

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

EXPERIMENTAL PERIODICALS  
CO-PALLETIZATION DROPSHIP DISCOUNTS FOR  
HIGH EDITORIAL PUBLICATIONS, 2004

Docket No. MC2004-1

RESPONSE OF UNITED STATES POSTAL SERVICE  
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES OF  
TIME WARNER, INC. (TW/USPS-T1-14-18, 21-22)

The United States Postal Service hereby files the responses of witness Altaf H. Taufique to the following interrogatories of Time Warner, Inc.:

TW/USPS-T1-14-18, 21-22, filed on April 2, 2004.

Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.  
Chief Counsel, Ratemaking

/s/  
David H. Rubin  
Attorney

475 L'Enfant Plaza West, S.W.  
Washington, D.C. 20260-1137  
(202) 268-2986; Fax -6187  
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**TW/USPS-T1-14.** On page 5 of your testimony, line 16, you say: “The challenge for the Postal Service is to find a middle ground between leaving these publications in sacks, and proposing a more fundamental change in the current rate structure at this time.”

a. Do you agree that the new rates you propose will put in place a set of incentives and options that did not exist before. Explain any disagreement.

b. Do you agree that mailers and possibly their agents are likely to make changes and invest money in response to these new incentives? Explain any disagreement.

c. Do you agree that if “more fundamental change[s]” are made to the rate structure at some point in the future, the specific incentives in the current proposal will in all likelihood be withdrawn and the mailers will then be faced with a new set of incentives and options? Explain any disagreement.

d. (1) Do you believe it is fair and equitable to expect mailers to invest and make changes aligned with the rates in the current proposal and then in a reasonably short period of time to invest and make changes aligned with a “more fundamental” change in the rate structure? (2) Please explain whether you believe it is likely that after adjusting to the second change, mailers might wish they had not adjusted to the first change.

e. In order to help mailers and their agents to adjust to the changes proposed at this time, please provide information about the nature and timing of any “more fundamental change[s]” that are likely to be proposed in the future.

f. Assuming “more fundamental” changes are proposed in the future, please explain your opinion on whether the implementation of the more fundamental changes should be tempered so that the adjustment from the proposed rates is limited, thus placing a constraint on the more fundamental changes and decreasing their effectiveness.

g. Please present any analysis you have done of the extent to which the rates being proposed are in line in a fair and progressive way with any more fundamental changes that are likely to be proposed in the future.

**RESPONSE:**

a. Agreed.

b. Possibly. But some of the investment plans and changes could have been made or planned based on the first co-palletization experiment. The proposed incentives should allow better use of those changes and investments by inducing

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a larger volume to utilize the changed infrastructure. As I have stated in my testimony, this proposal is a logical extension of the existing co-palletization experiment. USPS-T-1, at 1. We expect that the proposed discounts will attract publications that would not have co-palletized and dropshipped with the existing experimental discounts while also facilitating their use.

- c. I do not know. I do not know what you mean by a “new set of incentives and options.” I am confident that the Postal Service will continue, in some form or another, to advocate providing incentives for small publications to combine their mail and enter it on pallets at an ADC or SCF. Our goal will remain to provide incentives and options that encourage behavior changes similar to those already observed in the existing experiment.
- d. Your question assumes too much concerning the nature and timing of possible future changes. I cannot predict with certainty whether any future proposal by the Postal Service would be ultimately recommended, approved, and implemented under our administrative process, or when such changes would take effect. I would expect that any future Postal Service proposals would be consistent with the objectives embodied in the current proposal, namely, to make it more likely that smaller mailers would combine their mailings to achieve palletization and dropshipment. In this regard, I do not see anything inequitable or unfair about providing consistent pricing signals to the mailers. The Postal Service, and, I believe, the Commission, have generally tried to consider the impact on mailers’ current practices when deciding about rate and classification changes.

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- e. As I have stated in my previous response, I cannot predict future pricing changes. I can state with reasonable certainty that the Postal Service would like to provide incentives for the behavior change that is sought in this docket.
- f. I do not understand what “implementation of the more fundamental changes should be tempered” means. My testimony supports the Postal Service’s proposed experiment in the absence of fundamental change. Future Postal Service proposals will be influenced by a variety of factors, including the results of the proposed experiment, if it is ultimately recommended, approved, and implemented.
- g. I do not have any analysis of this nature. I do believe that the Postal Service’s proposal in this proceeding is fair and progressive.

