach to promoting more efficient Periodicals mailing practices through rate design changes.

In this case, the Postal Service has adhered to the incremental approach laid out by the Commission in the Time Warner et al. complaint case. Building on insights developed in that case, the Postal Service has taken a first step toward recognizing containers as a cost driver for Periodicals -- although the Commission should not permit the proposed container charge to apply to uncontainerized mail that is entered in accord with Postal Service rules. The Postal Service has also proposed modest destination-entry discounts from the otherwise flat editorial pound charge -- although the proposed level of that charge is too high and unduly burdens the wide dissemination of small, high-editorial publications.

The Postal Service proposal would increase incentives for small publications to prepare more efficient sacks or pallets and thereby reduce costs. It would also increase rewards for larger publications that already engage in efficient mailing practices. In accord with the Commission's guidance in the Docket No. C2004-1, however, the Postal Service has not tried to accomplish too much too soon in proposing rates designed to encourage more efficient mailing practices.

As a result, the Postal Service proposal would have substantially less adverse rate impact on smaller publications than would the MPA/ANM proposal or the Time Warner proposal, which would cause the most adverse rate impact. Further, because the Postal Service proposal would encourage efficient behavior -- preparing fewer but fuller sacks -- that is feasible for most publications, they would have real prospects of mitigating rate increases by engaging in such behavior.

By contrast, the MPA/ANM proposal would primarily increase rewards to Periodicals mailers who are already efficient rather than incenting those who are less

efficient to become more so. It essentially reflects a *status quo* approach. It also tends to have an adverse rate impact on high-editorial publications, as does the Time Warner proposal. The Commission recognized in Docket No. C2004-1 that the phasing in of most aspects of the rate structure presented there, as Time Warner seeks to do here, is far less palatable than the incremental approach adopted by the Postal Service in this case.

I. THE GUIDANCE OF THE COMMISSION IN DOCKET NO. C2004-1

In Docket No. C2004-1, Time Warner and four other large magazine publishers (Newsweek, Inc., Condé Nast Publications, TV Guide Magazine Group, Inc., and Reader's Digest Associations, Inc.) filed a complaint with the Commission asserting that the existing rate structure for Outside-County Periodicals mail (consisting of various per-pound and per-piece rates) should be replaced with a more cost-based rate structure that -- like the proposal of Time Warner in the current case -- added an array of container charges (ranging up to \$3.30 for each sack and \$42.39 for each pallet, depending on the presort level of such containers and the degree to which they were dropshipped), as well as similar charges (ranging up to 37 cents) for each bundle of mail (including "firm" bundles) within the containers, and a surcharge (ranging up to 13 cents, depending on presort) for each non-machinable piece of mail within the bundles. Time Warner et al. also proposed in Docket No. C2004-1 (unlike in the current case) to replace the flat (unzoned) editorial pound charge with an editorial pound discount.

The Commission rejected the complaint of Time Warner et al., after a full hearing on the merits over the course of a year, finding that the existing rate structure for Outside

County Periodicals is indeed consistent with the rate-making standards under the Act.¹ While the Commission commended Time Warner et al. for "identifying and quantifying cost drivers associated with bundles, sacks and pallets" (C2004-1 Order, ¶ 1013), the Commission did "not find the rate design suggested by Complainants [to be] superior" to the existing rate design. *Id.*, App. B, ¶ 13. *See also id.*, App. B, ¶ 33. ("Complainants have not demonstrated that ... their proposed restructuring of Periodicals rates better satisfies the criteria of the Act"). This conclusion of the Commission was supported primarily by two broad factors: (1) the potential adverse rate impact on small mailers and (2) the resultant threat to editorial diversity within the Periodicals class (even apart from the proposed abolition of the flat editorial pound charge).

A. Rate Impact

The Commission found that the "impact of the [Time Warner et al.] proposed container rates on smaller mailers is a major impediment to recommending that the Postal Service adopt them." C2004-1 Order, ¶ 4026.² The Commission elaborated that those rates would have their

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.

Id. ¶ 4033. Indeed, the Commission noted testimony indicating that "the impact of the

¹ Docket No. C2004-1, Order Addressing Complaint of Time Warner et al., October 21, 2005 ("C2004-1 Order")

² The Commission appeared to be referring in this regard to the rate impact of the proposed rates as a whole. The Commission observed that while "bundle and container rates represent only one aspect of the total changes proposed in this docket," the "impact of each of these factors alone would be difficult to assess if the package moves forward as currently proposed." *Id.* ¶ 4035. *See also id.* ¶¶ 4066-67.

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." *Id.* ¶ 4036.

