

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

POSTAL RATE AND FEE CHANGES)
_____)

Docket No. R2006-1

**REPLY BRIEF
OF
THE McGRAW-HILL COMPANIES, INC.**

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January 4, 2007

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The McGraw-Hill Companies, Inc. ("McGraw-Hill"), through its undersigned counsel, respectfully submits this reply brief opposing the rate designs for Outside-County Periodicals mail proposed, respectively, by (1) Magazine Publishers of America and Alliance of Nonprofit Mailers jointly ("MPA/ANM") and (2) by Time Warner Inc. ("Time Warner") with support from U.S. News & World Report, L.P. ("U.S. News"), as alternatives to the rate design for Outside-County Periodicals mail proposed in this docket by the Postal Service, which McGraw-Hill generally supports (except for the proposed level of the unzoned editorial pound charge, and the proposed application of a container charge to uncontainerized mail), as does American Business Media ("ABM").

With respect to underlying cost issues, McGraw-Hill fully supports the analysis in the MPA/ANM brief (pp. 5-31), and the corresponding analysis in the initial brief of the Postal Service (pp. 63-111, 119-128), respecting the volume-variability of both mail processing costs and city carrier costs, and the attribution to subclasses (Outside-County Periodicals mail in particular) of mail processing

costs and city carrier costs. McGraw-Hill likewise fully agrees with the analysis in the MPA/ANM brief (pp. 31-33) demonstrating that payments by the Postal Service into its Retiree Health Benefit Fund, as mandated by the recently enacted Postal Accountability and Enhancement Act, should be treated as institutional costs, not as attributable costs.

I. UNDER THE COMMISSION'S PRECEDENT, THE RATE DESIGN PROPOSED BY THE POSTAL SERVICE FOR OUTSIDE-COUNTY PERIODICALS IS FAR SUPERIOR TO THE ALTERNATIVE RATE DESIGN PROPOSED BY MPA/ANM.

As demonstrated below, the rate design proposed by the Postal Service would incent both small and large publications to change from less efficient to more efficient mailing practices so as to reduce costs to the Postal Service and benefit the subclass as a whole. Thus, under the Postal Service proposal, potential rate increase would more easily be mitigated even by small publications. By contrast, the primary effect of the rate design proposed by MPA/ANM would be to reward large mailers for current mailing practices through a non-cost-based discount that would push up rates for smaller publications. The MPA/ANM proposal, unlike the Postal Service proposal, would impose significant adverse rate impact on thousands of small high-editorial publications that are widely distributed.

A. The Postal Service Proposal, Far More Than The MPA/ANM Proposal, Follows The Commission's Mandate For Progress Toward More Cost-Based Rates That Would Incent More Efficient (Cost-Reducing) Mailing Practices By All Periodicals Mailers.

MPA/ANM acknowledge that the rate design proposed by the Postal Service for Outside-County Periodicals in this docket would indeed "increase ... the existing incentives for commingling [co-mailing and co-palletization] and dropshipping." MPA/ANM initial brief at 4. See also *id.* at 51-53.¹ While MPA/ANM assert that their alternative rate design proposal would provide greater "incentives" in this regard, it would primarily serve only to provide greater *rewards* to larger publications (at the expense of smaller publications) for mailing practices that they already engage in anyway (for reasons unrelated to postal rates).² By contrast, the Postal Service proposal is focused on incenting both small and large publications to change from less efficient to more efficient mailing practices in order to reduce the costs to the Postal Service of handling Periodicals mail. Accordingly, the Postal Service proposal, and not the MPA/ANM proposal, is responsive to the recommendation by the Commission in Docket C2004-1 for "*improving* the efficiency of Periodicals" through incremental

¹ Postal Service witness Taufique pointed out, moreover, that the extent of the increased incentives was likely understated by Postal Service witness Tang's analysis (because under that analysis, each publication in a co-palletization pool was apparently assessed fully with all container charges for the pool as a whole, even though each such publication would in fact incur such charges only for those containers in which the publication was in fact mailed, and would incur only a portion of the charge for a container that also contained another publication). See Tr. 39/13456 (lines 13-21).

