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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268

Annual Compliance Report, 2012	:	Docket No. ACR2012

REPLY COMMENTS OF TIME INC.
ON USPS FY 2012 ANNUAL COMPLIANCE REPORT
(February 15, 2013)

Pursuant to Order No. 1609 (issued January 2, 2013), Time Inc. hereby submits its reply comments on the United States Postal Service FY 2012 Annual Compliance Report ("ACR"). Appended hereto are the separate Comments of James O'Brien on FY 2012 Periodicals Cost Coverage.

These comments reply to Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc. [hereinafter "Valpak"] Initial Comments on the United States Postal Service FY 2012 Annual Compliance Report (filed February 1, 2013). Mr. O'Brien's comments, also in reply to Valpak, focus on recent developments in the processing of flats mail.

1. Valpak: A study in consistency

This year, as it does every year, Valpak argues that it is time for the Commission to take punitive action against Periodicals mailers for failing to cover their costs again, because "**All Prior Rationales for Delay Have Been Rendered Moot**."[1] The Commission, in turn, has been no less consistent in setting out its reasons for not taking such action, most recently just six months ago explaining to the Court of Appeals for the District of Columbia Circuit why its treatment of Standard Flats in Docket No. ACR2010 was not "inconsistent with the Commission's treatment of other market-dominant products, several of which have comparable, or even lower, cost coverages than Standard Flats."[2]

Rather than address this Order, which is both recent and thorough, or the Commission's even more complete and detailed discussion in the FY 2010 Annual Compliance Determination, Valpak has chosen instead to respond to the extremely summary, four-sentence-long treatment of the subject in the FY 2011 ACD. Comments at 130-33.[3] We will therefore reply first to Valpak's discussion of the FY 2011 ACD, and then to several related arguments.

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1 Valpak Comments at 125. *See also* Docket No. ACR2011, Valpak . . . Initial Comments (February 3, 2012), at 68 ("**Previous Rationales for Deferring Action on Periodicals Are No Longer Available**"); and Docket No. ACR2010, Valpak . . . Initial Comments (February 2, 2011), at 38 ("**The Previous Rationales for Deferring Action on Periodicals Are No Longer Available**").

2 *See* Docket No. ACR2010-R, Order on Remand (August 9, 2012), 14-20; the quoted words are from the Court's decision remanding the FY 2010 ACD, *USPS v. PRC*, April 17, 2012, No. 11-1117, slip op. at 6-7.

3 The Order on Remand devotes six pages to explaining how differences in the circumstances of underwater products such as Periodicals and Standard Flats justified differences in the Commission's treatment of them, and the FY 2010 ACD itself (March 29, 2011) contained seven double-column pages of close legal analysis of the relevant issues (at 13-19).

a. Statement One

The first of four circumstances mentioned by the Commission in the FY 2011 ACD that Valpak argues has now been rendered moot is that "Periodicals had cost coverage shortfalls in the years prior to passage of the PAEA." Comments at 130 (quoting FY2011 ACD at 17). Except for belaboring the obvious, which is that Periodicals cost coverage has not improved since passage of the PAEA, all that Valpak is able to suggest in support of its view is that "[t]he Commission cannot and should not assume that Congress wanted Periodicals to be subsidized indefinitely and irrespective of the amount of the losses." *Id.* We don't think that anyone has advocated making such an assumption. If Valpak wishes to inquire seriously into the intentions of Congress, however, three potential sources of enlightenment suggest themselves.

The first and most dependable of these sources is the language and structure of the PAEA itself. The second is the presumptive understanding of Congress of the situation of Periodicals class at the time of the PAEA's adoption. The Commission provided an excellent analysis of both of these the FY 2010 ACD:

> Section 3622 creates a hierarchy based on “requirements,” sections 3622(d) and (e), “objectives,” section 3622(b), and “factors,” section 3622(c). With the exception of an exigent rate request and use of banked pricing authority, the PAEA’s price cap mechanism in section 3622(d)(1)(A) takes precedence over the statutory pricing objectives and factors in sections 3622(b) and (c), even if some of these can be considered quantitative. Therefore, to the extent an objective or factor with a quantitative component can be seen as competing with the price cap, the price cap has primacy.
>
> In bills that became the PAEA, the price cap was understood as a feature that would focus management’s attention on cost control. There is also an indication, in the section 708 directive for a joint Postal Service/Postal Regulatory Commission study

> of Periodicals costs and efficiency practices, that legislators were aware that the attributable cost floor provision would pose special challenges for any class that had experienced difficulties in satisfying former section 3622(b)(3) under the Postal Reorganization Act of 1970 (PRA).
>
> The PAEA, in section 3622(a), required the Commission to establish a modern system for regulating rates and classes for market dominant products within a relatively short time after enactment. It further provided, in section 3622(d)(1)(A), that an annual limitation [cap] on rates was a requirement of that system. With this cap in place, the Commission was directed to design the system to achieve certain objectives set out in section 3622(b)(1) through (9). And, in establishing or revising the cap-based system, the Commission was directed to "take into account" the factors set out in section 3622(c)(1) through (14). The Commission understands this directive as one which clearly calls for the application of its considered judgment.
>
> The price cap is the signal feature distinguishing the modern system from the cost-of-service approach under the PRA. Many of the statutory objectives the cap-based system is to be designed to achieve, and the factors that are to be taken into account, are expressed in language similar to the ratemaking considerations under the old system, and present familiar challenges in terms of achieving an appropriate balance; however, none has precisely the same standing under the PAEA as they did under the PRA. Instead, the objectives and factors, including those that can be regarded as quantitative operate within the context of the price cap; they are not on an equal footing with it.

FY 2010 ACD at 18-19 (footnotes omitted).