In the latter regard, the Commission observed in Docket No. C2004-1 that while "private industry is making great strides in co-mailing and co-palletizing," the "record is mixed on whether these programs provide *most* Periodicals titles with a practical alternative to sacks." *Id.* ¶ 4023.³ The Commission recognized that "ability to participate in co-mailing and co-palletization programs is constrained by several factors," including the "threshold volume," both for individual publications and the pool, that is necessary to make the programs successful as well as "[p]roduction schedules, trim size, frequency of publication, and inability to use mail.dat files." *Id.*

The Commission likewise observed in Docket No. C2004-1 that "the record does not contain sufficient information to determine the number of publishers that might be able to take advantage of co-palletization, *even if* such programs were widely available in all parts of the country." *Id.* ¶ 4024. *See also id.*, App. B, ¶ 39 ("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"). It appeared to the Commission, however, that "there are some small circulation mailers who will never be able to modify their mailing practices because their volume is too small." C2004-1 Order, ¶ 5008. The Commission's conclusion that "practical and equitable limitations" precluded "wholesale implementation of the proposed bundle and container rates" in

³ All italics in quotations in this brief are supplied by the undersigned counsel unless otherwise indicated.

Docket No. C2004-1 was based on the Commission's finding that "[c]o-palletization and co-mailing simply are not an option for *some* mailers at this time." *Id.* ¶ 4033.

B. Editorial Diversity

The Commission noted in Docket No. C2004-1 that "McGraw-Hill opposes 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.'" *Id.*, App. B, ¶ 36 (quoting testimony by McGraw-Hill witness Schaefer) (citation omitted).⁴ The Commission declared that it "shares this concern" (*id.*), explaining:

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 notion together "by meeting diverse informational needs that may not otherwise be served, and forming and sustaining distinct communities defined by common interests rather than geographic proximity."

Id. ¶ 37 (quoting McGraw-Hill witness Schaefer) (citation omitted). *See also id.* ¶ 4 & n.2 (legislative mandate under § 3622 (b)(8) of the Act to foster both diversity and dissemination of editorial content, i.e., mailed matter having "educational, cultural, scientific and informational (ECSI) value...to the recipient"); Docket MC91-3, Second-

⁴ The Commission paraphrased related testimony by witness Schaefer in Docket No. C2004-1 to the effect that "McGraw-Hill publishes 84 Periodicals in diverse fields such as finance, healthcare, and construction. Its largest publication, *BusinessWeek*, 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 *BusinessWeek*. Nevertheless, 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'." *Id.* (quoting McGraw-Hill witness Schaefer) (citations omitted). Excerpts from the testimony of McGraw-Hill witness Schaefer in Docket No. C2004-1 have been incorporated into the record in this rate case. *See* 37/12594-12628. Since witness Schaefer's testimony in Docket No. C2004-1, McGraw-Hill has sold three healthcare publications (ranging from approximately 50,000 to 135,000 in mailed pieces per issue) and taken on three additional construction magazines that each mail about 35,000 pieces per issue.

Class Pallet Discount,⁵ Op. & Rec. Dec. ¶ 1017 ("we cannot allow the policy of cost tracking -- valuable and necessary as it is -- to endanger the diversity of news, information and opinion which second-class helps promote"), ¶ 1018 ("if the current diversity is threatened, the first publications to suffer would predominantly be smaller ones.")

Small publications, which tend to have higher costs and fewer resources, comprise about 84% (25,000) of the roughly 30,000 Periodicals, and therefore account for a "large proportion of the editorial content in Periodicals." C2004-1 Order, App. B, ¶ 35 (quoting Postal Service witness Tang) (citations omitted). The Office of Consumer Advocate ("OCA") accordingly urged in Docket No. C2004-1 that "extended averaging in the Periodicals class" is appropriate to promote "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 Complainants." *Id.*, App. A, ¶¶ 322, 328. The Commission concluded in Docket No. C2004-1 that: "[c]ost averaging ... is an accepted rate design alternative," particularly where it furthers a "specific statutory directive, namely, binding the nation together through the widespread dissemination of the educational and informational value of Periodicals." *Id.*, App. B, ¶ 9. (footnote omitted).⁶

⁵ The Periodicals class was called Second Class at the time.

⁶ In a similar vein, the Commission quoted McGraw-Hill witness Schaefer as follows: "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.* App. A, ¶ 217. Indeed, by definition, a

C. Preferred Approach

The Commission thus recognized in Docket No. C2004-1 that "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." C2004-1 Order, App. B, ¶ 28. *See also id.* ¶ 38 (other factors include "operational readiness" and the "need to account for revenue leakage, particularly given Periodicals' lean cost coverage") (citing testimony of Postal Service witness Tang). The Commission pointed out in this regard that its decision not to recommend the rate structure proposed by Time Warner et al. "should not be read as a ringing endorsement of the status quo," but rather "largely reflects concerns over the impact on mailers and the policy implications that flow from the Complainants' proposal." *Id.* ¶ 28. In other words, the Commission found 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." C2004-1 Order, ¶ 1019.2.

