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POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268

Annual Compliance Report, 2009	:	Docket No. ACR2009

REPLY COMMENTS OF TIME WARNER INC.
ON ACR2009 PURSUANT TO ORDER NO. 380
(February 23, 2010)

Pursuant to Order No. 380, Notice of Filing of Annual Reports to the Commission by the Postal Service and Solicitation of Public Comment (issued January 5, 2010) and Notice of Schedule Changes (issued February 10, 2010), Time Warner Inc. (Time Warner) hereby submits its reply comments on the United States Postal Service FY 2009 Annual Compliance Report (filed December 29, 2010) (hereinafter "FY 2009 ACR").

Summary

These comments reply to the discussions of FY 2009 Periodicals class rates in the initial comments in this docket of Valpak[1] and the Public Representative,[2] as well as to comments of Valpak and the Public Representative at the Public Forum sponsored by the Commission on February 17, 2010.[3]

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[1] Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Initial Comments on the United States Postal Service FY 2009 Annual Compliance Report (filed February 1, 2010).

[2] Public Representative Comments on Annual Compliance Report 2009 (filed February 2, 2010).

[3] Transcript, Volume 1: Official Transcript of Public Forum on Annual Compliance Determination (posted on www.prc.gov February 18, 2010).

Section 1 summarizes the discussions of Periodicals class in the initial comments of Valpak and the Public Representative.

Section 2 explains why Time Warner believes that a finding that FY 2009 Periodicals rates were not in compliance with applicable provisions of chapter 36 of the Postal Accountability and Enhancement Act (PAEA) is not warranted in this proceeding.

Section 3 reviews the arguments of the Public Representative that the remedies provision of § 3662 of the Act authorizes the Commission to order that rates be raised to levels in excess of the applicable annual limitation ("price cap") of § 3622(d). We observe that those arguments are unsupported by any direct or inferential evidence to be found in other provisions of the Act, or the Act's structure, purpose, or legislative history, and we show that the Public Representative's conclusions defy logic and contradict the plain meaning of § 3662.

Section 4 argues that, should the Commission make a determination of noncompliance with respect to FY 2009 Periodicals class rates, its consideration of appropriate remedies should take due consideration of current, exceedingly dismal economic conditions in the periodicals publishing industry; should give due deference to the judgment of the Postal Service that immediate rate increases would be counterproductive to its efforts to achieve financial stability; and should continue to follow the path set out in all Commission decisions in recent years by emphasizing improvements in the efficiency of Periodicals class operations and the creation of better incentives for mailer efficiency in the Periodicals rate structure.

1. Summary of the arguments of Valpak and the Public Representative concerning alleged noncompliance of Periodicals class rates

Valpak (at 10) argues that the FY 2009 rates for Outside County Periodicals violate §§ 3622(c)(2) of the PAEA, the attributable-cost recovery requirement, and § 101(d), which states that "[p]ostal rates shall be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis." However, Valpak has apparently taken note of the fact that § 101(d) falls outside the jurisdictional scope of § 3653(b), which authorizes the Commission to make determinations of noncompliance solely with respect to "applicable provisions of this chapter [ch. 36] (or regulations promulgated thereunder)." It therefore recommends (at 17) that the Commission make a "finding that the Periodicals class for FY 2009 was not in compliance with . . . [§] 3622(c)(2)" and on that basis "enter an order under . . . section 3653(c)," but makes no similar recommendation with respect to § 101(d).

We also take note here of a point we will return to later in this discussion. The remedial order that Valpak recommends the Commission issue is

> such order . . . as the Commission determines best to abate the hemorrhage from Periodicals and *move the class toward compliance* with 39 U.S.C. section 3622(c)(2) *over an established period of time.*

Id. at 17-18 (emphasis added).