One might add that, as Valpak's Table VII-1 illustrates, although Periodicals class has failed to cover its costs for six years under the PAEA, it failed to cover its costs for the ten years immediately preceding adoption of the PAEA. In view of the history of Periodicals class, of which Congress was fully aware, there are no grounds at all for thinking that the mere duration of its continuing difficulties outstrips anything that Congress might have thought possible.

The third potential source of information about congressional intent has to do with the Congress that is currently in session and that is, of course, actively considering postal reform legislation. Each house has a bill left over from the previous Congress that addresses the issue at hand, and both of these bills--one of which was passed by the Senate, and one of which was reported out of the House Committee on Governmental Affairs--would have delayed for a period of years any rate increases above the current statutory limits based on failure to achieve full cost coverage, until after the Commission completes an investigation into the question of whether excess processing capacity has been causing distortions in the attributable cost figures for some mail.[4] Such sentiment as has recently been expressed in Congress therefore appears to be against precipitous action of the kind that Valpak urges on the Commission.

b. *Statement Two*

Following is Valpak's description of what it identifies as the second Commission justification for "inaction on Periodicals in the FY 2011 ACD" that it finds no longer "persuasive for FY 2012":

> [T]he Commission correctly concluded, "Periodicals as a class fails to cover costs, thus foreclosing a rebalancing pricing strategy," but "there is no suggestion that the Postal Service has ignored its pricing flexibility under the PAEA with respect to the Periodicals products." FY 2011 ACD, p. 17. (The Commission made this same point about pricing flexibility in its FY 2010 ACD (p. 17).)

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[4] *See* S. 1789, 112th Cong., 2d Sess. (2012), ____ CONG. REC. S2538-39 (daily ed. April 19, 2012); S. REP. NO. 112-143, 112th Cong., 2d Sess. (January 31, 2012) 33, REPORT OF THE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENT AFFAIRS TO ACCOMPANY S. 1789, 21ST CENTURY POSTAL SERVICE ACT OF 2012; and H. R. REP. 112-363, PT. 1, 112th Cong., 2d Sess. (January 17, 2012) 55, 87-88, REPORT FROM THE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM, POSTAL REFORM ACT OF 2011.

Comments at 130 (emphasis deleted).

It made the point as well, and much more comprehensibly than does Valpak, in its Order on Remand in Docket No. ACR2010-R at 19, where it explained to the D.C. Circuit:

> Periodicals, as a class, and both of the Periodicals products fail to cover costs, thereby limiting the opportunity for achieving full cost coverage by price increases within the price cap for the Periodicals class. To the extent permitted by the constraints of that price cap, the Postal Service has increased prices.

The Commission, that is to say, has viewed the Postal Service's inability to take any further action on the pricing side within the constraints of the price cap as evidence of *absence of grounds* for a finding of noncompliance.

Valpak's view is precisely the opposite:

> Of course, any inability of the Postal Service to act is all the more reason why the Commission must act [i.e., by breaching the price caps]. Failure to act would indict the whole pricing scheme under PAEA.

Comments at 131.

Valpak's comment is thus not to the effect that circumstances have changed or that the Commission's previous rationale has become moot. It is simply that the Commission's previous rationale is and always has been wrong. It is based on nothing more than Valpak's opinion that a regulatory scheme that makes the price cap predominant and allows the possibility of profits or losses on market-dominant products (and provides the exigent circumstances clause and the possibility of

Congressional intervention as the sole ultimate backstops against institutional insolvency) is intolerable.[5]

Valpak's position, viewed objectively, amounts to the following:

> *The law forbids the Postal Service to act;*
> *because it did not act, it must be found in noncompliance with the law;*
> *to remedy its noncompliance with the law, the Postal Service must be compelled to take the action that law forbids it to take.*

That would be an absurd way to set up a statute. It would also be, it is some relief to observe, in flat contradiction to the Commission's sensible exposition of the statutory hierarchy in the FY 2010 ACD, at 18-19:

> With the exception of an exigent rate request and use of banked pricing authority, the PAEA's price cap mechanism in section 3622(d)(1)(A) takes precedence over the statutory pricing objectives and factors in sections 3622(b) and (c), even if some of these can be considered quantitative. Therefore, to the extent an objective or factor with a quantitative component can be seen as competing with the price cap, the price cap has primacy.

c. *Statement Three*

The third reason that the Commission has given for declining Valpak's persistent urgings to find Periodicals class in noncompliance, and that Valpak asserts for the third year in a row to be moot, is "that 'management has not yet fully brought to bear . . . changes which could alter the attributable cost picture for Periodicals.'" Comments at 131 (quoting FY 2011 ACD at 17; emphasis deleted). It is entirely unclear why Valpak thinks that this reason is moot. It remarks that (a)

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[5] We believe that the drafters of § 3662(c)'s penalty provision had competitive products in mind when they included among examples of possible remedies for violations of the Act orders to discontinue "loss-making products."

"[t]he Postal Service identified the extensive operations changes it had undertaken, which impacted Periodicals costs, in FY 2012," (b) "the Postal Service was not able to 'isolate the cost savings resulting from the ... initiatives,'" and (c) the initiatives did not produce "sufficient savings to prevent cost coverage from declining further." *Id*. at 131-32. All of this tends to support rather than contradict the proposition that "management has not yet fully brought to bear . . . changes which could alter the attributable cost picture for Periodicals" (emphasis omitted). For a more detailed discussion of this point, see the appended comments of James O'Brien.

d. *Statement Four*

The fourth reason that the Commission gave in the FY 2011 ACR for declining to find "Periodical rates to be out of compliance with the applicable statutory provisions," but that Valpak believes has been rendered moot in the 11-month interval between then and now, is that "'[t]he Commission takes seriously the concerns that price increases on Periodicals may, as a consequence, drive periodical publishers out of the print business.' FY 2011 ACD, p. 17." Comments at 132 (emphasis deleted).