The Commission outlined "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." *Id.* ¶ 5005.

In the current case, Time Warner's proposal reflects the first alternative, by which the Commission contemplated that "the change to the more cost-based type of rate structure would be phased in over two or more proceedings by starting with low

"subclass is a grouping of mail across which attributable costs are measured and *averaged*." Docket No. MC95-1, Mail Classification Reform, Op. & Rec. Dec. ¶ 3018.

bundle/container charges and gradually increasing them case-by-case as experience with impact on mail users is evaluated and taken into consideration." *Id.* ¶ 5006. In Docket No. C2004-1, however, the Commission expressed considerable skepticism regarding this approach: "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 mailing community." *Id.* The Commission added that 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." *Id.* ¶ 5008.

The Commission envisioned that the second alternative -- the piecemail approach -- "would introduce reform to the rate structure incrementally by first proposing one or more changes per rate case or classification case." *Id.* ¶ 5007. The Commission appeared to prefer this approach to the first alternative because it would "allow mailers time to adjust practices, and would lead to additional cooperative efforts to develop efficient mail processing practices." *Id.* The Commission further stated in this regard that:

"Measured introduction of changes would also 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. ... Gradual introduction of changes would allow focused evaluation of the benefit of specific changes as against their impact on Periodicals mailers."

Id. ¶ 5008.

Indeed, the Commission appeared strongly to encourage the Postal Service to adopt the piecemail approach, declaring that the Postal Service "should...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." *Id.* ¶ 1016. The Commission further stated that it is 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." *Id.* ¶ 1017. *See also id.*, App. B, ¶ 38 (noting approvingly the position of the Postal Service that a "more *balanced* approach 'can *enhance efficiency without sacrificing the broad diversity of editorial content* in Periodicals'" (quoting testimony of Postal Service witness Tang)) (citation omitted).

The Commission also observed approvingly that the Postal Service, while opposing the rate structure proposed by Time Warner et al., nevertheless "believes that much more can be done to *improve efficiency* in Periodicals rate design, and is, indeed, considering changes that would *move in the direction* proposed by Complainants." *Id.*, App. B, ¶ 12 (quoting a Postal Service brief in Docket No. C2004-1) (citations omitted). In the current case, the Postal Service proposal does indeed move incrementally in that direction, with the least adverse rate impact on small publications and editorial diversity, as discussed below. The rate structure proposed by MPA/ANM, by contrast, appears to reflect an essentially *status quo* approach, except for the fact that it would tend to provide increased reward (with little if any additional cost savings to the Postal Service) to larger publications that *already* engage in more efficient practices, at the expense of small publications that are unable to do so.

II. THE RATE STRUCTURE PROPOSED BY THE POSTAL SERVICE LARGELY REFLECTS THE GUIDANCE AND EXPECTATIONS EXPRESSED BY THE COMMISSION IN DOCKET NO. C2004-1, BUT AT LEAST TWO IMPORTANT CHANGES ARE WARRANTED.

A. The Proposed Container Charge Would Create The Right Type Of Incremental Efficiency Incentive.

The flat 85-cent container charge proposed by the Postal Service represents progress in recognizing a cost driver for Periodicals mail that was first explored in Docket No. C2004-1 -- "if you're heading in that direction ... [instead] of having a pallet discount you're moving towards a container cost, which ... is the first step in the right direction" and "follows the spirit of what the C2004-1 decision asked us to do." Tr. 39/13536-37 (Taufique). In the latter regard, Postal Service rebuttal witness Taufique testified at the hearings that:

The Commission in its decision on C2004-1 talks about three different alternatives. The last one is the opt-in approach, the first one is the sort of gradual implementation of what Time Warner proposes, and the second one is piecemeal.

I think what we are trying to do is number two in terms of again it's a gradual change, but that is our goal is to sort of follow the Commission's recommendation in a gradual fashion in Alternative 2, which is in terms of piecemeal, I believe.

Tr. 39/13534.

Further, as applied to three different sacks containing 12 mailpieces, 24 mailpieces (the minimum, generally), and 42 mailpieces (the subclass average),⁷ respectively, the proposed 85-cent container charge would amount to 7.1 cents per piece, 3.5 cents per piece, and 2.0 cents per piece, respectively.⁸ The proposed container charge

⁷ See direct testimony of Postal Service witness Tang at 5-6.