The Public Representative (at 35) argues that the FY 2009 rates for Outside County Periodicals violate § 3622(b)(8) of the Act, "as unjust and unreasonable, as well as discriminatory." However, the Public Representative does *not* on that basis

recommend that the Commission should make a finding of noncompliance under § 3653(b) and so enter a remedial order under § 3653(c).[4] Instead, the Public Representative attempts to reach the same destination by a more roundabout path. Once one penetrates the verbal fog with which the Public Representative has enveloped the subject, it appears fairly clear that he is saying the following: if the Postal Service does not seek a rate increase under the exigency provision of § 3622(d)(1)(E) in order to avoid insolvency, and if on this basis the Commission makes a finding of noncompliance and orders rates increased above the caps in order to avoid insolvency, the Commission "may order additional rate increases" to remedy imbalances of revenues and attributable costs that it has *not* found to constitute noncompliance.

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[4] The Public Representative's reluctance to make such an argument is understandable, for two reasons. Section 3622(b)(8) states one of nine statutory "objectives" of the new ratemaking system, "each of which shall be applied in conjunction with the others": "(8) To establish and maintain a just and reasonable schedule of rates and classifications . . . ."

(1) Section 3622(b) makes no mention of discrimination or discriminatory rates or classifications. However, § 403(c)--which is outside the jurisdictional scope of § 3653(b)--provides that "the Postal Service may not, except as specifically authorized by this title, make any *undue or unreasonable* discrimination among users of the mail" (emphasis added). In the absence of some other statutory provision dealing with rate discrimination, it follows that rate discrimination is not disapproved by the Act unless it is also "undue and unreasonable." That implication is reinforced by the portion of § 3622(b)(8) that the Public Representative does not see fit to quote. The entire provision, with the unquoted portion in italics, reads as follows:

> (8) To establish and maintain a just and reasonable schedule for rates and classifications, *however the objective under this paragraph shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail.*

(2) In order to argue that Periodicals rates are subject to a finding of noncompliance under § 3653(b) by reason of failing to comply with § 3622(b)(8), therefore, the Public Representative would have to argue that rates which fail to cover attributable costs are necessarily unjust and unreasonable. That argument would prove too much. It would make surplussage of § 3622(c)(2), which makes full cost coverage by classes of market-dominant mail a "factor" to be considered in designing the new ratemaking system. (If below-cost rates are by definition "unjust and unreasonable" within the meaning of § 3622(b)(8), § 3622(c)(2) becomes at best redundant; its limitation to "classes" of market-dominant mail becomes inexplicable.)

2. Reasons why the Commission should not make a finding of noncompliance with respect to § 3622(c)(2) or § 3622(b)(8)

As early as August 2007, in its initial comments in the first rulemaking for the purpose of adopting regulations implementing the PAEA, and as recently as February 1 of 2010, Time Warner stated what in its view is the correct standard for making a determination of noncompliance under § 3653(b):

> in performing its annual compliance review under § 3653, the Commission [should], absent extraordinary justification, make a determination of "noncompliance" only with respect to matters that involve a clear and determinate obligation imposed on the Postal Service by either the statute or the Commission's regulations at the time the rates were in effect.[5]

In order for FY 2009 rates to meet that standard with respect to § 3622(c)(2), that provision would have to have imposed "a clear and determinate obligation . . . on the Postal Service" at the time the rates were in effect. (No party has alleged that FY 2009 rates violate any Commission regulation implementing § 3622(c)(2).)

Time Warner does not believe that that standard has been met in this case, because no such "clear and determinate obligation" has been established with respect to § 3622(c)(2). That no such obligation has been established is proven by a consideration of the Postal Rate Commission's precedents under the Postal Reorganization Act and the Postal Regulatory Commission's precedents under the PAEA. We have discussed the PRA-era precedents at length elsewhere[6] and will recall here only two points. First, no one has expressed disagreement with the view

[5] Docket No. RM2007-1, Initial Comments of Time Warner Inc. in Response to Commission Order No. 2 (filed April 6, 2007), at 18; Docket No. ACR2009, Initial Comments of Time Warner Inc on ACR2009 in Response to Order No. 380 (filed February 1, 2010), at 3.