² See Initial Brief of McGraw-Hill at 20 n.18 (noting the Commission's longstanding recognition that large publications began maximizing their use of pallets by the early 1980s for reasons unrelated to postal rates, and that pallet discounts from postal rates would have "severe negative impact" either on smaller publications (non-palletizers) or on postal revenues).

rate design changes³ -- ideally to incent "small circulation mailers ... to change their mailing practices" so as to "reduce the costs imposed on the Postal Service." See initial brief of McGraw-Hill at 10-11, quoting C2004-1 Order, ¶¶ 1017, 5008.

The distinguishing characteristic of the MPA proposal is its perpetuation, in a significant way, of *non-cost-based* ratemaking. Thus, a central feature of the MPA/ANM proposal is a 70% expansion (from 1.6 cents to 2.7 cents per piece generally, plus 1.5 cents per piece on 5-digit pallets) of *per-piece* discounts for palletized Outside-County Periodicals mail. There appears to be an emerging consensus, however, that the costs to the Postal Service of handling containers such as sacks and pallets are *not* incurred on a per-piece basis, but rather on a per-container basis.⁴ Per-piece pallet discounts are therefore misaligned with container costs. Per-piece pallet discounts do not encourage fewer, more fully utilized pallets (which would reduce costs to the Postal Service) because the

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

⁴ As noted by the Postal Service in its initial brief (at 345) in the current docket, "the design of the ... pallet discounts was criticized by the Commission in Docket R2001-1, when they were introduced." In that docket, the Commission suggested (at ¶ 3177) that per-piece discounts may be an inappropriate way to recognize cost savings associated with pallets because the "associated savings, in terms of transportation, may have a pound orientation and may vary with distance." The question was not pursued at the time in view of the settlement of Docket R2001-1, but was pursued in Docket C2004-1, where the Commission indicated its tentative agreement in principle with the concept (supported by MPA at the time) that pallet and sack costs are incurred on a per-container basis rather than a per piece basis. See Order No. 1446, ¶ 4013; *id.*, App. A, ¶¶ 6-8, 66, 85, 92, 126. Time Warner accordingly states in the current docket that: "The proposal of ANM/MPA does not even pretend to move in the direction of recognizing the cost drivers that the Commission has said should be recognized. Its goal is retain and enlarge a per-piece pallet discount, even though pallet costs are not piece-related." Initial Brief of Time Warner at 14, citing Tr. 31/10524-25 (Time Warner witness Mitchell) (unlike the Postal Service proposal, the MPA/ANM proposal does not move toward a more cost-based rate design, but rather "moves backwards and increases the reliance on a per-piece discount for palletization" even though "pallet costs are not incurred on a per piece basis"). Even MPA/ANM proposes per-piece pallet discounts only on an "interim" basis. MPA/ANM-T-1 at 23-24 (Cohen).

same discounts are available if a mailer elects instead to use multiple pallets containing relatively few pieces.

Further, the expanded per-piece pallet discounts proposed by MPA/ANM would amount to a windfall for those publications (mostly larger) that already use pallets to the extent feasible. Because the windfall would not reflect any savings to the Postal Service, it would be funded by commensurately higher piece rates paid by other publications (mostly smaller) that lack practical opportunities to use pallets. While MPA/ANM purport to justify the windfall under general economic theory (MPA/ANM brief at 66-67), this ignores the postal ratemaking reality that in order to meet revenue requirements, discounts divorced from postal savings necessarily push up other postal rates, such that the resultant impact on disadvantaged mailers (and editorial diversity) is an important regulatory concern. While MPA/ANM attempt to minimize the extent to which the proposed 5-digit pallet discount would have such effect (*id.* at 60, 76), this ignores the much greater revenue leakage from the proposed 2.7 cents per piece discount for all Outside-County Periodicals mail that is palletized.

By contrast, the container charge proposed by the Postal Service is reasonably designed to incent *all* Outside-County Periodicals mailers (not just those able to palletize) to *reduce* to the extent feasible the container costs incurred by the Postal Service (not primarily to further reward those mailers that already use pallets). The proposed container charge would not only provide an increased incentive, for those publications able to do so, to switch from sacks to

pallets,⁵ but would also provide all Outside-County periodicals with a new rate incentive (there is no counterpart in the MPA/ANM proposal) to reduce Postal Service costs by using fuller and thus fewer sacks.