⁸ For the average pallet containing 1642 mailpieces (*see id.*), the proposed 85-cent container charge would amount to only 0.05 cents per piece. For pallets containing only 821 mailpieces and 410 mailpieces,

thus encourages even small publications to adopt more efficient mailing practices -- using fuller and fewer sacks or moving from sacks to pallets -- that reduce Postal Service costs. MPA/ANM witness Cohen acknowledged that "for small sacks with below average pieces in them the container charge proposed by the Postal Service provides more incentives to palletize than would the MPA proposed pallet discount." Tr. 30/10222.

Postal Service rebuttal witness Taufique accordingly testified at the hearings that:

[G]iven the status of periodicals cost increases, almost anemic cost coverage, ... the goal the Postal Service has in mind is to provide incentive for *change in behavior* where it *counts the most* and not to reward behavior that is already happening that is efficient.

... We could have offered a discount for a 5-digit pallet. We chose to go with the container charge, which is a *direct incentive* for people to prepare their mail in [fewer] sacks[,] as opposed to rewarding a lot of this behavior that is already happening.

...[W]e think a direct incentive to change behavior will be *more appropriate than what MPA has proposed because that would reward a lot of existing behavior*.

Q.: Will it produce more efficient mailer behavior or not than the MPA proposal?

A.: Yes, where it's needed.

[M]oving mail out of sacks onto ... any kind of pallets ... is preferable to providing incentive to move from ADC pallets or SCF pallets to five digit pallets.

Tr. 39/13465-66, 13468, 13471.

In terms of incenting more efficient mailing practices, therefore, the Postal Service proposal is clearly superior to the MPA/ANM proposal. It may also provide

respectively, the proposed container charge would amount to only 0.1 cents per piece and 0.2 cents per piece, respectively. Thus, on average, the container charge amounts to a 1.95-cent discount for using a pallet (0.05-cent container charge per piece) rather than sacks (2.0-cent container charge per piece). This average implicit pallet discount under the Postal Service proposal is higher than the current 1.6-cent discount for using *and* dropshipping a pallet, and it rises rapidly in the case of below-average pieces per sack (or per pallet).

clearer incentives than the Time Warner proposal which, as recognized in the C2004-1 Order (¶¶ 4035, 4066-67), provides multiple and sometimes conflicting signals.⁹ In addition to providing greater and more direct incentives, the Postal Service proposal would also provide greater rewards than under the current rate structure for already efficient mailers of periodicals, both through a lower container charge and through piece rates lower than those proposed by MPA/ANM, as well as new and enhanced destination-entry discounts.

B. The Postal Service Proposal Appears To Impose The Least Adverse Rate Impact.

Among the three proposals, the Postal Service proposal generates the lowest average rate increase for the small and medium publications sampled in response to Presiding Officer's Information Request No. 19. *See* Tr. 39/13457-58 (direct rebuttal testimony of witness Taufique). The Postal Service proposal also generates the smallest range of rate increases for the sampled publications,¹⁰ except for small low-density publications. *See* Tr. 39/13457-60. That stratum contains three of the four sampled publications (of 259) which would have higher rate increases under the Postal Service proposal (23.5%, 26.8%, 29.1% and 43.7%) than the highest rate increase (22.6%) under the MPA/ANM proposal. However, each of these four publications is an In-County mailer receiving preferential In-County rates (which do not include any container charge) on most of its mailed circulation, and incurs relatively little additional postage on its few

⁹ *See also* R2006-1, Response of Time Warner Witness Stralberg to Questions Posed at Hearing by McGraw-Hill, filed November 20, 2000.

¹⁰ The Postal Service modified its rate structure proposal, prior to filing it, in order to reduce adverse rate impact. Tr. 39/13514 (Taufique).

Outside-County pieces -- between \$3 and \$4 per issue in the case of the publication that would receive the highest rate increase. *See* Tr. 39/13539-40 (Taufique).¹¹

Moreover, rate increases under the Postal Service proposal could more easily be mitigated by small publications than under the MPA/ANM or Time Warner proposals. Under the Postal Service proposal, rate increases could generally be mitigated even by small publications simply by consolidating mailpieces into fewer sacks. Under the MPA/ANM proposal, rate increases could be mitigated by small publications only through co-mailing or co-palletization, which is not available as a practical matter to many small publications (or many other publications). *See* Tr. 39/13502 (Taufique) ("huge number of people who do not have copalletization or comailing as an option, and that is where the impact is a concern of ours"). The greater adverse rate impact under the Time Warner proposal has no clear antidote for many mailers, not even co-mailing.¹²

There seemingly should be yet another way to permit some small publications to mitigate container charges under the Postal Service proposal -- by dispensing with any requirement that very small volumes of periodicals mail be entered in sacks or any other container, thus removing any justification for the Postal Service to assess any container handling charge (there being no container to handle in such instance).¹³ Instead,

¹¹ Some 35% of sampled very small publications are primarily In-County mailers. *See* Docket No. C2004-1, Statement of Postal Service Witness Tang in Response to Comments of Witness Stralberg Regarding NOI No. 1, filed December 20, 2004 ("Tang Statement").