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**TW/USPS-T1-15.** Consider a zone-8 print location that prints 4 journals that weigh 9 ounces each. Two of the journals have 65 percent advertising and can be made eligible for the co-pallet-I discount by co-palletizing the journals and achieving a 300-pound pallet with 533 pieces on it. The other two journals have 15 percent advertising and can be made eligible for the co-pallet-II discount by the same procedure of copalletizing and achieving a similar 300-pound pallet with 533 pieces. There is nothing in the operations of the printer (or any transportation agent) that is sensitive to the split between editorial and advertising. In other words, they view all 4 of these publications as operational identical. The printer and the associated publisher are considering DSCF entry.

a. Please confirm that the co-pallet of 65-percent-advertising publications could under R2001-1 rates receive a dropship discount of \$94.37 ( $=533*(0.159047$  discount on advertising + 0.008 per-piece DSCF discount + 0.01 per-piece pallet discount)). Explain any disagreement.

b. Please confirm that with the co-pallet-I discount of 1 cent per piece, this same pallet of 65-percent-advertising pieces could obtain a dropship discount of \$99.70 ( $=94.37 + 533 * 0.01$  co-pallet-I discount). Explain any disagreement.

c. Please confirm that for this mailer the co-pallet-I experiment is to see if an increase in the discount of 5.6 percent, from \$94.37 to \$99.70 will cause otherwise nonparticipating mailers to begin to participate.

d. Consider now the co-pallet of 15-percent-advertising publications, and confirm that it could under R2001-1 rates receive a dropship discount of \$29.16 ( $=533*(0.0367$  discount on advertising + 0.008 per-piece DSCF discount + 0.01 per-piece pallet discount)).

e. Confirm that if the co-pallet of 15-percent-advertising publications takes advantage of the proposed co-pallet-II discount, it would receive a dropship discount of \$62.30 ( $=29.16 + 533 * \text{the proposed } 0.13 * \text{the editorial weight}$ ).

f. Please confirm that for 15-percent-advertising publications, the proposed copallet-II discounts become an experiment to see if increasing the dropship discount by 113.6%, from \$29.16 to \$62.30, will cause otherwise nonparticipating mailers to begin to participate.

g. If there are any mailers similar to the 65-percent-advertising mailers in this example who are not already co-palletizing and dropshipping under current rates for a discount of \$94.37 (even before co-pallet-I discounts are applied), do you believe it is reasonable to expect that 15-percent-advertising mailers similar to those in this example will co-palletize and dropship for a discount of \$62.30?

h. Has the Postal Service done any analysis to determine the characteristics of mailers already co-palletizing and dropshipping (even before the co-pallet-I

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discounts became effective) to help assess the likelihood that mailers will find the discounts in co-pallet-II attractive? If it has, please present the results of that analysis. If it has not, please explain whether you believe it is reasonable to expect an organization like to [sic] the Postal Service to perform such analyses to use in guiding experiments?

i. If the Postal Service has not done any analysis allowed by the current rates, as suggested above, would you characterize the proposed experiment as unsupported by a priori analysis, as suggested on lines 3 through 7 of page 1 of your testimony?

**RESPONSE:**

- a. Not confirmed. I estimate the discount to be \$97.03. The difference could be that your question assumes \$0.01 for the per-piece pallet discount. If this mail is on a pallet and dropshipped at the destination SCF then the applicable discount is \$0.015 per piece.
- b. Not confirmed. I estimate this number to be \$102.36. Please see my response to part (a).
- c. Not confirmed. In addition to our calculation difference which gives me a 5.5 percent increase in discount compared to your calculation of 5.6 percent, I disagree with the premise of your question. Our goal in filing Docket No. MC2002-3 (the first co-palletization case) was to build upon the momentum for palletization and dropshipment that was achieved in the settlement of Docket No. R2001-1. In Docket No. R2001-1, the Postal Service had proposed a \$0.005 per-piece pallet discount and additional discounts on dropshipped editorial pounds. The rates that resulted from the settlement process provided two pallet discounts: one for pieces prepared on pallets, regardless of dropshipment, and the other one for pieces prepared on pallets and dropshipped. Given this rate structure, we decided that the additional incentive proposed in Docket No.

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MC2002-3 would help in improving mail preparation and destination entry.

Please see my Docket No. MC2002-3 testimony, USPS-T-1, at 4.

Thus, the 5.5 or 5.6 percent that was estimated in this example is not the only incentive that will cause non-participating mailers to begin to participate. This additional incentive works in conjunction with the enhanced palletization and dropship incentives resulting from Docket No. R2001-1.

