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Mr. Sam Winters
Chairman
Postal Service Governors
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Dear Mr. Chairman:

I am pleased to submit to you and your fellow Governors the following comments of Time Warner Inc. on the Postal Rate Commission's recommended decision in the Docket No. R97-1 rate case. A separate appendix to this letter presents Time Warner's comments on a critical but highly technical aspect of the Commission's decision: the doubtful reliability of the Postal Service's allocation of mail-processing costs to the various subclasses.

The Governors should approve the rates recommended by the Commission but implement them no earlier than March 1, 1999.

Time Warner has not forgotten how this rate case began. After a long period of rate stability, profitability, and progress in restoring equity, the Postal Service requested the most modest rate increase since its creation in 1970 – the second request in succession that averaged less than the rate of inflation.

This request embodied three principles important to the Postal Service, its customers and the mailing public: pay back negative equity and reverse a history of chronic operating deficits; extend nearly a decade of holding average rate increases to less than inflation; and respond positively to the longstanding desire of business mailers, including Time Warner, for smaller, more predictable rate increases. We applaud the impressive record of success compiled by USPS under the stewardship of the Governors and former Postmaster General Marvin Runyon, which made such a responsible request possible.

Time Warner, of course, supports the Governors' determination to restore the Postal Service to financial stability and responsibility. But restoring twenty years of losses at a rate faster than the planned nine-year recovery period would unfairly burden current ratepayers. It is now clear that unexpectedly large profits and low expenditures since the filing of the rate case have put the Service well ahead of its schedule for recovering prior years' losses, creating the likelihood of unfair burdens on mailers if new rates were approved and implemented according to the plan at the time the rate request was filed. The more modest rate increases recommended by the Commission appear to us a reasonable response to these developments, while still fully adequate to meet the Governors' schedule for restoration of USPS equity. We urge the Governors to accept those recommended rates.

Moderating the size of the increases originally proposed, however, is not under the Service's current unprecedentedly successful financial circumstances alone sufficient to prevent rates that would impose an unfair burden on business mailers and the mailing public. Putting any rate increase into effect when current rates almost surely will generate the fourth consecutive sizeable surplus for an institution charged by law to "break even," virtually by definition creates such a burden.

It is plain to anyone who can read a balance sheet that USPS has turned in an extraordinary financial performance. After three successive years of surpluses near or exceeding $1.5 billion, Postal Service surpluses continue higher and expenditures lower than projected, producing a current net operating surplus more than halfway through this fiscal year of $1.3 billion. In FY 1997, three quarters into the year, Postal Service management predicted a year-end surplus of $600 million, underestimating by a factor of 100% its actual year-end surplus of $1.2 billion. We believe history is about to repeat, even more emphatically, in FY '98. This Service's projected loss of $1.4 billion in the current year, absent an increase in rates, simply cannot be reconciled with its current surplus. American businesses facing a high level of competition situations would be hard pressed to raise prices and we very strongly believe such happy financial circumstances dictate the same for USPS.

Similarly, management's very large overestimates in recent years of how rapidly it would implement capital improvements suggest that the Governors should be skeptical of any representations that speedy implementation of higher rates is necessitated by capital spending programs. Based on the first half of FY '98, we believe it highly unlikely that expenditures will be incurred on anything like the schedule that management presented in its rate case testimony. Until management provides final surplus and cost figures for this fiscal year and demonstrates that more rapid implementation of capital programs is a reality rather than merely an aspiration, the Governors should adopt a wait-and-see attitude on the question of when to implement new rates.

Periodicals mailers believe it is critical that before the next omnibus rate case management seriously examine long-unresolved questions about the reliability of the Postal Service's distribution of mail-processing costs.

Time Warner and other mailers have for years pressed management to investigate extensive evidence that the Postal Service's system for allocating mail-processing costs is seriously unreliable and systemically biased in ways that exaggerate the costs of Periodicals mail. The appendix to these comments reviews major issues that remain unresolved even after extensive testimony concerning these matters in the R97-1 case, and explains why the Commission's decision increases the need for Postal Service inquiry into these issues. We urge the Governors to instruct management to undertake an in-depth investigation of the full scope of unresolved issues concerning mail processing costs: how they are caused, measured, analyzed, and how they are affected by management and staffing practices in mail-processing facilities.