¹² The rate impact of the Time Warner proposal appears to be driven by diverse factors, including machinability, presort level, pre-barcoding, number of bundles, and use of firm bundles, in addition to palletization, dropshipping and number of mailpieces per container. *See* R2006-1, Response of Time Warner Witness Stralberg to Questions Posed at Hearing by McGraw-Hill, November 20, 2006.

¹³ To the extent that the proposed container charge is adopted, and results in fewer containers, as would seem likely, the Postal Service would realize net savings to the extent that the 85-cent charge does not reflect full container-bundling costs. No such savings are reflected in the revenue requirement. *See* Tr. 17/1648-52 (Tang).

publications should be permitted to enter very small volumes of Periodicals mail directly into specified receptacles on outside platforms at postal facilities, at least destination facilities. To the extent that the Postal Service permits entry of uncontainerized periodicals, it should not be permitted to assess any container handling charge on such mail. The Commission should recommend incorporation of such rule in the Domestic Mail Classification Schedule in the event that the Commission recommends the container charge proposed by the Postal Service.

C. The Postal Service Proposal Better Fosters Wide Dissemination And Diversity Of Editorial Content, But The Proposed Unzoned Editorial Pound Charge Should Be Lowered

The Postal Service proposes to establish destination-entry (dropship) discounts for editorial pounds, in addition to the existing destination-entry discounts for advertising pounds and for pieces. It appears that the proposed additional dropship discounts would primarily benefit large and relatively low editorial publications that already engage in dropshipping, as well as publications with a local focus (such that destination-entry and origin-entry amount to the same thing). About two-thirds of all editorial pounds are already destination-entered. *See* Tr. 7/1666 (Tang). Those publications that rely on the Postal Service -- and on the flat (unzoned) editorial pound charge -- for wide distribution tend to be small and high-editorial publications.¹⁴ The proposed editorial pound discounts amount to partial zoning (de-averaging) of the heretofore flat editorial pound charge.

¹⁴ *See* Docket No. C2004-1, Tang Statement (Dec. 20, 2004). *See also* R77-1, Op. & Rec. Dec. pp 350-51.

The Postal Service proposal contemplates a smaller pass-through of destination-entry savings (40%), and thus smaller editorial pound discounts, than do the similar proposals of Time Warner and MPA/ANM. In order to recoup revenue leakage caused by the proposed new discounts, however, the Postal Service proposes to increase the unzoned editorial pound charge by 14.3% -- well above the average proposed rate increase (11.65%) for Outside-County Periodicals, and far above the average increase of 7.6% for *advertising* pounds under the Postal Service proposal. See Tr. 7/1668-70 (Tang). MPA/ANM proposes an even higher 16.26% increase in the unzoned editorial pound charge. Time Warner proposes a greater degree of de-averaging of the flat editorial pound charge than do the Postal Service or MPA/ANM. See part III. C. 2, *infra*.

While McGraw-Hill would not otherwise oppose the Postal Service proposal to establish modest destination-entry discounts for editorial pounds, any such additional efficiency incentive should not come at the expense of undermining the Commission's longstanding commitment to promoting widespread dissemination of diverse editorial content. The unzoned editorial pound charge has traditionally been set about 75% of the Zone 1&2 advertising pound charge,¹⁵ and is currently 77.7% of that charge, but as proposed by the Postal Service would amount to 83% of the Zone 1&2 advertising charge. The Commission should recommend that the proposed increase in the unzoned editorial pound charge be reduced to (or at least close to) its traditional level vis-à-vis the Zone 1&2 advertising change, and that the resultant revenue leakage be recouped by raising the well below-average proposed rate increases (7.6%) for advertising pounds.

¹⁵ See R97-1, Op. & Rec. Dec., ¶ 5783; C2004-1 Order, App. A, ¶ 43.