This new incentive would extend to and potentially benefit both smaller (and other) publications that are unable as a practical matter to use any pallets as well as larger (and commingled) publications that are constrained to use a substantial number of sacks in addition to pallets. The proposed container charge would directly incent more efficient containerization in a flexible manner -- like a sliding scale, it would provide at least some incentive even for relatively small improvements, while providing greater incentives for greater improvements. It would therefore provide virtually all Outside-County periodicals with a feasible opportunity to mitigate rate increases by reducing Postal Service costs. At the same time, those periodicals that currently use pallets would be rewarded both with a negligible container charge on a per-piece basis (see *id.*) and with lower piece rates than under the MPA/ANM proposal.

MPA/ANM has no effective response to the testimony of Postal Service witness Taufique that:

For all those who are interested in the viability of Periodicals as a subclass, greater weight should be placed on establishing pricing that leads to *cost-reducing* behavior, rather than simply rewarding existing efficient preparation. While nearly all pricing incentives will reward existing efficient preparation, it is important to construct the incentives such that they are obtainable for a *wide range of mailers, especially* those that are producing high-cost mailings.

⁵ The incentive provided by the proposed container charge in this regard is equivalent on average to a 1.95 cent per palletized piece discount. See initial brief of McGraw-Hill at 12-13 n. 8.

USPS-RT-12 at 4 (Tr. 39/13456), See also Tr. 39/13468 (Taufique testimony that the Postal Service proposal would result in "more efficient mailer behavior ... where it's needed" than the MPA/ANM proposal).

The suggestion by MPA/ANM (initial brief at 56) that the proposed container charge would not encourage "much" cost-reducing change in mailing practices because small publications (despite constituting some 84% of all Outside-County periodicals) "do not enter a significant volume of mail" is unfounded. It ignores the fact that the container charge would encourage more efficient mailing practices on the part of *all* Outside-County periodicals, regardless of circulation size, and is inconsistent with contentions that small publications may be a significant source of relatively high costs burdening the subclass as a whole. These conclusions are not undermined by the 24-piece minimum for sacks because the proposed container charge would incent change from minimum-piece sacks to average- (and above-average) piece sacks, and the resultant savings to the Postal Service would be significantly larger than the resultant reduction in container charge revenues. See initial brief of McGraw-Hill at 12-13 n. 8, 16 n.13.⁶

⁶ Likewise misdirected is the assertion by MPA/ANM (initial brief at 60 n. 42) that the MPA/ANM proposal would provide "more incentive" than the Postal Service proposal in the "areas of palletization and dropshipping." In this regard, MPA/ANM ignore the incentive under the proposed container charge (but not under the MPA/ANM proposal) to use fewer sacks even if palletization is not feasible. MPA/ANM also fail to distinguish between rate incentives that (like the proposed container charge) are geared toward changing mailing practices in order to reduce costs, and rate "incentives" that (like the MPA/ANM-proposed pallet discounts) are geared primarily toward rewarding current mailing practices. Further, the bald assertion of MPA/ANM that "[t]he way in which mailers react to postage incentives is unaffected by whether the incentive is direct or indirect" (*id.*) seems highly dubious. The container charge would operate like a surcharge on sacks (see initial brief of McGraw-Hill at 12-13 n.8), and would thus appear much

MPA/ANM suggest (initial brief at 60-65) that apart from rewarding current mailing practices, their rate design proposal could in theory incent a marginal increase in co-palletization, co-mailing and/or dropshipping on the part of Periodicals mailers. However, MPA/ANM do not suggest, as they could not, that any such marginal increase in efficiency would exceed the increase in cost-reducing behavior under the Postal Service proposal,⁷ or would be as inclusive of smaller periodicals as the Postal Service proposal.⁸ McGraw-Hill nevertheless agrees with MPA/ANM, as do other participants in this proceeding, that certain refinements to the Postal Service-proposed container charge would be appropriate, *i.e.*, exempting from the container charge both uncontainerized bundles (entered in accord with Postal Service rules) and containers carrying mostly mail other than Outside-County Periodicals mail (in conformity with Postal Service rules).⁹

more likely to incent sack-users toward more efficient container usage than would pallet discounts that cause incremental increases in all piece rates paid by all subclass members (pallet-users and sack-users alike).