[6] *See* Initial Comments of Time Warner Inc. on ACR2009 Pursuant to Order No. 380 (filed February 1, 2010), at 6-9.

that under the PRA the attributable-cost recovery requirement was, in the Public Representative's words, "the bedrock of Commission ratemaking."[7] Second, under the PRA, despite an entire decade during which Periodicals rates struggled but failed to recover more than 100% of attributable costs, the Commission "never espoused the view that a failure to achieve that objective consistently and at all times rendered the associated rates *illegal*," never "single[d] out attributable-cost recovery for application of a year-by-year (rather than test-year) analysis," and never "adopt[ed] a policy of 'truing up' rates retrospectively in order to make up for failures of a class to recover attributable costs in previous years (similar to the allowance for recovery of prior years' losses in the Postal Service's revenue requirement)."[8] In view of the fact that the importance of the attributable-cost recovery requirement in the hierarchy of statutory values is diminished under the PAEA from what it was under the PRA, we do not think that the PRA-era precedents can reasonably be construed as establishing a "clear and determinate obligation" that revenues for a class must exceed attributable costs in any given year or over any established period of time.

Obviously of more relevance are the Commission's precedents under the PAEA, and especially its most recent precedent, its decision in Docket No. ACR2008.

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[7] Docket No. RM2007-1, Office of the Consumer Advocate Comments in Response to Order No. 26 Proposing Regulations to Establish a System of Ratemaking (filed September 24, 2007), at 19-20.

[8] *Id*. at 7-8.

In Docket No. ACR2007, "Valpak assert[ed] that the requirement that each class must cover its attributable cost is not being met, and [that] the Commission must find the Periodicals class in violation of this requirement." Annual Compliance Determination (ACD), FY 2007 (issued March 27, 2008), at 68. The Commission found that "[t]he attributable costs of Periodicals in FY 2007 clearly exceeded their revenues" (*id*. at 70), but it made no determination of noncompliance. Instead, it concluded:

> At this point in time, it is most appropriate to allow the recently adopted strategy for overcoming the Periodicals revenue-cost relationship a reasonable interval of time to succeed.

Id.

Valpak and the Public Representative have summarized the Commission's decision in ACR2008. As Valpak states in its initial comments in the instant docket (at 11):

> In Docket No. ACR2008, the Commission determined the Postal Service to be in compliance with PAEA despite the fact that 10 market-dominant products [including Periodicals In-County and Periodicals Outside County] lost a combined $1.1 billion. [Footnote omitted.]

As stated in the initial comments of the Public Representative (at 34):

> In the FY 2008 ACD, the Commission determined that these products [including Outside County Periodicals] failed to cover their attributable costs. . . . [Although it did so for other products,] [i]n the case of Outside County Periodicals, the Commission did not specifically direct improvement in cost coverage.

Moreover, as Valpak points out (at 14), at the time the Commission issued its FY 2008 Annual Determination of Compliance, it had already approved the FY 2009

price adjustments, even while anticipating that they would not bring Periodicals class revenues up to the level of attributable costs:

> In approving the price adjustments, the Commission anticipated that these adjustments would not permit Periodicals to cover its costs in FY 2009, but deferred the matter:
>
> > The [FY 2008] ACR case appears to be a better forum for considering those issues. [Docket No. R2009-2, Order No. 191, pp. 41-42.]
>
> In that then-pending ACR case, the Commission took no action with respect to Periodicals. . . .

It is hard to imagine how, based on those precedents, the Postal Service could have concluded that it was under a "clear and determinate obligation" to bring FY 2009 Periodicals class rates up to the level of attributable costs, or could have anticipated that its FY 2009 Periodicals rates would subject it to a determination of noncompliance under § 3653(b). Faced with Periodicals class rates that had also been well below attributable costs in FY 2007 and FY 2008, the Commission in its FY 2007 and 2008 Annual Compliance Determinations: (1) did not make any determination of noncompliance; (2) did not issue any remedial mandate; and (3) did not clarify its interpretation of the scope of § 3653(b) with respect to future proceedings.