Citing the example of NEWSWEEK, Valpak remarks that "periodicals publishers leaving the print business does not equate with periodicals publishers going out of business." Also, Valpak states, "many publishers leaving the print business have managed to survive online only," an assertion for which, not surprisingly, no citation is proffered. A more forthright way for Valpak to have expressed the same view would have been simply to say that *Valpak* does *not* take seriously the concerns that price increases on Periodicals may, as a consequence, drive periodical publishers out of the print business.

The Commission should reject Valpak's limp reprise of its previous essays on mootness and should stand by its cogent analysis of the reasons for differences in the treatment of market-dominant products with cost-coverage shortfalls in the FY 2010 ACD at 18-19 and the Docket No. ACR2010-R Order on Remand at 14-20.

2. Valpak's arguments regarding alleged cross-subsidies to Periodicals class from other classes of mail misconceive the nature of price-cap regulation

On page 123 of its Comments, Valpak provides Table VII-1, according to which Periodicals class mail has incurred losses of $3.4 billion during the six years since the PAEA became effective. Valpak concludes, *inter alia*, that "the Postal Service violated section 403(c) by maintaining Periodicals' prices in FY 2012 so that they unduly and unreasonably discriminated against other mailers, who were forced to pay a higher cost coverage to cross-subsidize Periodicals." *Id*. at 129. That conclusion defies logic. Under the PAEA there is no reason to believe that any non-Periodicals mailer has paid a penny more in postage than it would have if Periodicals had been profitable.

First of all, a glance at another table provided by Valpak shows that the Postal Service's total losses over those six years were $40.1 billion, bringing the institution from a position of $6.3 billion net surplus to $34.8 billion net deficiency. Comments at 5. The *need* to price other classes up to the allowable statutory maximum was very far from being affected by the $3.4 billion in losses in Periodicals class.

Under the PAEA, the maximum price for any given category of mail is a result of how the annual price cap is applied to its individual class. The maximum is unaffected by whether other classes are making or losing money. That losses due to underwater products have not been subsidized by extraordinary returns from other classes is suggested by the fact that not one class has been above the cap or has had extraordinary returns or has been in a position where it could be below the cap. If other classes had subsidized the $3.4 billion shortfall in Periodicals cost coverage, that amount should have appeared in the form of prices that were higher by that amount.

Second, there is no sound reason to believe that, even if the price cap were lifted for Periodicals class, a different set of rates would reliably increase net revenues from the class by an amount that is meaningful in relation to the class shortfall. Rate increases in current circumstances could drive out substantial volumes without either pulling in substantial revenues or driving out costs equal to the revenues lost due to reduced volume. This is a point that has been persuasively explained repeatedly by the American Catalog Mailers Association (ACMA). *See* its Initial Comments in this docket (filed February 1, 2013).

It is also a point that Valpak has effectively conceded in its Comments:

> Admittedly, it is unknown what will happen if the Postal Service begins to use its pricing flexibility to achieve a markedly higher contribution from marginal products, because prices will need to be increased far above the range where current elasticity estimates apply. A substantial portion of those marginally profitable products may not be willing to pay a price that is significantly higher (*e.g.*, 25 to 40 percent more). The volume of those products then could decline to the point where the Postal Service will continue having considerable excess capacity and redundant costs that will require still further downsizing and restructuring, as the Postal Service struggles to achieve financial self-sufficiency.

Comments at 18-19.

That sounds to us like the kind of consideration that the Postal Service does take into account and is entitled to take into account in *sometimes deciding not to raise prices on low-contribution products* under the PAEA, and that counsels against an automatic resort to price increases as the presumptive "remedy" in cases of failures in cost coverage.

Thus with regard to cross-subsidies from an underwater class, such as Periodicals, under the class-based price cap regime of the PAEA, during a period when the losses in question are dwarfed by systemwide losses, the evidence for inter-class cross-subsidy, and the basis for drawing an inference of cross-subsidy, are nil.

Therefore, Valpak's suggestions that Periodicals class is in violation of sections 403(c), or 101(a) or (d), by virtue of having harmed or benefitted from unfairness to any other class, on no stronger ground than that Periodicals class is losing money, cannot be sustained.

Valpak may not be unaware of this obstacle to its subsidy theory, for it does suggest an alternative basis for that allegation:

> When the Postal Service underprices a product, and cannot extract extra contribution from other mailers as a cross-subsidy, it must cut costs, sometimes in ways it would not want to do, such as degrading First Class Mail Service Standards. . . . *As 62.9 percent of the Postal Service's operational deficit over the past five year has come from underwater products, this is the dominant reason the Postal Service has been seeking ways to cut service*, including eliminating Saturday delivery, reducing overnight service for First-Class Mail and Periodicals, and closing or reducing the hours for a large number of post offices, stations, and branches.

Comments at 37 (emphasis added).

According to Valpak, at the end of a period over which the Postal Service lost over $40 billion, its need to cut operational expenses can be associated with a particular $5.6 billion in revenue deficiencies. Valpak needs to explain how that could be the case. Has money ceased being fungible?

3. Valpak's theory of collective responsibility

Valpak does briefly advert to the Commission's Order on Remand in a section of its Comments captioned "PAEA Requires the Commission to Evaluate Compliance of Products, Individually and Collectively." Valpak Comments at 33. Here Valpak attempts to get around the embarrassing facts that: (1) the Order and the last three ACD's have all emphasized the reasons for making *distinctions* among underwater products; and (2) that there is no possible reason to think that the rates for products in any other class have been higher under the PAEA on account of losses in Periodicals class.