Maintenance of an unzoned (flat) editorial pound charge, at a level that is advantageous for the small, high-editorial and widely distributed publications that depend on it, has always been financed by higher rates for advertising pounds (which deserve no better treatment than Standard rates). Under the current Postal Service proposal, however, the level of the unzoned editorial pound charge apparently depends on the level of the proposed editorial pound destination-entry discounts. In other words, instead of the traditional approach where advertising pounds fund the unzoned editorial pound charge at its traditional level, the Postal Service apparently contemplates that the level of the unzoned editorial pound charge will be subject to a tug of war between long-haul and short-haul periodicals mailers, and will gravitate toward ever higher levels if editorial dropship discounts are deepened, and vice versa. In Docket No. R97-1, Op. & Rec. Dec. ¶¶ 5783-5788, the Commission rejected a proposed departure from traditional methodology for determining the level of the flat editorial pound charge because it could undermine the extent to which the flat editorial pound charge promotes widespread dissemination of diverse editorial content through the mail. The Commission should do likewise here.

III. THE RATE STRUCTURES PROPOSED BY MPA/ANM AND TIME WARNER DO NOT REFLECT THE GUIDANCE AND EXPECTATIONS EXPRESSED BY THE COMMISSION IN DOCKET NO. C2004-1.

A. Efficiency Incentives

1. The MPA/ANM Proposal Fails To Provide Substantial New Incentives for Increased Efficiency.

The rate structure proposed by MPA/ANM is essentially a *status quo* approach. Despite the preference of the Commission expressed in the C2004-1 Order for

"improving the efficiency of Periodicals" (§ 1017), the MPA/ANM proposal, unlike the Postal Service proposal, offers no new incentive to improve the efficiency of small mailers. The MPA/ANM proposal contains no incentive to reduce container costs by using fewer and fuller sacks or pallets. *See* Tr. 30/10220 (MPA/ANM witness Cohen). Instead, it offers a deepened per-piece pallet discount that is impervious to the number of pieces on the pallet, as well as an added per-piece discount for 5-digit pallets, which tend to have substantially fewer pieces than other pallets.¹⁶

These enhanced discounts would appear to hurt, rather than help, most small mailers because they drive up the piece rates (to cover the revenue leakage caused by the discounts), and because small mailers generally lack sufficient circulation volume to be able to use pallets and thereby qualify for the pallet discounts. *See* Tr. 30/10431-32 (MPA/ANM witness Glick).¹⁷ Even for larger mailers, MPA/ANM witness Glick referred to *marginal* incentives for increased palletization. Tr. 30/10245-46. The primary effect of the pallet discounts proposed by MPA/ANM would doubtless be to further reward large mailers that have long since already maximized their pallet use for reasons other than postage savings. *See* Tr. 39/13455 (Postal Service rebuttal witness Taufique) (MPA/ANM proposes "to reward mail that is already prepared efficiently").¹⁸

¹⁶ Compare direct testimony of Postal Service witness Tang at 5-6 (average of 1642 pieces for all pallets) with Tr. 30/10226 (MPA/ANM witness Cohen) (average 1100 pieces per 5-digit pallet).

¹⁷ MPA/ANM witness Glick acknowledged that the reason why small, low-density publications would tend to have higher rate increases under the MPA/ANM proposal than under the Postal Service proposal was because "we've proposed larger dropship discounts" and "[w]e have proposed a larger incentive to palletize." *Id.*

¹⁸ As early as Docket No. R87-1, the Commission was "concerned that a pallet discount provided to mailers who palletize for their own purposes may have a severe negative impact on postal revenues" (§5422) unless rates for non-palletizers were raised commensurately. The Commission observed that even in 1987, "many large publications already use[d] pallets to a significant degree" (*id.*) -- including *Readers Digest* at 98%, *Newsweek* at 93% and *Timeat* "more than" 90%. *Id.* n. 116. The Commission noted in Docket No.

In Docket No. R2000-1, ¶ 5746, the Commission rejected a 5-digit pallet discount that was proposed by Time Warner and opposed by the Postal Service, declaring that:

This discount would be useful only to a small group of the largest mailers, and there is little evidence that it would cause any meaningful changes in mailer behavior. If further discounts are to be given, an assessment should be made of where potential cost savings are the largest, and of which discounts are more likely to bring about mailer response that enhances Postal Service efficiency.