⁷ There have been significant increases between FY 2003 and FY 2005 in the amount of Outside-County Periodicals mail that is palletized (from 54.5% to 72.5%) and/or dropshipped (from 50.5% to 62.2%) -- even without the expanded incentives proposed by MPA/ANM. See USPS-RT-12 at 2 (Tr. 39/13454) (Taufique). Further, the use of 5-digit pallets for Outside-County Periodicals mail is "already a fairly widespread practice" --even without the 1.5 cent per piece discount proposed by MPA/ANM for 5-digit pallets. USPS-RT-12 at 3 n.2 (Tr. 39/13455) (Taufique). See also initial brief of MPA/ANM at 74. Finally, there is no basis for the suggestion by MPA/ANM (*id.* at 55) that the container charge proposed by the Postal Service would materially disincent 5-digit pallets. As applied to pallets, the container charge would be *de minimis* on an average, per-piece basis. See initial brief of McGraw-Hill at 12-13 n. 8. Moreover, it seems apparent that as in the case of 5-digit sacks, periodicals prepare 5-digit pallets for service reasons, *i.e.*, to obtain faster delivery of periodicals.

⁸ See part I.B, *infra*.

⁹ See initial brief of MPA/ANM at 56-57; initial brief of McGraw-Hill at 15-16; initial brief of National Newspaper Association, part III. However, McGraw-Hill does not agree with the suggestion in the initial brief of MPA/ANM (at 57) -- never explored on the record in this proceeding -- that a

B. The MPA/ANM Proposal, Far More Than The Postal Service Proposal, Would Have An Adverse Rate Impact on Editorial Diversity and Dissemination.

McGraw-Hill demonstrated in its initial brief that: (1) under the Commission's precedent, adverse rate impact on thousands of smaller periodicals may undermine a paramount statutory policy of binding the nation together through Periodicals mail meeting diverse informational needs (pp. 6-8); (2) the rate design presently proposed by MPA/ANM for Outside-County Periodicals, by comparison with the Postal Service proposal, would generate almost three times as many rate increases of 20% or more, nearly all for small high editorial publications that are widely distributed and comprise some 10% of sampled publications, which may translate to some 3000 small publications (pp. 23-24); and (3) the only two such publications in the sample that would incur -- absent alteration of their mailing practices -- higher than 22.6% rate increases under the Postal Service proposal both receive preferential In-County rates for most of their mailed circulation, and would incur (even absent any mitigating change in mailing practices) relatively little additional postage on their few Outside-County pieces (pp. 14-15, 25 n. 23).

MPA/ANM nevertheless argue simplistically that in terms of its rate impact on small publications, the MPA/ANM proposal is preferable to the Postal Service proposal because 4 of the 107 sampled small publications would incur -- absent any mitigating alteration of their mailing practices -- higher rate increases (23.5%,

container charge for co-palletized or co-mailed publications could not be administered so as to avoid any potential state sales tax liability (see Tr. 7/1679 (Tang)), or that the proposed container charge for pallets (which would be *de minimis* on an average, per-piece basis) should otherwise be rejected.

26.8%, 29.1%, and 43.7%, respectively) under the Postal Service proposal than the highest rate increase (22.6%) among the sampled small publications under the MPA/ANM proposal. As an initial matter, MPA/ANM conveniently assume without basis that the threshold for significant adverse rate impact should be set just above the highest rate increase that would be incurred, at least among the sampled publications, under the MPA/ANM proposal (assuming that no mitigating change in mailing practices would likely be feasible for small publications under that proposal).

However, the Commission could reasonably determine that rate increases exceeding 20% constitute significant adverse rate impact, particularly in view of the fact that under the MPA/ANM proposal, such rate increases would burden primarily small high-editorial publications that are widely distributed. By the same token, the MPA/ANM proposal is reasonably viewed as imposing far more significant adverse rate impact than the Postal Service proposal on editorial diversity and dissemination, contrary to a paramount statutory policy.