Valpak finds its means of circumvention in the language of section 3653(b), which, as it says, requires the Commission to:

> make a written determination as to — (1) whether any rates or fees in effect during such year (for products **individually or collectively**) were **not in compliance** with applicable provisions of this chapter (or regulations promulgated there under).... [39 U.S.C. § 3653(b) (emphasis added [by Valpak]).]

Id.

Unlike the Commission, however, Valpak sees no reason to distinguish between the subject of "were not in compliance"--namely, "rates or fees"--and the parenthetical phrase that modifies it:

> In the past, the Commission's Annual Compliance Determination evaluated compliance for products individually,

> but not collectively. Of course, “collectively” could mean (i) all market dominant products, (ii) all products within a class, or (iii) all products that perennially lose money and together are a financial threat to the Postal Service’s survival as a financially independent entity; these comments focus on the third meaning. Viewed “collectively,” the eight underwater market dominant products violate: 39 U.S.C. section 3622(b)(5) (the objective of ensuring adequate revenues); [etc.]

Id.

As the language of the statutory provision makes clear, the Commission determines whether "rates or fees," not "products," are in compliance. And it makes perfect sense to talk of a rate or fee for products collectively and whether that rate or fee is in compliance. Several products in the same class may pay the same permit fee, for instance. But how can *individual* products be *collectively* in noncompliance *as products*? Consider the example Valpak provides. Valpak says that, "[v]iewed 'collectively,' the eight underwater market dominant products violate . . . the objective of ensuring adequate revenues." Is that so only because they each violate the objective individually? Or only because they violate the objective when added together? If the former, collective responsibility adds nothing to individual responsibility; it is a redundancy. If the latter, how is it consistent with logic or fairness to hold a product in violation of an objective that it can be deemed to violate only when its conduct is aggregated with the conduct of other products that it has no control over, responsibility for, or relation to? It is a fundamental principle of American law that culpability for violations of law can be imposed only when there was fair warning of what the law requires and the putative offender is able to conform his conduct to those requirements.

Thus, in order to aggregate individual instances of compliance into a collective state of noncompliance, Valpak must torture the language of the statute and set not just logic but a fundamental principle of our law at defiance. Nonetheless, Valpak goes on, serene in the conviction that it has established the legitimacy of collective noncompliance for groups of products. It latches onto a statement by the Commission in its Order on Remand that "[t]he totality of circumstances presented is critical to Commission evaluations under section 3653," and proceeds to assemble a set of circumstances out of several observations about the collective losses of nine underwater products over the past five years, based on which it indulgently "requests the Commission to make a finding of noncompliance with respect [only] to the seven products collectively that have been underwater continuously since FY 2008." Comments at 36-37 (emphasis deleted).

Unlike the "totality of circumstances" considered by the Commission in the FY 2010 and FY 2011 ACRs, which reflected a capacious appreciation of diverse statutory policies and values, Valpak's proposed "totality of circumstances" appears to reflect an exclusive concern with Objective (b)(5), "adequate revenues [and] financial stability." The often overlapping circumstances that Valpak cites are:

(1) the collective amount of the losses from all the products over the life of the PAEA;

(2) the continuous nature of the losses;

(3) the adverse impact of the losses on the Postal Service's ability to survive financially;

(4) the "fact" that the Postal Service has taken no meaningful steps to make the products profitable; and

(5) the "fact" that the Postal Service has no plan to make the products profitable.

Thus, when carefully examined, Valpak's purported reliance on the

Commission's "totality of circumstances" approach looks more like just another appeal to the Commission to: (1) somehow nullify the choice of Congress to make the price cap the central, organizing ratemaking provision of the PAEA; and (2) somehow restore the breakeven requirement of previous law by elevating Objective (b)(5) to the premier position in the PAEA's hierarchy of statutory authority.

4. Valpak's actual objective is to persuade the Commission to correct what Valpak views as the bad choices made by Congress

Valpak regards the PAEA as a fundamentally defective piece of legislation under which the Postal Service never had any real chance of being financially self-sufficient. "It should now be apparent to all," writes Valpak, "that PAEA has undermined Postal Service finances completely, despite the fact that the modern system for regulating rates for market dominant products was supposed to be designed: '[t]o assure adequate revenues, including retained earnings, to maintain financial stability.'" Comments at 9 (emphasis deleted). Nor can the financial collapse of the Postal Service caused by the PAEA, in Valpak's view, be ascribed to unforeseeable events that have occurred since the passage of the legislation, such as the depth of the 2008 recession or bad judgments by USPS management. According to Valpak:

> The present liquidity crisis was clearly foreseeable, even if the precise timing was slightly less predictable. In 2006, the Board of Governors felt constrained as fiduciaries for the mailing public to take the politically-difficult step of strongly opposing enactment of PAEA.

Comments at 20, n. 21.

In fact, according to Valpak, "four features of PAEA [that] were incompatible then . . . are incompatible now, and . . . will continue to be incompatible in the future . . . virtually guaranteed that the Postal Service could not comply with the key objective of financial stability embodied in 39 U.S.C. section 3622(b)(5)." Comments at 19, 20 (emphasis deleted). These are:

> 1. the objective to assure revenues adequate for **financial stability and retained earnings**;
>
> 2. the PAEA-imposed burden to **pre-fund** future retiree health benefits in the amount of $56 billion within only 10 years;
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> 3. the CPI **price cap**, along with Postal Service pricing flexibility, which generally takes precedence over all statutory objectives, including the one for financial stability cited here; and
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> 4. The **lack of any authority to reduce operating expenses** or a mandate to give top priority to operating profits and prefunding of the RHBF.

Comments at 19.