Conclusion

In sum, Time Warner urges the Governors to accept the Commission's recommendation, but implement the recommended rates no sooner than March 1, 1999. Between now and the filing of the next omnibus rate case, it is critical to the integrity of the Service's costing analysis, the prospects for that analysis in other Commission proceedings, and the welfare of Periodicals mailers that the Postal Service resolve the serious questions about the reliability of its costs system. Therefore, we further urge the Governors to instruct management to this effect.

I greatly appreciate the opportunity provided by the Governors to express Time Warner's views on these difficult and important issues.

Respectfully submitted,

Don Logan

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Time Inc.

Attachment
cc: Mr. Thomas Koerber
Secretary, Board of Governors
All parties, Docket No. R97-1 service list

Appendix to Comments of Time Warner Inc. on Opinion and Recommended Decision of Postal Rate Commission, Docket No. R97-1 (May 21, 1998)

Increased Importance Of Unresolved Questions About Distributing Mail-Processing Costs After The Docket No. R97-1 Recommended Decision

Since 1990, Time Warner and other Periodicals mailers have tried to call the Postal Service's attention to an anomalous, persistent, and disturbing trend in the costs of processing flat-sized mail, particularly Periodicals mail, that has resulted in a decade of cost and rate increases far exceeding increases in average unit processing costs and hourly wage rates for clerks and mailhandlers.

We have argued that there are two main reasons for this counter-intuitive phenomenon:[1]

1. Clerks who previously sorted letter-sized mail manually have been reassigned, rather than replaced by attrition or otherwise, to manual flats and bundle sorting operations, leading to excess labor and reduced productivity at these operations where much of the processing of publications mail takes place. That is, on a volume-adjusted basis the Postal Service is using more people to sort the same amount of publications mail. The Postal Service still depends on a method of measuring costs that was designed in the late 1960s when all mail was sorted manually. This system cannot recognize the cause of falling productivity in flats and bundles. It is clearly inadequate and cannot properly measure costs in a highly automated postal system.

2. The In-Office-Cost-System identifies the "direct" costs associated with employee handling of specific subclasses of mail. It then attributes the remaining ("indirect") costs (i.e., "mixed," "overhead," and "piggyback" costs) to the various classes of mail in proportion to their "direct" costs, relying on assumptions adopted when mail was sorted manually. Although much less employee time is spent directly handling mail in automated and mechanized operations, the pool of "indirect" costs has increased substantially. These increases in "indirect" costs are mainly a consequence of automation. However, due to the proportionality assumptions used, a major portion of the increased "indirect" costs are wrongly attributed to the least automated mail, whose direct costs have decreased less. They should instead be added to the costs of automated mail, or at least treated as institutional costs rather than charged to manually-processed mail that is not causing them.

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[1] See "Towards Improved Costing and More Efficient Management of Personnel Resources: Comments on the USPS Strategic Plan," a paper presented to the Governors by Time Warner as an appendix to our Comments on the USPS Strategic Plan (May 23, 1997), at 1-2.

We have called this problem to the attention of postal officials at all levels in numerous meetings over the years, including recently. The Postal Rate Commission has also expressed its concern about the phenomenon and the Postal Service's failure to find an explanation, both in its R90-1 and R94-1 recommended decisions and through instituting a rulemaking proceeding to examine the issue, which was unsuccessful because the Postal Service refused to cooperate.[2]

In its pricing testimony in support of the R97-1 rate request, the Postal Service cited these continuing uncertainties about the causes of anomalous reported cost trends for Periodicals as justification for a moderate Periodicals rate increase reflecting a cost coverage of only 107. At the same time that its pricing witness cited continuing uncertainties about reported mail processing costs as justification for moderate Periodicals rates, however, its mail-processing cost distribution witness proposed a new methodology that purported to address and resolve those questions but that in fact simply assumed the reliability of the existing cost data system and proposed to revise the use of that data in a way that would distribute substantially more costs to Periodicals than the previous system.