- d. Not confirmed. I estimate the discount to be \$31.82. See my response to part (a) above.
- e. Not confirmed. I estimate the discount to be \$70.54. See my response to part (a) above.
- f. Not confirmed. Since the increase is from \$31.82 to \$70.54 the percent increase is approximately 122 percent.
- g. It is reasonable to expect that the proposed discount combined with existing discounts on the rate schedule would be attractive to many publications. The savings for a customer that has sacked mail entered at origin would not be from \$31.82 to \$70.54, as provided in your example; rather, the savings are from zero to \$70.54. We understand that it is less than the discount for a publication with high advertising content, but there are other benefits from the mailer's perspective. As explained in the April 5 letter from Cadmus Communications to Commissioner Covington, the proposed incentives will justify Cadmus' shift of their low advertising publications, as well as their other publications, to pallets. There are operational savings for the printer when sacks are completely replaced by pallets. Since the co-palletized mail will be dropshipped to either a destination

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ADC or SCF there are possible improvements in delivery (even accounting for the delays due to co-palletization). Reduction in bundle breakage and less damage to mail pieces because of palletization is another advantage. Please see my response to Time Warner interrogatory TW/USPS-T1-4.

- h. Instead of analyzing the characteristics of mailers already co-palletizing and dropshipping, the Postal Service has focused its attention on mailers that were using sacks. Thus, the Postal Service provided a reasonable basis for the Docket No. MC2002-3 co-palletization experiment, which has led to additional palletization and dropshipment. Moreover, the proposal now under consideration has the support of the largest print supplier to the scientific journals market, a large source of sacked mail. Potential participation from the titles printed by this printer alone is approximately 13 million pieces annually with a potential annual reduction of over 300,000 sacks from postal operations (see Cadmus database attached to my response to ABM/USPS-T1-4). Given the experience to date we believe that implementation of the proposed discount would increase participation in the current experiment, as well as attract new volume to co-palletizing and dropshipping. Please see my responses to interrogatories ABM/USPS-T1-3 and 4, and TW/USPS-T1-4.
- i. No. I believe that the Postal Service has provided reasonable justification for proposing this experiment, including the data collection plan discussed at pages 19 to 20 of my testimony, USPS-T-1.

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**TW/USPS-T1-16.** On page 23 of your testimony, lines 12-13, you indicate that your proposal will “help maintain the widespread dissemination of editorial matter.” Please discuss the nature of the test you would use to determine whether the dissemination of editorial matter is less widespread or more widespread under your proposal. Focus only on the concept of the test and not on how to carry it out or on whether it is difficult to carry it out.

**RESPONSE:**

The Postal Service has not proposed any quantitative measurement of editorial matter’s dissemination. The purpose of this experiment is to test whether the proposed discounts induce more co-palletization and dropshipment by the targeted publications. We intend to collect data on that particular subject to inform future pricing proposals for Periodicals.

I do believe that this proposal will help maintain the widespread dissemination of editorial matter, because it would provide incentives for high-editorial content, relatively heavy, and smaller circulation publications, to increase use of the more efficient palletization and dropship practices. To the extent that these publishers find it more economical to use the mail to distribute periodicals containing high editorial content, their ability to disseminate editorial matter will be enhanced.

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**TW/USPS-T1-17.** On page 1 of your testimony, lines 11-12, you indicate that some “small publications do not find the current discounts attractive enough to change their behavior.”

- a. Please explain whether you have reached a preconceived conclusion that some mailers should change their behavior.
- b. Please explain whether you view the result of whether mailers change their behavior as an indicator of whether the current discounts are adequate. If you do, please provide references to any theoretical literature indicating that the efficiency of a set of rates can or should be measured by whether buyers change their behavior.
- c. Please explain whether you believe that the efficient component pricing rule is based on a presumption that efficient rates can be set without knowing how mailers will respond and then allowing mailers to make their own decisions.
- d. If under the efficient component pricing rule a mailer decides to purchase a high-cost service instead of a low-cost service, do you know of any basis for concluding that this is an undesirable outcome? Explain.

**RESPONSE:**

Before responding to the specific questions, I would like to provide the full context of the sentence fragment that is quoted from my testimony, at page 1, lines 11-12.

This proposal is a logical extension of the current experimental per-piece discounts for co-palletized and dropshipped pieces (Docket No. MC2002-3). In many instances, high-editorial (editorial content is also referred to as non-advertising content), heavier weight, small publications do not find the current discounts attractive enough to change their behavior. The proposed experiment would provide per-pound discounts for editorial pounds in co-palletized and dropshipped mail, based on the entry points and zones skipped.