The CPI price cap is of course the chief villain in Valpak's eyes:

> PAEA itself virtually guaranteed that the Postal Service could **not comply** with the key objective of **financial stability** embodied in 39 U.S.C. section 3622(b)(5). The statutory price cap constraint alone, made it unlikely that any pricing system designed by the Commission could have prevented the current financial crisis.[6]

Ranking just below the price cap as villains are an imaginary "precedence [given to] pricing flexibility . . . over all [other] statutory objectives" and an equally imaginary

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[6] Comments at 20. *Compare* this view with the Commission's judgment in its Section 701 Report: Analysis of the Postal Accountability and Enhancement Act of 2006 (September 22, 2011), at 39 ("The Commission finds that, in furtherance of the PAEA's goals, the use of the price cap promotes pricing flexibility for the Postal Service; predictability and stability in prices for mail users; and encourages cost reductions for the Postal Service. The Commission recommends no legislative changes in this area.").

"lack of any authority to reduce operating expenses" (emphasis deleted).[7]

The Commission's decision to find Standard Flats in noncompliance in the FY 2010 ACD and the nature of the remedy it imposed are a definitive refutation of the notion that deference to Postal Service pricing flexibility has taken "precedence over all [other] statutory objectives" under the PAEA. As to the PAEA's supposed "lack of any authority to reduce operating expenses," the Postal Service's determination over the past several years to insist on its prerogatives under that law to take painful and controversial steps to cut expenses, most recently by its announced transition to 5-day delivery this coming August, debunks that allegation as well.

Valpak's solution to the dilemma it has conjured up--in which the "PAEA has undermined Postal Service finances completely," the Postal Service has no ability to reduce costs, and Postal Service management, accorded limitless deference to its pricing decisions, has shown "an affinity for endlessly nurturing money-losing products, while believing that prices of profitable products can be driven ever higher with no adverse long-term consequences"--is the same solution that Valpak recommends for every malady--to insist that the Postal Service be compelled to substantially raise the rates of other people's mail, even though this will require the Commission to substitute its judgment about pricing for that of the Postal Service, to adopt a simplistic pricing theory that assumes that anytime a product loses money,

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7 The virulence of Valpak's antipathy to the PAEA is positively arresting. It appears to regard that legislation not merely as a debacle, which is certainly arguable, but as intentionally malevolent. *See, for example,* Comments at 12: "One premise underlying the USO was that the Postal Service would be allowed to raise prices as necessary to support it, regardless of how costly those activities might be, or might become. PAEA's price cap deliberately undermined this source of funds to support the USO."

the reason must be that it is underpriced,[8] and in the case of Periodicals, to assert authority to violate the § 3622(d) price cap based on an extremely ambitious interpretation of its statutory powers.[9]

Valpak's real complaint appears to be that Congress, after careful deliberation, decided to change the basic assumption that underlay postal ratemaking prior to passage of the PAEA: namely that rates would be increased by however much was required to cover the Postal Service's costs, no matter how much faster those costs might rise than the costs of other goods in the economy. Valpak would like to see the price cap overthrown and the old assumption reinstated by putting Objective number 5, the assurance of adequate revenues to maintain financial stability, at the top of the statutory hierarchy. Whether that ought to be done is a debate worth having, indeed a debate being had in the halls of Congress even as these words are written. It is not something, however, that the Commission can properly undertake or be asked to undertake.

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[8] Valpak appears to take it as bordering on axiomatic that the way to maximize net revenues, or, conversely, minimize deficits, is "to focus [rate increases] largely on products that either are underwater, or are only marginally profitable." Comments at 18. But as ACMA has demonstrated, the assumption is in fact arbitrary.

[9] We have comprehensively addressed the issue of the Commission's putative authority to breach the rate cap under the remedial provision of § 3662 in previous filings. *See* Docket No. ACR2010, Initial Comments of Time Inc. (February 2, 2011), at 17-22; Reply Comments of Time Inc. (February 17, 2011), at 8-12; and Docket No. ACR2011, Reply Comments of Time Inc. (February 17, 2012), at 10-11.

Conclusion

For the aforesaid reasons, Time Inc. respectfully submits that the arguments presented by Valpak in favor of holding Periodicals class mail in noncompliance under § 3653 of the PAEA contain nothing substantially new since its filings in previous ACRs and provide the Commission with no reason to depart from the analysis regarding Periodicals class cost coverage that it has consistently adhered to in past ACR dockets.

Respectfully submitted,

s/__________________________
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ADDENDUM TO

REPLY COMMENTS OF TIME INC.
ON USPS FY 2012 ANNUAL COMPLIANCE REPORT

COMMENTS OF JAMES O'BRIEN ON FY 2012 PERIODICALS COST COVERAGE

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Purpose

The purpose of my comments is to demonstrate that there are numerous opportunities to further improve cost coverage for flat shaped mail in FY 2013 and beyond.

I. FY 2012 Periodicals cost coverage decline

In sharp contrast to a cost coverage improvement for Standard Flats, Periodicals mail again experienced a cost coverage decline in FY 2012. Standard Flats cost coverage improved by 1.4 percentage points while Outside County Periodicals cost coverage declined by 3.0 percentage points to 71.8%. Given that Standard Flats and Outside County Periodicals are processed on the same equipment, it is difficult to understand how they could have such disparate results.

FY 2012 was the first full year of FSS processing. The Postal Service has testified that it "saves approximately $325,408 for each month of operation of each FSS machine."[10] On an annual basis, this should amount to a savings more than $390 million for flat mail, and a portion of these savings should have been attributed to Periodicals class mail. Is the Postal Service actually achieving the projected FSS savings, and are those savings helping to improve Periodicals class cost coverage? The answers to these questions are not clear and require further examination.

In addition to the full implementation of FSS, the carrier route portion of Periodicals mail has continued its steady increase in FY 2012. Since Docket No. R-2008-1, carrier route has grown from 51.0% to 62.6% of Periodicals, a 22.7% increase. One of the key drivers of this improvement is co-mail. The following chart shows the growth in carrier route percentages for the Time Inc. non-weekly magazines.