Periodicals mailers, in a singular display of the seriousness which they attach to this issue and of the unanimity of their views concerning it, devoted nearly all of their efforts in the rate case to acting jointly to present extensive testimony and briefs demonstrating the inadequacies of the Postal Service's traditional system for distributing mail processing costs among the subclasses, how these inadequacies cause a systematic overstatement of Periodicals and other flats costs, and how the revised system proposed in this case exacerbates the bias of

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2 See PRC Op. R97-1 (May 11, 1998), ¶ 3189, n. 28

the previous system without inquiring into the longstanding allegations about the existence and causes of such bias.[3]

The Commission partially rejected the Postal Service proposed cost distribution, based on the Periodicals mailers painstaking and extensive evidentiary demonstration that it would attribute to Periodicals substantial new mixed-mail and not-handling costs that the evidence indicated are not caused by Periodicals mail.[4] However, the Commission also accepted it in substantial part--albeit with the qualification that its conclusion that this part of the new Postal service methodology "is likely to reduce the risks of bias . . . is tentative and requires further study." This acceptance of the revised methodology, although only partial and qualified with numerous reservations, nevertheless had severe detrimental effects on the costs attributed to Periodicals. Thus, although the Commission agreed with the Postal Service that an exceedingly moderate rate increase for Periodicals was justified, in part because of the still unresolved possibilities of bias against Periodicals in the costing system it felt constrained to adopt on this record, and though it went to the length of recommending rates that would lower regular rate Periodicals cost coverage to 101 percent, it was nevertheless compelled by its estimates of attributable mail-processing costs to recommend a rate increase for regular rate Periodicals nearly twenty percent greater than requested in the Postal Service's rate filing.

The urgency of addressing these unresolved questions before the next rate case is heightened by the fact that the impact of questionable cost estimates on Periodicals rates cannot be mitigated by adjusting cost coverage. A 101 percent cost coverage leaves no room for maneuver.

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3 Acting jointly were the Alliance of Nonprofit Mailers, American Business Press, Coalition Of Religious Press Associations, Dow Jones & Company, Inc., Magazine Publishers of America, the National Newspaper Association, The McGraw-Hill Companies, Inc., and Time Warner Inc.

4 See, e.g., PRC Op. R97-1, ¶¶ 3167-68, 3172, 3177-79.

The case for serious Postal Service inquiry into these questions before the filing of another rate case is strengthened by the tentative nature of the Commission's partial and tentative acceptance of the Postal Service's cost distribution approach. That case is substantially strengthened as well by the Commission's analysis in its opinion of the most extensively investigated, documented, analyzed and argued record ever made on this issue. On the basis of that record, to which its opinion devotes sixty-one pages of dense exposition and analysis, the Commission repeatedly comes to the same conclusion as the Periodicals mailers with respect to the need for the Postal Service to look into a number of unresolved questions concerning Periodicals mail processing cost trends. These are the same issues that Periodicals mailers have raised repeatedly with Postal Service management for nearly a decade and that management has repeatedly evaded, denied, ignored--and never investigated.

More recently, there have been signs that management is finally willing to look into these issues. It has agreed to conduct a joint inquiry into Periodicals mail processing with industry technical experts, a project that the Commission's opinion "welcomes" [¶ 3194] and that we strongly urge be carried forward as soon as practicable. It has also let out a contract for a "Data Quality Study" that specifically raises a number of Periodicals mailers' longstanding criticisms of Postal Service mail processing costing procedures.[5] We commend those actions. But in view of the approach to cost distribution taken in the R97-1 rate case, which represents an inconsistent, indeed contradictory, attitude to whether these issues should be investigated, their ultimate significance remains to be seen.

These inquires should be given the fullest possible scope to explore all of the unresolved issues. They should not prejudge the nature or extent of problems in the cost distribution system or foreclose any promising avenue of inquiry. Nor should they be

5 See solicitation number 102590-97-A-0044 for a Data Quality Study.

confined arbitrarily to narrow channels such as touring mail-processing facilities or refining operational or mail-preparation procedures. In any event, currently planned activity in this area falls well short of what is needed, which is a serious inquiry into a number of quite specific, detailed, and challenging questions about whether the mail processing costing system suffers from biases that systematically misrepresent reality to the detriment of certain categories of mailers, including Periodicals.