With respect to the Public Representative's argument that the rates violate § 3622(b)(8), "as unjust and unreasonable, as well as discriminatory," we have already noted that the PR does not make this assertion the basis for a recommendation of a finding of noncompliance. It should be added that the arguments we have adduced against making such a finding with respect to § 3622(c)(2) also apply to § 3622(b)(8). It would be extremely difficult to conclude that the Postal Service had

any reason to think its FY 2009 Periodicals class rates might be in violation of some "clear and determinate obligation" imposed by § 3622(b)(8), in light of the Commission's precedents in ACR2008 (or precedents under the PRA, which imposed the more stringent requirement that rates must be "fair and equitable"). Moreover, the Public Representative does nothing at all to establish the meaning of the term "just and reasonable" or the significance of the substitution of that term for the PRA's "fair and equitable." The meaning of "just and reasonable" in laws providing for rate regulation is a subject with an extensive literature, to none of which the Public Representative makes reference.

3. The remedies section of § 3662 does not authorize the Commission to raise rates to levels above the applicable price caps

For purposes of the present discussion, It is possible to reduce the long series of conditional (if/then) propositions that constitutes the Public Representative's argument concerning possible remedies for alleged Periodicals class noncompliance to just two essential steps:

1) "*If* [emphasis added] the Postal Service's [FY 2009] rates and fees did not yield sufficient revenues to recover *total* costs of its *collective* products to maintain *financial stability* and protect the Postal Service from imminent insolvency, the collective rates and fees were not in compliance with the applicable provisions of chapter 36 of title 39." (Initial Comments at 13.)

2) "*If* ordering rate adjustments that the Postal Service is unwilling to propose in the form of an exigent rate increase [as a remedy for the noncompliance posited in proposition 1], the Commission *could also consider* proportionately higher adjustments for these three products [which include Outside County Periodicals] to remove or ameliorate the discrimination inherent in their failure to recover a large portion of attributable costs." (*Id*. at 3 [emphasis added].)

To get from the first step to the second, it is necessary to assume that the Commission has the authority to order rates increased to levels in excess of the annual limitation of § 3622(d) (hereinafter, price cap) as a remedy for the noncompliance posited in proposition 1,[9] and that when it does so, the Commission also has the authority to raise rates still further in excess of the price cap *not* for the purpose of remedying noncompliance under § 3653(b) but rather for the purpose of making the rate structure more consistent with its preferences. That the Commission has the authority to raise rates in excess of the price cap to remedy an instance of noncompliance is, for all intents and purposes, asserted in proposition 2 (and at a number of points elsewhere in the Public Representative's comments). That the Commission may piggyback upon this authority the authority to order additional increases above the price cap, in order to remedy conditions that are not subject to a finding of noncompliance, is also asserted (at pp. 35-36 of the Public Representative's comments):

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[9] At the Public Forum held by the Commission on February 18, 2010, in a colloquy with Chairman Goldway, the Public Representative confirmed that he is asserting that the Commission possesses such authority:

> CHM. GOLDWAY: The one specific question is in your interpretation you give the Commission wide latitude with regard to adjusting rates if we find that the postal service is not in compliance. the law in which we have to make findings with regard to rates covering costs . . . . Do you believe that the Commission is empowered to make immediate adjustments . . . in the context of this ATD, and, if we are, are we also constrained by the price cap?
>
> MR. RICHARDSON: No, I don't think you're constrained by the price cap. . . .
>
> CHM. GOLDWAY: And lawful levels does not include the inflation cap in your interpretation there[?]
>
> MR. RICHARDSON: Correct. Correct. I think the inflation cap is more or less irrelevant at that point.

ACR2009, Tr. 1/80-81.