Another dispositive consideration, moreover, is that under the Postal Service proposal, potential rate increases could more easily be mitigated even by small publications simply by consolidating their mailed copies into fewer sacks, and thereby reducing the container charges that they would pay. Further, doing so would reduce by considerably greater amounts¹⁰ the substantial costs to the Postal Service of handling containers, and would thereby benefit the subclass as

¹⁰ See initial brief of McGraw-Hill at 16 n.13.

a whole.¹¹ Under the MPA/ANM proposal, by contrast, small publications could not apparently mitigate potential rate increases by altering mailing practices unless they were able to co-mail or co-palletize, which the Commission well recognized in its C2004 Order was not feasible (and would never likely become so) for a material number of small (and other) publications.¹²

In a futile attempt to circumvent the adverse rate impact of the MPA/ANM proposal on small publications, MPA/ANM nevertheless theorize (initial brief at 72-75) that some small publications could mitigate such impact through co-mailing or co-palletization. However, as confirmed by Time Warner (initial brief at 55),¹³ there have been no significant changes in the little more than a year since the C2004-1 Order was issued that should cause the Commission to change its conclusion expressed in that Order. MPA/ANM did not call any printer witness in the current proceeding, much less one who could contradict the Commission's controlling conclusion in the C2004 Order (§ 4033) that co-mailing and co-

¹¹ Also, the proposed container charge should not apply at all to uncontainerized mail entered in accord with Postal Service rules. See note 9, *supra*. In addition, potential rate increases should be mitigated by the Commission by lowering the proposed unzoned editorial pound charge. See *id.*, part II.C. See also part II.B, *infra*. Further still, as indicated by the Postal Service (initial brief at 348), §1003(2) of the recently enacted Postal Accountability and Enhancement Act amends 39 U.S.C. §3626(g) by adding (among other things) a subparagraph (4) to the apparent effect that any copies of an issue of an In-County periodical that are distributed outside the county of publication shall be subject to In-County rates, provided that the total paid circulation of such issue outside the county of publication is less than 5000. The Postal Service, noting "possible flexibility in implementation rules" (*id.*), accordingly states that it is "likely that the significant percentage increases [for the Outside-County portion of four sampled In-County publications under the Postal Service proposal] may not materialize or be sustained." *Id.* See also initial brief of McGraw-Hill at 14-15, 25 n.23.

¹² See initial brief of McGraw-Hill at 5-6, 21.

¹³ "Time Warner does not argue that all publications can be comailed or co-palletized. *Clearly, many are too small for these to be viable options.* ... Nor does Time Warner dispute the fact that comailing or co-palletization is not a viable option for some small and medium-sized publications that are so time-sensitive that their publishers find it worthwhile to airlift them to destinating facilities." *Id.* See also initial brief of American Business Media.

palletization are not viable options for a material number of periodicals, particularly small publications and news weeklies.¹⁴

II. THE ALTERNATIVE RATE DESIGN PROPOSED BY TIME WARNER IS AT ODDS WITH COMMISSION PRECEDENT APPLYING TO PERIODICALS MAIL IN PARTICULAR STATUTORY RATEMAKING POLICIES THAT INCLUDE IMPORTANT NON-COST CONSIDERATIONS.

The rate design proposed by Time Warner in this case should be rejected in accord with the Commission's analysis set forth in the C2004-1 Order. Of the three pending rate design proposals for Outside-County Periodicals, the Time Warner proposal would have unacceptably greater adverse impact on editorial diversity, and on wide dissemination of editorial content, with no clear path for mailers to mitigate such impact by changing their mailing practices. Among other things, the distance-based container charges proposed by Time Warner would effectively de-average the unzoned editorial pound charge, and thereby reduce the current recognition of editorial matter in postal rates for Periodicals.

A. Time Warner Distorts The Commission's Order In Docket C2004-1 As Well As Other Commission Decisions.

As demonstrated in McGraw-Hill's initial brief (pp. 3-8), the Commission concluded in Docket C2004-1 that: **(1)** the rate structure proposed by Time

¹⁴ MPA/ANM rely solely on economic theory and unbridled speculation in assuming (initial brief at 63) that sufficient capacity would timely emerge to provide co-mailing and co-palletization services to some 30,000 Outside-County Periodicals mailers throughout the nation, even putting aside (as MPA/ANM do) the inherent practical constraints for many thousands of publications, including very small publications and time-sensitive publications. MPA/ANM further assume in this regard that most Periodicals mailers would be willing and able to switch from their current printers to others in order to obtain such services, regardless of contracts, cost, geographic proximity, longstanding relationships, etc. In Docket MC95-1, however, the Commission rejected "heavy emphasis on 'changing mailers' behavior' and 'driving costs from the system' without full appreciation of the impact this may have" on many publishers who cannot change or could do so "only after considerable adjustments in almost every aspect of their operations." Op. ¶ 5134.