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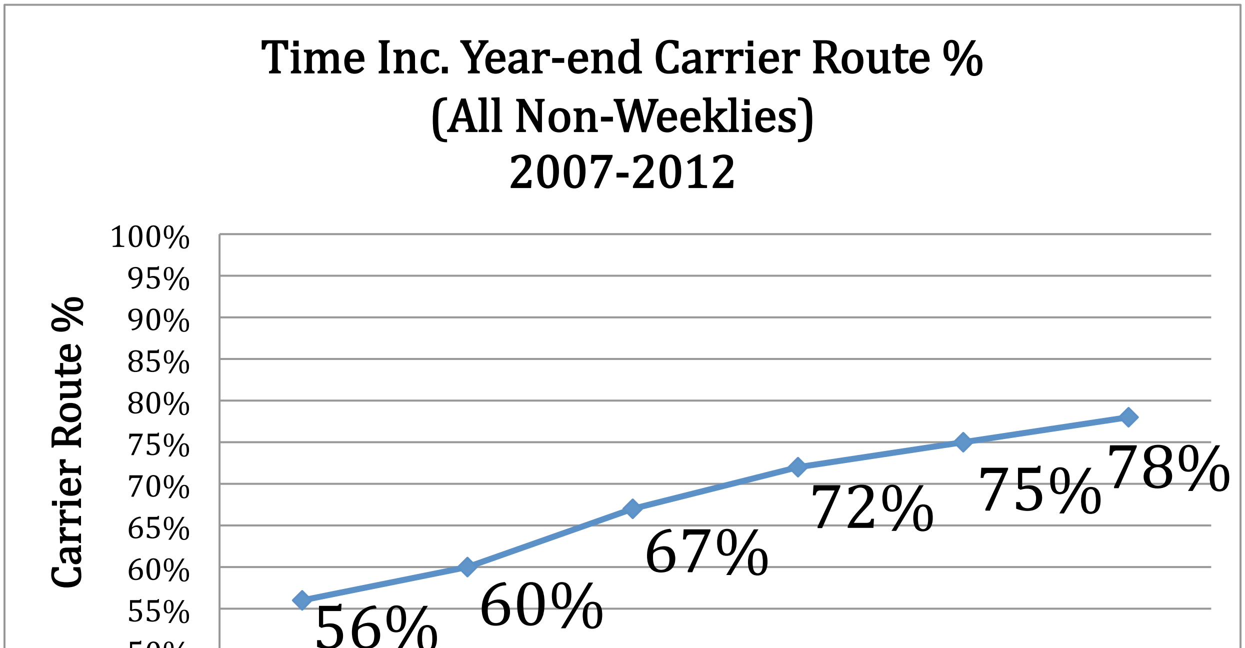
[10] *Northrop Grumman Systems Corp. v. United States*, United States Court of Federal Claims, No. 12-286C, Defendant's Answer and Counterclaim (filed October 31, 2012), at 61.



	2007	2008	2009	2010	2011	2012
ALL	56%	60%	67%	72%	75%	78%

Because the carrier route discount passes through only 71.3% of the savings associated with this activity, the increases in carrier route percentage are highly profitable for the Postal Service. The low passthrough percentage combined with the growing percentages of carrier route volume should make carrier route mail a significant contributor to cost coverage improvement. Why hasn't the growth of carrier route mail translated into an increase in cost coverage?

These significant unanswered questions regarding the decline of Periodicals class cost coverage must be resolved.

II. Cost containment process is not complete

Several cost reduction efforts that should result in an improvement in cost coverage are currently in progress. The most significant is "Network Rationalization," a reduction in the number of postal facilities. Although the Commission and the Postal Service do not agree on the savings from Network Rationalization, the Commission believes that somewhere between $46 million and $2 billion is probable if all proposed assumptions prove correct. In FY 2012 the Postal

Service began Phase I of the Network Rationalization process, closing 46 facilities. It plans to close another 86 facilities in 2013. Phase II will begin in 2014 with an additional 89 facility closures. The result of Network Rationalization will clearly be some level of cost reduction that will have a positive effect upon cost coverage for all mail classes. Network Rationalization will thus bring Periodicals class closer to 100% cost coverage.

In addition to Network Rationalization savings, the full benefits of FSS have yet to be realized. In FY 2012, the Postal Service processed approximately 59% of the volume available in the FSS zones (city routes) on the FSS machines. As it continues to improve its FSS processing and flows, the volume processed on FSS will grow. The net effect will be a further reduction in manual casing costs.

While it continues to increase flats processing on the FSS, however, the Postal Service has been unable to eliminate a parallel processing operation which adds unnecessary expense. The Commission is well aware that FSS machines are large, complex pieces of equipment that occasionally break down or cannot process all of the available volume within the applicable service standard window. To compensate for breakdowns and avoid service failures, the Postal Service has established contingency plans that completely bypass the FSS operation if FSS capacity is inadequate or unavailable. These alternative ways to process the mail without using the FSS equipment cause the Postal Service to incur additional expense that it would not have incurred if the mail could have been processed on the FSS.

For example, if the mail is prepared according to the FSS sort plan and the FSS machine breaks down, the Postal Service cannot simply send the bundles to the Destination Delivery Units (DDU), because each bundle will contain pieces for a variety of carrier routes and/or zip codes. Since the DDUs no longer have clerks with scheme knowledge available to sort mixed carrier routes, this volume must be processed on the AFSM 100 machines. The AFSMs will then sort the pieces to the individual carrier routes in each zip code and the flats will be manually cased at the DDU. If the mail could have been processed on the FSS, the Postal Service would not be forced to incur the additional expense of processing on the AFSM 100 and manually casing the mail.