> Any across-the-board increase in rates as estimated by the Public Representative would not significantly alter the rate discrimination imposed upon users of the other products recovering all of their attributable costs and a fair share of institutional costs. Although the Public Representative has computed estimates of the impact with across-the-board rate level adjustments, the Commission may alternatively consider first ordering rate adjustments focused on these products to reduce the discrimination caused by their shortfall of revenues. If the Postal Service is unwilling to adjust these rates which failed to recover almost $1.5 billion of attributable costs to avoid insolvency, the Commission should consider whether, and may determine, these particular rates are contrary to objective 3622(b)(8) as unjust and unreasonable, as well as discriminatory. If so, it may order additional rate increases in incremental amounts to, at a minimum, bring into balance revenues and attributable costs for these products. . . .
>
> The rates must be significantly increased in steps with a view toward balancing revenues and attributable costs.

The Public Representative offers no argument whatsoever in support of the extraordinary claim that the Commission possesses such authority, other than to point out (at 14) that the remedies subsection of § 3662 "offers specific examples of remedies available to the Commission for unlawful rates such as *ordering unlawful rates to be adjusted to lawful levels*," and (at 15, n. 29) that

> [t]he Commission's complaint rules provide that upon finding a complaint is justified, the Commission will order the Postal Service to take such action as the Commission determines appropriate to "(1) Achieve compliance with the applicable requirements; and (2) Remedy the effects of any noncompliance."[10]

[10] When asked to explain his interpretation of § 3662 at the Public Forum held on February 18, 2010, the Public Representative had no additional arguments to offer and stated: "Once the Commission finds the rates are unlawful or noncompliant, then the findings under 3662 kick into effect, and there, the Commission has apparently unlimited authority." Tr. 1/83.

The Public Representative's interpretation of the § 3662 remedies subsection piles *non sequitur* upon *non sequitur*.

The first of the Public Representative's two conclusions--that the Commission may order increases to levels in excess of the applicable caps in order to remedy an instance of noncompliance it has found under § 3653(b)--fails to address two obvious objections, both of which are fatal: (1) in the absence of a request for an exigent rate increase by the Postal Service that is approved by the Commission, rate levels in excess of the applicable caps are not "lawful levels" but rather *unlawful* levels; and (2) it is absurd to interpret § 3662(c)'s statement that the Commission "shall order that the Postal Service take such action as the Commission considers appropriate in order to achieve compliance with the applicable requirements" as meaning that the Commission may order an action that achieves compliance with one requirement of the Act only by creating noncompliance with another.

The Public Representative's second conclusion (which, of course, depends crucially on the correctness of his first) fails to address yet a third fatal objection. The remedial subsection of the complaint provision may be triggered only by a Commission finding that the Postal Service is not in compliance with "requirements" of the law. See §§ 3653(b) and 3662(a)-(b). The only possible meaning of that provision's authorizing the Commission to "order . . . such action as the Commission deems appropriate to achieve compliance with the applicable requirements and to remedy the effects of any noncompliance" is therefore that the Commission may order action to achieve compliance with the requirement or requirements with respect to which it has found the Postal Service *not to* be in compliance. If that were

not so, the remedial subsection would come to a full stop after authorizing the Commission to "order . . . such action as the Commission deems appropriate." Absent a specific statutory direction to the contrary, it seems to us self-evident that the Commission's authority under § 3662(c) is limited to remedial steps designed to remedy the illegality which constitutes the basis for its authority to order remedial action in the first place.[11]

Although Time Warner does not agree that the Commission has the authority to raise rates in excess of the price caps on the basis of a finding of noncompliance under § 3653(b)--because in our view this would constitute raising rates not "to lawful levels" but to *unlawful* levels--and much less do we agree that it has the authority to pile on additional *supra*-CPI-U increases without even an assertion that they are remedial within the meaning of § 3653(c)--we take note here of one welcome limitation in the Public Representative's suggestions that we will have occasion to refer to later in this discussion. The Public Representative speaks of "rate increases *in incremental amounts* to . . . bring into balance revenues and attributable costs," and argues that rates must be "increased *in steps with a view toward* balancing revenues and attributable costs" (emphasis added). No commenter has argued in favor of the sort of draconian increase that would be necessary to make Periodicals class rates immediately equal to attributable costs

[11] The implications of statutory silence on so momentous an issue should also be noted. In the places where it obviously might have done so--the exigency provision (§ 3622(d)(1)(E)) and the complaint provision--the Act does *not* authorize the Commission either to initiate an exigency case on its own motion or to order rates increased to levels in excess of the applicable price caps. When Congress intended to authorize the Commission to initiate a proceeding on its own motion, it had no difficulty making its intention explicit. See §§ 3652(e)(2) and 3654(e).