Warner there, as here, is on balance "not ... superior" to the existing rate design (see *id.* at 4); **(2)** the Time Warner proposal would "effectively punish ... [many] publications for their small size", which precludes them as a practical matter from using pallets instead of sacks (see *id.* at 5-6); **(3)** the adverse rate impact of the Time Warner proposal on small publications would undermine a paramount statutory policy of "binding the nation together" through postal ratemaking (including cost-averaging) that promotes wide dissemination through the mail of diverse editorial content (see *id.* at 6-8); **(4)** phasing in the Time Warner proposal, by initially tempering the adverse rate impact, was not the best answer to the extent that a significant number of small publications was less likely to be able to alter their mailing practices meaningfully, and thus more likely to incur such adverse rate impact eventually (see *id.* at 9-10); and **(5)** the Postal Service should instead pursue "incremental changes" in rate design that improve the efficiency of Periodicals mail without undue adverse impact on small publications, and thus on wide dissemination of diverse editorial content. (See *id.* at 10-11).

Time Warner's initial brief, by contrast, distorts the Commission's Order in Docket C2004-1. Time Warner catalogues virtually every statement by the Commission in its C2004-1 Order (as well as in other cases) that recognizes efficiency and cost-reduction as postal ratemaking goals, as though these were the *only* such goals. See, e.g., Time Warner initial brief at 1, 4-8.¹⁵ Time Warner

¹⁵ For example, Time Warner quotes a Commission statement in its Docket R2005-1 Opinion (¶ 5032) that "the Commission will seek to obtain economically efficient cost-based rates [in the next proceeding]." The context of this statement, which had reference to all mail classes, was to distinguish uniform percentage rate increases across mail classes in cases resolved by settlement.

gives short shrift to perhaps the most fundamental principle of postal ratemaking, applied by the Commission in Docket C2004-1, that "the choice of a rate design entails tradeoffs among various competing factors of the Act," including not only costs but also "impact on mailers, and policy concerns." C2004-1 Order, App. B, ¶ 28. Time Warner's current rate design proposal, like the similar proposal it presented in Docket C2004, fails to pass muster under the Commission's analysis set forth in the C2004-1 Order, as demonstrated below.¹⁶

B. Of The Three Rate Design Proposals, Time Warner's Would Have Unacceptably Greater Adverse Impact On Editorial Diversity and Dissemination.

As pointed out in McGraw-Hill's initial brief (at 23-24), the rate design proposed by Time Warner in this case -- even as tempered by a 60% pass-through of bundle and container costs -- would have a much greater adverse rate impact on small (and medium-circulation) publications than even the MPA/ANM proposal (which in turn would have a significantly greater adverse impact on small publications than the Postal Service proposal, as demonstrated in part I.B, *supra*). Moreover, as recognized by the Commission in its C2004-1 Order (¶ 5006), the "tempering" of the Time Warner proposal in this case may (like the proverbial camel's nose in the tent) simply lay the groundwork for even greater

¹⁶ Perhaps recognizing this, Time Warner asserts that "some of the most significant deficiencies in the Postal Service's rate design result from errors in its cost analyses," and argues that the Commission should at least take cognizance of the analysis of Time Warner witness Stralberg in this regard. Time Warner initial brief at 12 n.14 (quoting witness Mitchell, TW-T-1 at 13-14). McGraw Hill's opposition to the Time Warner rate design proposal in this case does not necessarily extend to witness Stralberg's critique of Postal Service witness Miller's mail flow model, as to which McGraw-Hill takes no position presently.

adverse rate impact in the future, if the Time Warner proposal were to be recommended by the Commission and implemented by the Governors.

There is no clear path for most smaller mailers to follow in terms of changing their mailing practices in an attempt to mitigate adverse rate impact under the Time Warner proposal. See initial brief of McGraw-Hill at 15 & n.12. For example, for many small publications, there could be no substantial mitigation of the distance-related container charges under the Time Warner proposal by dropshipping, which generally requires use of pallets.¹⁷ Nor could any mailer seemingly mitigate a rate increase to the extent that, under the Time Warner proposal, it reflects a drastic reduction in prebarcoding discounts, or a large increase in rates for firm pieces (treated as bundles) mailed to classrooms throughout the nation. Time Warner acknowledges (initial brief at 52) that many heavy publications could not feasibly avoid a non-machinability surcharge under the Time Warner proposal (nor do heavier publications necessarily have higher advertising revenues).