Or if a mailer presents the USPS with carrier route sorted bundles for an FSS zone but the FSS is unavailable, the Postal Service will sort the bundles to the appropriate DDU on the Automated Package Processing System (APPS) and, once again, manually case the mail. In this case, the APPS process would have taken place regardless of whether or not the mail was processed on the FSS. However, the cost of manually casing the flats could have been avoided if the FSS equipment had been available.

The Postal Service has made significant improvements in FSS reliability and reductions in the amount of down time following a failure. As it continues to improve its FSS performance, the additional costs associated with FSS work-around processes will be further reduced or eliminated, thereby yielding a reduction in the cost of processing flats.

In summary, there are current and ongoing opportunities to further reduce mail processing costs through the implementation of Network Rationalization and process improvement on the FSS. The result of these improvements will be a reduction in attributable costs for flat mail and an increase in cost coverage for Periodicals and Standard Mail flats.

III. Additional cost reduction opportunities have been identified

In addition to the developments described above, the mailing industry has independently developed a summary of process improvements that will reduce costs through minimizing container handling, bundle handling, and piece handling. IDEAlliance is calling this initiative the Mail-flow Optimization Matrix (MOP) (see attachment A). The MOP identifies how container handling costs can be reduced by increasing destination entry of flats and lists the various items that could be implemented within each functional area to achieve the goal. The cost improvements that MOP identifies are achievable through initiatives in a wide variety of functional areas, including, mailing standards and business mail acceptance, prep rules and parameters, price signals within today's rate structure, price signals using a new rate structure, mail processing and operations, and USPS engineering and systems, as well as changes made by the mailing industry. The first iteration of the MOP identifies 52 ways to reduce the costs associated with processing flats.

The MOP project is still in its formative period. The concept was presented to MTAC at the November 2012 meeting and was well received by both industry and Postal Service representatives. As the result of this initial presentation, a host of opportunities for improvement are being explored both within and outside of MTAC. Not all of them will be implemented, but there can be little doubt that many will. Each item on the MOP has the potential to reduce costs for flat mail and improve cost coverage.

In addition to the efforts of IDEAlliance, on January 4, 2013, the USPS Office of Inspector General issued a Flat-Shaped Mail Costs Audit Report**,** which states:

> Management's decision to manually process potentially machinable mail and the lack of flats mail processing equipment at certain processing facilities limit the Postal Service's efforts to reduce costs associated with manually processing flat mail. In FY 2003, the Postal Service reported that it manually processed 33.3 percent of all flat mail. Eight years later, the percentage of manually processed flat mail has decreased by about 3.3 percent to about 30 percent. While declining flat mail volume and Postal Service initiatives to reduce manual flat mail processing have slightly reduced the percentage of flat mail manually processed and overall flat mail processing costs, further reductions are achievable. [¶] . . . While the Postal Service's goal in FY 2011 was to process 29.9 percent of flat mail manually, we estimate it could save about $129.6 million annually if it met its stretch goal of 20 percent. . . . [¶] While achieving $129.6 million in workhour savings only represents about 10 percent of the $1.2 billion in cost reductions needed to increase Periodicals and Standard Mail cost coverage to 100 percent, we believe that these cost reductions are critical.[11]

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[11] Office of the Inspector General, United States Postal Service. Flat-Shaped Mail Costs Audit Report, Report Number MS-AR-13-003 (January 4, 2013), at 3.

IV. Conclusion

As noted by the OIG, cost reductions for Periodicals and Standard Mail flats are critical. In these comments, I have identified numerous cost reduction opportunities available from Network Rationalization, FSS process improvements, and Mail-flow optimization. The mailing industry expects flat shaped mail cost coverage to improve over the next few years as the initiatives mentioned above come to fruition.

Biographical Note

James O'Brien is the Vice President of Distribution & Postal Affairs for Time Incorporated, a division of Time Warner. He is the former Chairman of the Association for Postal Commerce (PostCom), and the former Chairman of the Magazine Publishers of America (MPA) Postal Committee, and currently serves on the board of directors of PostCom. He represents PostCom at the Mailers Technical Advisory Committee (MTAC), is a member of the Periodicals Operations Advisory Committee (POAC), MPA Postal Committee, and the MPA Government Affairs Committee. In 2004 he testified before the President's Commission on the United States Postal Service. He was a member of the Periodicals Operations Review Team that focused on the cause of rapidly rising Periodicals class costs in 1998, and as a result of his work on the Review Team, was a witness before the Postal Rate Commission in Docket No. R2000-1.

Mr. O'Brien holds a Bachelor of Science degree from the University of Illinois and is a graduate of the Program for Management Development at the Harvard Business School.