(and that would as a consequence drive untold numbers of periodical publications out of existence).

In fact, no commenter has argued that the Commission should impose *any* rate increase on *any* mailer pursuant to a finding of noncompliance in this proceeding. At the Public Forum, the Public Representative stated (Tr. 1/71, 74):

> As a general matter, I want to make it clear that the [P]ublic [R]epresentative did a study which did *not* recommend rate increases [emphasis added] . . . . At this point, I have no particular recommendation. . . .

Counsel for Valpak stated (Tr. 1/86-87):

> I do believe that there is a requirement to find noncompliance. At that point, it does trigger, as the [P]ublic [R]epresentative was saying, the powers and the complaints section, and I don‘t think those powers would require, for example, the Commission to increase rates immediately. They would require you to order the Postal Service to take some action to address this perhaps in their next rate increase. We‘re not -- for example even Valpak, who has been raising this issue before, is not advocating an immediate change in rates for [P]eriodicals.

4. Appropriate remedy in the event that the Commission makes a determination of noncompliance

We have indicated above why we believe that Valpak is wrong in arguing that a determination of noncompliance is warranted with respect to the failure of some FY 2009 rates to recover attributable costs. We have also explained why we think that the Commission must reject the Public Representative's suggestion that Periodicals class rates may be raised in excess of the amount permitted under the rate cap as part of an across-the-board "remedy" for the Postal Service's "noncompliance" with § 3622(b)(5) (in failing to generate revenues in 2009 that would "insure . . . financial stability"), and then raised again to still higher levels,

without a finding of noncompliance, in order to bring revenues into line with attributable costs. But it remains to be considered what remedy would be appropriate in the event that the Commission *were* to make a determination of noncompliance with respect to the failure of Periodicals class rates to recover attributable costs.

On some points, all commentators, including Time Warner, Valpak, and the Public Representative, have been and remain in agreement. The Public Representative states (at 15):

> The PAEA does not dictate the time period for adjusting unlawful rates to lawful levels. Given the magnitude of the financial distress and the implications of rate shock, the PAEA does not inhibit the Commission from lawfully ordering corrective action conditionally, in steps, or temporarily, as appropriate, to remedy the effects of noncompliance.

Valpak, after recommending that the Commission make a determination of noncompliance with respect to Periodicals class rates, states that the Commission should issue "such order . . . as the Commission determines best to abate the hemorrhage from Periodicals and *move the class toward compliance* with 39 U.S.C. section 3622(c)(2) *over an established period of time*." Initial Comments at 17 (emphasis added).

The nature of the steps that will move Periodicals class toward full coverage of its attributable costs, without exceeding the limits imposed by the price cap, are well known. The first, obviously, is raising the rates up to the level permitted by the cap. The Postal Service did this in FY 2009. Since the annual limitation on price increases in FY 2010 is a negative percentage, there is nothing further that the Postal Service can do immediately in this regard**.** Nor does the Postal Service

believe that significant price increases at this time would be helpful, given the very severe volume losses it has recently experienced and the severe financial challenges currently besetting both the Postal Service and the periodicals publishing industry.[12]

A major cause of the decline in Periodicals class cost coverage in FY 2009 was a precipitous drop in advertising pages, which pay a substantially higher rate of postage than does editorial matter. Fewer advertising pages results in lower revenue per piece and negatively impacts cost coverage. However, it now appears that the advertising market hit bottom in 2009, and advertising pages are showing a modest improvement in 2010. Last month, *WWD* reported:

> First-quarter ad-page numbers are in, and things are looking up for most titles. Then again, after 22 percent ad-page declines in the first quarter of last year, it would be hard for things to get any worse. Overall, this year's ad pages are up 2.2 percent for the first three months of 2010.[13]

If advertising page volumes continue to improve at this pace, we will see a corresponding improvement in Periodicals cost coverage in FY 2010.