The Postal Service likewise opposes the 5-digit pallet discount proposed by MPA/ANM in this case on grounds that it would not likely lead to any substantial cost-reducing behavior, but rather would simply reward those publications that currently choose to use 5-digit pallets. *See* Tr. 39/13455-56, 13465-66, 13471-72 (Postal Service rebuttal witness Taufique). McGraw-Hill concurs. MPA/ANM presents no reason why the Commission should approve in this case a preferential pallet discount that it broadly rejected in R2000-1.¹⁹

MPA/ANM appear to present co-mailing and/or co-palletization as a potential panacea (if only the postage rewards are ever increased). However, they do not suggest that there have been any major changes in the little more than a year since the C2004-1 Order was issued that should cause the Commission to change its conclusions expressed in that Order. Neither MPA/ANM nor Time Warner called any printer witness in the current proceeding, much less one who could contradict the Commission's controlling conclusion in the C2004-1 Order (¶4033) that co-mailing and co-palletization were not

MC91-3, ¶1006, that "[l]arge mailers ... have used pallets for at least a decade[] simply because they can move their product more efficiently -- they save money."

¹⁹ The MPA/ANM-proposed 5-digit pallet discount -- unrestricted by entry location or weight -- "would have a detrimental operational impact on the Postal Service." Rebuttal testimony of Postal Service witness McCrery (USPS-RT-14) at 2-3. The Commission rejected the 5-digit pallet discount proposed by Time Warner in R2000-1 even though it was restricted to DSCF or DDU entry.

viable options for at least a significant number of Periodicals, particularly small publications and news weeklies.²⁰

2. The Time Warner Proposal Is At Odds With the Commission's Guidance in the C2004-1 Order, and None of Its Separate Elements Are Appropriate for Piecemeal Adoption.

As demonstrated at the outset, and elaborated below, the proposal presented by Time Warner in this case ignores the guidance provided by the Commission in the C2004-1 Order on how best to reconcile potential adverse rate impact on most of the 25,000 small Outside-County Periodicals mailers, and the Commission's strong policy to maintain and promote editorial diversity, with the need to encourage more efficient mailing practices. *See* part I.C, *supra*, and parts B and C.2 below. Counsel for Time Warner was not persuasive, in his oral cross-examination of Postal Service witness Taufique, when he invoked proposed steep rate increases for certain categories of *Standard* mail in seeking to impugn the adherence by the Postal Service to the path for Periodicals mail outlined by the Commission in its C2004-1 Order. *See* Tr. 39/13518-26.

Further, McGraw-Hill submits that the Commission should not seek in this case to graft onto the rate structure proposed by the Postal Service an element of the Time Warner proposal that would impose a substantial rate penalty on Outside-County Periodicals mail that is not machinable on the AFSM 100 sorting machine. It appears that the Postal Service plans to introduce the Flats Sequencing System (FSS) in test year 2008 for more advanced automated processing of flats mailstreams that include

²⁰ Time Warner itself acknowledged in Docket No. C2004-1 that "there obviously are many small- and medium-sized publications that for some time will remain without access to comailing, co-palletization, and dropshipping." Initial Brief of Time Warner at 40.

Periodicals mail. MPA/ANM witness Cohen accordingly testified that she did not propose in this case any rate differential for non-machinable Periodicals mail because

looking at the difference between the AFSM 100 and the FSM 1000, knowing that the FSS system is going to be coming into play if machinability criteria are almost identical to the 1000, so since we are in a period of changing definitions and this would be an entirely new rate element, I didn't think that this was a good time to put that in

I think that once we see what the FSS machinability standards are then that will be appropriate to do

Tr. 30/10175-76.

McGraw-Hill concurs with this reasoning. It appears to be consistent with the approach adopted by the Commission in its C2004-1 Order that cautioned against recommending new rate elements that may be affected by future operational changes pursuant to the Postal Service's current flats strategy. *See* C2004-1 Order, ¶¶ 4022, 4034-35, 5004. Further, the Commission declared in that Order that the Postal Service should update its machinability standards, in cooperation with Periodicals mailers, and provide them with clear and ample notice before pursuing any rate differential for non-machinable Periodicals mail. *See id.* ¶¶ 4045, 5007.²¹

B. Adverse Rate Impact

This factor clearly favors the Postal Service proposal. *See* part II.B, *supra*. According to the data provided in response to Presiding Officer's Information Request No. 19, the MPA/ANM proposal would generate almost three times as many rate increases of 20% or more, all for small or a few medium-sized publications comprising some 10% of the sampled publications. Assuming that the sample is valid, some 3000

²¹ Machinability standards and rate elements for other mail classes are not necessarily germane to Periodicals. *See* rebuttal testimony of Postal Service witness McCreary (USPS-RT-14), pp. 8-13.

small publications (of the roughly 30,000 members of the subclass) would incur rate increases of 20% or more under the MPA/ANM proposal.

The results are even grimmer under the Time Warner proposal. Some 17% (5000) of the small and medium-circulation publications would incur rate increases ranging from 25% to 59%, while more than 13% (4000) of the remaining publications (large and small) would incur rate increases below 6%, or rate decreases. Under the Postal Service proposal, by contrast, only about 1% of Periodicals mailers would incur rate increases greater than 25% or less than 6%.