Time Warner is therefore reduced to asserting (initial brief at 13) that the "apparent goal of the Postal Service ... to minimize differences in the percentage increase experienced" is "without any discernible basis in the policies of the Postal Reorganization Act." However, the Commission correctly concluded in its C2004-1 Order (¶ 4026) that the "impact of the [Time Warner] proposed

¹⁷ The container charges under the Time Warner proposal are higher to the extent that containers are not entered at destination facilities. They are also higher to the extent that containers are more highly presorted (such that an origin-entered container would travel further through the postal system and require more handling). Reducing presort levels would not appear to be a viable mitigation option in this regard.

container rates on smaller mailers is a major impediment to recommending that the Postal Service adopt them," particularly considering the potential effect on editorial diversity. See *id.*, App. B, ¶¶ 36-37.¹⁸

The container rates proposed by Time Warner would undermine both editorial diversity and wide dissemination of editorial content because, unlike the container rate proposed by the Postal Service, the container rates proposed by Time Warner are distance-based (although based on entry points and presort levels rather than zones),¹⁹ but make no allowance for editorial content. They would thus substantially de-average the unzoned editorial pound charge,²⁰ and undermine its longstanding role in binding the nation together by fostering wide distribution through the mail of diverse editorial content. See initial brief of McGraw-Hill at 25-26.

¹⁸ It is likewise unavailing for Time Warner to assert (initial brief at 52) that "some publications ... would get a higher than average increase because until now they have been able to pay below-cost rates." See *also* initial brief of U.S. News at 7. As the Commission noted in its C2004-1 Order (App. B, ¶ 9), "[c]ost averaging ... is an accepted rate design alternative," particularly when it furthers a "specific statutory objective, namely, binding the nation together through the widespread dissemination of the educational and informational value of Periodicals." See *also* initial brief of McGraw-Hill at 8 & n.6. Moreover, smaller publications generally pay much higher postage per piece than larger publications. See Tr. 37/12600-12606 (McGraw-Hill witness Schaefer). Larger publications nevertheless benefit considerably from the reduced markup of Periodicals costs in recent years, although the reduced markups were intended primarily to benefit the smaller publications that have borne the brunt of above-average cost increases for Periodicals in recent years. See *id.*

¹⁹ See note 17, *supra*; initial brief of Time Warner at 11, 19-20. This would appear to be the major difference between the container charges proposed by Time Warner and the Postal Service, respectively (none of which reflect close to a full cost pass-through). It is not apparent that two separate container charges reflecting average costs for sacks and pallets, respectively, necessarily reflect a better rate design than a uniform container charge designed essentially as a sack surcharge.

²⁰ Time Warner now attributes significantly more mail processing costs to handling containers than it did originally. See initial brief of Time Warner at 27-28. By the same token, the costs attributed to the pound rates under the Time Warner proposal are reduced. See Tr. 31/10485 (Time Warner witness Mitchell).

It therefore appears that the Time Warner proposal does *not* "continue all current recognition of editorial matter." Initial brief of Time Warner at 17. Further, the container charges proposed by Time Warner are effectively higher for sacks than pallets, to the extent containers travel further through the postal system, and thus impact smaller publications (which tend to use sacks rather than pallets) more heavily than larger publications (which tend to use pallets). See initial brief of Time Warner at 19-20.

Time Warner characterizes its entry point-calibrated container charges as "dropship discounts." *Id.* at 11, 19-20. It seems questionable whether separate dropship discounts per container, in addition to dropship discounts per piece, per advertising pound, and per editorial pound (proposed), are both justified and necessary. If so, and unless an unzoned editorial *container* charge is considered, it would appear appropriate to reduce the unzoned editorial *pound* charge to a level substantially *below* its traditional level (75% of the Zone 1&2 advertising pound rate) in order to compensate for de-averaging the unzoned editorial pound charge (into pound-based transportation and container-based nontransportation components), and thereby "continue all current recognition of editorial matter." *Id.* at 17.

CONCLUSION

For all of the foregoing reasons, the Commission should recommend the rate design proposed by the Postal Service rather than either of the rate designs 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,

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