The remaining steps are those that were recommended to the Postal Service by the Commission in its decision in ACR2008 and in a number of previous decisions and orders.[14] They are, in Valpak's words (at 14): (1) "to change incentives within the Periodicals pricing structure"; and (2) to "achieve cost

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[12] *See* statement of the Postmaster General (October 15, 1009) (*quoted in* Response of the United States Postal Service to Commission Information Request No. 1 (January 29, 2010), at 3).

[13] *WWD*, "Fashion Titles See Ad Pages Rise," January 25, 2010 (rpt. <http://www.wwd.com/media-news/fashion-memopad/fashion-titles-see-ad-pages-rise-a-kardashian-reality-2429041>).

[14] *See, e.g.,* Annual Compliance Determination, FY 2008 (issued March 30, 2009), at 54, 58-59; Docket No. C2004-1, Order No. 1446 (issued October 21, 2005), at 6-7, 22.

efficiencies through operational changes." Time Warner has for two decades been in the forefront of efforts to persuade the Postal Service to pursue these objectives more actively. While we do not believe that an adequate legal basis exists for a finding of noncompliance in the instant case, we believe that, if the Commission determines otherwise, any remedy it chooses should follow the path of pursuing these two objectives**.**

With regard to operational improvements, it should be noted that the causes of existing inefficiencies are not necessarily traceable to characteristics of Periodicals mail. As recounted in his report appended to Time Warner's Initial Comments in this docket (filed February 1, 2010), Halstein Stralberg recently visited several Postal Service facilities along with representatives from the Postal Service and the Commission. One of Stralberg's observations was that the AAPS machines which process flat bundles and small parcels are increasingly being utilized to process Priority Mail boxes. In FY 2009, the Postal Service experienced a 7.3% increase in Priority Mail pieces. Given that Priority Mail is both highly time-sensitive and highly profitable for the Postal Service, it is understandable that the Postal Service wants to utilize its latest sorting equipment on this volume. However, reasonable business decisions such as these can and do have a negative impact upon the costs of other mail classes.

It should also be noted that there are reasons to expect improvements on the operational side. The Postal Service is now in the implementation phase of its FSS program and anticipates having 100 machines in place by the end of 2010. The

FSS machines will result in a decrease in manual sortation of flats by the letter carriers and an improvement in cost coverage.

Respecting operations, there is little reason to think that the Commission can improve matters by substituting its judgment for the expertise of the Postal Service. We therefore respectfully recommend that in this area the Commission concentrate on spurring the Postal Service to greater efforts.

With respect to changing incentives in the Periodicals rate structure, Valpak's comments (at 15) state the following:

> [I]t appears that the Postal Service earns a profit on many periodicals, while losing substantial amounts on others. If so, use of pricing flexibility granted by PAEA to make price adjustments allowed within the rate cap could reduce losses greatly within the Periodicals class. In last year's ACD, the Commission itself noted that the pricing structure for Periodicals (I) has **price-cost ratios for** bundle, sack, and pallet **passthroughs that are significantly below 100 percent,** and (ii) otherwise **does not reflect cost incurrence** or **send the right signals** to mailers. . . . The Commission admonished the Postal Service to align the pricing structure for Periodicals more closely with cost incurrence. Sending the right price signals could accomplish much to discourage extremely costly periodicals.

Time Warner cannot pretend that it is without sympathy for these arguments, since it originated them and has taken every possible occasion to commend them to the Postal Service and the Commission. However, we are confident that the Commission will not proceed down this path without caution. Time Warner has never recommended that the rates for Periodicals class publications that currently pay less in postage than it costs the Postal Service to handle them should be increased in one step to full cost coverage.

Respectfully submitted,

s/ _____
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