C. Adverse Impact on Editorial Diversity and Dissemination

1. The MPA/ANM Proposal

Of the 25 of 259 sampled publications that would face a rate increase of 20% or more under the MPA proposal: (1) all but one are very high in editorial (non-advertising) content, averaging 89%; (2) all but three are small or very small in circulation (none use pallets); (3) most have a dispersed national or regional distribution (spanning postal zones); (4) all but one enter few if any pieces at destination facilities, and (5) all but one would face a lower rate increase under the Postal Service proposal.²² It thus appears that by comparison with the Postal Service proposal, the MPA proposal tilts against small high-editorial publications that tend to provide diversity in focus and perspective, and to bind the nation together by connecting geographically dispersed communities of interest. The MPA proposal does so by incorporating a higher unzoned editorial pound rate (due to deeper destination-entry discounts from that rate), in addition to higher piece rates (due

²² See response of MPA/ANM witness Glick to Presiding Officer's Information Request No. 19, and the underlying MPA/ANM-LR-7, filed October 31, 2006. In particular, see data for publications 63, 89, 129, 166, 168, 172, 173, 176, 178, 179, 184, 185, 188, 191, 192, 193, 194, 201, 211, 214, 220, 226, 231, 232, and 253.

to per-piece pallet discounts, deeper per-piece destination-entry discounts, and a lower editorial piece discount).²³

2. The Time Warner Proposal

In Docket No. C2004-1, Time Warner proposed (among other things) to de-average the flat (unzoned) editorial pound charge, by subsuming it into distance-based zoned pound charges, on grounds that it did not reflect the "higher transportation *and non-transportation* costs associated with mailing to more distant zones." C2004-1 Order, ¶ 4056. The Commission rejected this proposal on grounds that the flat editorial pound charge continued to play a vital role in promoting widespread dissemination of diverse editorial content and thereby binding the nation together.

In the current case, the Time Warner proposal purports to maintain an unzoned editorial pound charge, apart from proposed editorial pound destination-entry (dropship) discounts. Putting aside those proposed discounts, however,²⁴ the current Time Warner proposal appears to undermine the unzoned editorial pound charge in another way. Under the Time Warner proposal, non-transportation costs that are nevertheless distance-related would be recovered from 100% editorial publications (as from all other

²³ Of the 25 publications in question, 22 weighed less than 6 ounces (0.375 lbs.). These relatively lightweight publications may be adversely impacted by MPA's proposal to shift editorial benefit from the piece rates to the pound rates by reducing the amount by which the editorial piece discount would increase under the Postal Service proposal, and using the revenue saved to mitigate the increase in the unzoned editorial pound charge under the MPA proposal. See testimony of witness Glick, MPA/ANM-T2 at 34-35. Only two small (or very small) high-editorial publications (nos. 253 and 259) would face a higher than 20% rate increase under the Postal Service proposal. Both are very lightweight, very small in circulation and locally oriented -- constituting the Outside-County portion of predominantly In-County periodicals that receive preferential rates for their In-County mailpieces. As discussed, moreover, each of these publications may be able to mitigate such rate increase by reducing or eliminating the container charge that it would otherwise pay.

²⁴ Time Warner proposes to increase the flat editorial pound charge to a level that is 83% of the Zone 1&2 advertising pound charge proposed by Time Warner, notwithstanding that the flat editorial pound charge has traditionally been set at 75% of the Zone 1&2 advertising pound charge.

publications) through container charges that (like the zoned advertising pound charges) increase with the distance that a container travels through the postal system. For example, origin-entered containers would pay much higher container charges than destination-entered containers.

Thus, under the Time Warner proposal, a 100% editorial publication would pay substantially more than the unzoned editorial pound charge for the privilege of making greater use of Postal Service transportation. To that extent, the purpose of the unzoned editorial pound charge is defeated.

CONCLUSION

For all of the foregoing reasons, the Commission should recommend the rate structure proposed by the Postal Service rather than either of the rate structures proposed by MPA/ANM and Time Warner, respectively, except that the Commission should recommend that the unzoned editorial pound charge be set at or close to 75% of the level of the Zone 1&2 advertising pound charge, and should require that the container charge not apply to uncontainerized publications that the Postal Service permits to be entered into the mailstream.

Respectfully submitted,

Timothy W. Bergin
Hall, Estill, Hardwick, Gable,
Golden & Nelson, P.C.
1120 20th Street, N.W.
Suite 700, North Building
Washington, DC 20036-3406
(202) 973-1200

Attorney for The McGraw-Hill Companies, Inc.