ATTACHMENT A

MAIL FLOW OPTIMIZATION MATRIX

Mailflow OPtimization Matrix (MOP) - Flats / Carrier Route Flow

FUNCTIONAL AREA OF SUPPLY CHAIN

	OPTIMIZATION OBJECTIVES		
Objective -->	MINIMIZE CONTAINER HANDLINGS	MINIMIZE BUNDLE HANDLINGS	MINIMIZE PIECE HANDLINGS
Vehicle -->	1. Increase Destination Entry	2. Increase CRRT/5D Pallet Prep	3. Increase CRRT Bundle Prep
1. Mailing Standards / BMA		(1) Change max # pallets printers can stack when loading	(I) Change PER 20oz mach rule to align with AFSM capabilities. (2) Change PER 20oz Mach. Rule for FSS copies to align with FSS capabilities (3) Change STD 16oz max to align with PER Mach weight (4) Create alt. CRRT bundle prep without LOT requirement
2. Prep Rules / Parameters	(1) Eliminate all preps finer than SCF but MXD CRRT/5D (2) Create CRRT/SCF pallet prep (3) Adjust presort logic order of container levels (4) Node based presort	(1) lower pallet weight min for all Dest. Entered pallets (2) node based presort	(1) Lower CRRT Min for both PER and STD (2) Change PER/STD mixed class comail prep rules to better incent action (3) Node Based Presort (4) Add CRRT # in 5D address label
3. Price Signals within existing Structure	(1) Increase Dest entered Pound Price incentive (2) Increase Destination entered pallet Incentive (3) Align Container prices with new preps above. (4) Decrease Non Dest. Entered pound Incentive (ad & edit)	(1) Inscrease Dest. Entered CRRT/5D pallet incentive (green pallet) (2) Increase all other Dest. entered pallet prep incentive (3) Increase CRRT Bundle / CRRT_5D pallet incentive (green pallet) (4) Increase all other bundle prep on Dest. Pallets (5) Decrease incentive for all sack preps	(1) Increase CRRT Delta between CRRT & 5D Piece Rate
4. Price Signals within new Structure	(1) Change STD to match PER (non ECSI related) (2) Create PER Zoned edit rate (3) Create zone pound rates for STD	(1) Change STD to match PER (non ECSI related) (2) Create new pallet price for 100% CRRT pallet (3) Create new bundle price for bundles on CRRT/5D pallet	(1) Change STD to match PER (non ECSI related) (2) Create incentive for Svc Providers to increase Comail (3) Create incentive for service providers to increase DPV%
5. Mail Processing / Ops	(1) Increase Destination Facility Density (NetRat) (2) Implement "DPS bundle Prep" in FSS sites that have no bundle processing. (3) Implement "DPS Bundle Prep" in NDCs to bypass ADCs downstream	(1) Ensure MTE inventory meets varying demand (2) Implement "DPS bundle Prep" in FSS sites that have no bundle processing. (3) Implement "DPS Bundle Prep" in NDCs to bypass ADCs downstream	(1) Improve APPS bundle handling to minimize bundle breakage
6. USPS Technical / Systems	(1) Enable mail direction to direct mail by container prep (2) Create Shape / Class Based Label List		(1) Increase DPV% with new process & technology
7. Industry	(1) Lower pallet minimum parameters in presort (2) Increase comail capacity (3) Lower transportation costs (4) Lower fuel costs	(1) Minimize bundles by maxing prep parameters & Strengthening packaging	(1) Increase comail capcity / flexibility (2) Increase DVP% with new process & technology (3) Miminize unreadable barcodes

Mailflow OPtimization Matrix (MOP) - Flats / DPS Flow

		OPTIMIZATION OBJECTIVES		
	Objective -->	MINIMIZE CONTAINER HANDLINGS	MINIMIZE BUNDLE HANDLINGS	MINIMIZE PIECE HANDLINGS
	Vehicle -->	1. Increase FSS Facility Entry	2. Increase DPS/FSS Pallet Prep	3. Increase DPS Bundle Prep
FUNCTIONAL AREA OF SUPPLY CHAIN	1. Mailing Standards / BMA		(1) Change max # pallets printers can stack when loading (2) Make FSS Container Prep Required (3) Remove option to place FSS bundles on non FSS pallets	(1) Make FSS Bundle Prep Required (2) Make FSS Container Prep Required (APPS = Breakage) (3) Change STD 16oz max to align with PER Mach weight
	2. Prep Rules / Parameters	(1) Node based Presort	(1) lower pallet weight min for all Dest. Entered pallets (2) Change PER/STD mixed class comail prep rules to better incent action (3) re-optimize container prep rules for AFP process (4) node based presort	(1) Require non-compensated bundles (2) Change PER/STD mixed class comail prep rules to better incent adoption (3) Node Based Presort
	3. Price Signals within existing Structure	(1) Increase Dest entered Pound Price incentive (2) Increase Destination entered pallet Incentive (3) Decrease Non Dest. Entered pound Incentive (ad & edit)	(1) Inscrease Dest. Entered FSS Scheme Pallet incentive (2) Increase Dest Entered FSS Facility Pallet incentvie (3) Lower CRRT Bundle / 5D pallet price	
	4. Price Signals within new Structure	(1) Change STD to match PER (non ECSI related) (2) Create PER Zoned edit rate	(1) Change STD to match PER (non ECSI related) (2) Create FSS Bunlde Price that incents prep (cost based) (3) Create FSS Container Price that incents prep (cost based) (4) Create incentive for Svc Providers to increase comail	(1) Change STD to match PER (non ECSI related) (2) Create FSS Piece rate that incents prep (cost based) (3) Create incentive for service providers to increase DPV% (4) Create incentive for Svc Providers to increase comail
	5. Mail Processing / Ops	(1) Implement "DPS Prep" in FSS sites that have no bundle processing. (2) Increase Destination Facility Density (NetRat) (3) Implement AFP in NDCs to bypass ADCs downstream	(1) Implement "DPS Prep" in SCFs that have no bundle processing. (2) Implement AFP in NDCs to bypass ADCs downstream (3) Ensure MTE inventory meets varying demand	(1) Implement "DPS Prep" in SCFs that have no bundle processing. (2) Expand DPS by redeploying FSS machines (3) Expand DPS by adding new FSS capabilities (4) Expand DPS new technology (FSS2, OMS, XMS) (5) Improve APPS bundle handling to minimize bundle breakage (induction & singlation)
	6. USPS Technical / Systems	(1) Enable mail direction to direct mail by container prep (2) Shape Based Label List	(1) Enable mail direction to direct mail by container prep	(1) Increase DVP% with new process & technology
	7. Industry	(1) Lower pallet minimum parameters in presort (2) Increase comail capacity (3) Lower transportation costs (4) Lower fuel costs	(1) Minimize # of bundles by maxing prep parameters & Strengthening packaging (2) Increase comail capacity	(1) Increase DVP% with new process & technology (2) Miminize unreadable barcodes (3) Improve packaging strength