We urge the Governors to instruct management to pursue these overdue inquiries, as we and others have long urged and as the Commission in its R97-1 opinion has strongly endorsed. Chief among those issues, as set out in the Commission's opinion, are the following:[6]

> The presort mailers argue that the rapid growth in mixed mail and not handling costs reflects automation refugees or other

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[6] Another detailed and closely parallel description of the measures that need to be taken can be found in "Towards Improved Costing and More Efficient Management of Personnel Resources: Comments on the USPS Strategic Plan." In that document (at 2-3) we stated:

> It takes much more employee time to process an average magazine or newspaper today than it took in FY86, even though today's mail pieces are better prepared and the Postal Service has better equipment with which to perform the processing. This is simply not acceptable. What is certain is that the costs charged to publications and some other mailers have increased far more rapidly than any reasonable person would think they should have.
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> For this reason, we request that the Postal Service, in formulating its 1998-2002 strategic plan, commit itself to the following goal:
>
> > No mail category should cost more to handle, except for increases in hourly wage rates, than it cost before 1987, when the Postal Service's automation effort started in earnest.
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> We believe this goal is achievable. To reach it, however, the Postal Service must both seriously rethink and reformulate the way it attributes costs among mail classes, and improve the management of its employee complement in a mostly automated environment. In particular, the Postal Service must address in earnest its large "automation refugee" problem, caused when clerks displaced by letter mail automation are assigned to other duties.

inefficiencies associated with automation. The Commission finds that the circumstantial evidence for this inference . . . warrants systematic investigation. It makes a similar finding with respect to the rising unit processing costs of Periodical mail. [¶ 3148.]

Postal Service witness Steele's description of management policy regarding allied operations is diametrically opposed to the actual management practices described by the Postal Inspection Service. He insists that management policy is to intensely manage staffing at allied operations to squeeze out any excess capacity there. [¶ 3184.] Witness Stralberg is probably correct that understanding the unsettling trends in not handling costs will require a model that relates them to the staffing strategies pursued by management. . . . The Postal Inspection Service reports strongly suggest that the official management staffing strategy described by witness Steele is not the full story. The Commission urges the Postal Service to make a more systematic inquiry into the causes of rising not handling costs, as these witnesses suggest. [¶ 3187.]

The Commission recognizes that the misclocking reported by the Postal Inspection Service is a potentially serious source of bias for cost distributions, particularly for allied pools. A more systematic survey of this problem is warranted. [¶ 3203.]

The Postal Service has not shown that the direct IOCS tallies in allied pools reliably reflect the ambiguous workload measures or "cost drivers" in the allied pools. [¶ 3143.] . . . To distribute allied costs to subclasses accurately, there must be some assurance that the direct mail costs in a given allied pool fairly reflect the effects of both the distribution support function and the bypass processing function. . . . Witness Degen has not provided this assurance. . . . Degen . . . has not provided a satisfactory way to relate the direct tally costs within a given allied pool to the Bradley cost driver, which measures the workload in the supported distribution pools. [¶ 3710.]

For the allied MODS pools, the Postal Service has not solved the problem of identifying direct costs that accurately reflect subclass responsibility for either their distribution support functions or bypass processing functions. The . . . potential bias is very large. . . . [W]hether *allied mixed mail costs are distributed only on allied* direct costs, or on all direct costs, has an enormous impact on Periodical, Priority, and Standard B mail. [¶ 3177.] . . . The Degen/Sellick method should be modified to ameliorate these potentially large biases, and the uncertainty that comes from using a small number of within-pool direct tallies as distribution keys. [¶ 3178.]

The Commission concludes that as long as a substantial portion of mixed mail is uncounted, the potential for significant selection bias against mail that is presorted, non-preferential, or bulky in shape remains. It also concludes that the potential for significant assumption bias remains. For this reason, the Commission urges that the Postal Service test the degree of bias that remains by selective audits of sampled facilities. [¶ 3145.] The . . . assumption that uncounted mixed mail costs have the same subclass distribution as direct mail costs is one that could be tested, if not systemwide, at least by spot sampling. . . . The Postal Service should also consider collecting information that identifies the presence of mail of particular shapes and subclasses in containers, even if it is not counted. It is also clear that better models of cost responsibility for allied operations are urgently needed. [¶ 3179.]