As can be seen from these three sentences, the primary goal was to extend the discounts that were implemented in Docket No. MC2002-3. So, a reasonable question to ask is whether the discounts proposed and recommended in Docket No. MC2002-3 were justified in the light of the efficient component pricing rule, which is the subject matter of the parts that follow. As stated in my response to interrogatory ABM/USPS-

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T1-1, the genesis of this type of worksharing discount was laid out in my testimony in Docket No. R2001-1. Also, my testimony in Docket No. MC2002-3 provides the justification for co-palletization and dropshipment discounts.

One of the key Periodicals issues in recent rate cases has been the need to control cost increases. The Postal Service employs worksharing incentives to encourage palletization and dropshipping, thus mitigating increases in processing costs. As of the base year in Docket No. R2001-1, about 69 percent of Periodicals mail was presented on pallets, and about 44 percent was dropshipped to destination facilities. Even with worksharing incentives, Periodicals volume still includes a substantial amount of sacked, non-dropshipped mail. More importantly, this volume accounts for a disproportionate amount of Periodicals processing costs, primarily because the same amount of mail requires the handling of many more sacks than pallets. (footnotes omitted)

Docket No. MC2002-3, USPS-T-1, at 2.

I also discussed the need for these types of discounts on page 4:

In Docket No. R2001-1, the Postal Service proposed new Periodicals incentives for both palletization and dropshipment. These proposals were designed to improve the preparation of mail and encourage entry closer to destination. I specifically discussed the benefits of dropshipping and palletization for Periodicals in my testimony in that case. Docket No. R2001-1, USPS-T-34, at 6, 8-11. The settlement and Recommended Decision in that docket resulted in enhanced Periodicals dropshipment and pallet discounts. PRC Op., R2001-1, at 104-06. While these discounts should encourage more dropshipment and palletization, I believe that additional discounts promoting copalletization (and subsequent dropshipping) should be tested, with the goal of reducing the increases in Periodicals costs. This could build on the momentum resulting from the recently implemented discounts.

Docket No. MC2002-3, USPS-T-1, at 4.

In light of this discussion, it is clear that changing behavior for the sake of changing behavior is not the goal of the proposed discounts. Rather the goal is changing behavior that is expensive both for the mailers and the Postal Service. We hope that this

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experiment will lead to reduced mailer preparation cost and Postal Service mail processing and delivery costs.

a-d. Please see the above discussion. The goal is to provide incentives for changing behavior that is costly both to the mailers and the Postal Service. The choice of proposed discounts depends on the effectiveness of the discounts in inducing cost-saving behavior. Discounts should be justified by cost savings to the Postal Service. The purpose of the experiment is to test the proposal against that goal.

Regarding the theoretical support for the proposal, I would like to quote an ex-postal and Commission economist, Mr. Robert W. Mitchell, on the philosophy of worksharing and efficient rates. In a paper titled, "Postal Worksharing: Welfare, Technical Efficiency, and Pareto Optimality," he states that "Some postal activities can be done more efficiently by mailers than by the Postal Service. The worksharing notion is to set up a rate structure that gives mailers choices. If done right, the mailers will choose to do the work only when they do it more efficiently than the Postal Service." Our goal is to test this particular hypothesis in the limited context of discounts on editorial pounds that are dropshipped to a destination ADC or SCF.

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**TW/USPS-T1-18.** On page 5 of your testimony, lines 6-7, you indicate that the current incentives “do not have a sufficient impact on high-editorial publications.” Please explain how you can tell whether any particular set of rates has a “sufficient” impact on any particular publication.

**RESPONSE:**

I did not have a specific definition of "sufficient" in mind when writing that part of my testimony. Rather, I was referring to my knowledge that the existing discounts did not affect Cadmus' use of sacks, and to the earlier discussion in my testimony that these discounts provide substantially lower postage savings for high editorial publications than for high advertising publications.

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**TW/USPS-T1-21.** On page 16 of your testimony, beginning on line 21, you say: “Using a 100 percent passthrough of the cost savings would mean providing discount levels that are inappropriately high relative to the base rate.”

a. Please explain whether you mean that the base rate minus the discount would result in a negative pound rate for the editorial pounds.

b. Suppose the base postage for a publication is 25 cents, including all piece and pound rates. Now assume this publication dropships and the Postal Service saves 30 cents in transportation costs and 8 cents in non-transportation costs. (1) Do you agree that if 100 percent of the transportation savings were given as a discount, the final postage paid by the mailers would be negative 5 cents? That is, the Postal Service would pay the mailer 5 cents for each piece submitted. Explain any disagreement. (2) Do you agree that for each piece that is both dropshipped and given 5 cents, the Postal Service comes out 8 cents ahead financially? Explain any disagreement. (3) In the general case, please explain why the Postal Service would be opposed to a rate arrangement under which it gained 8 cents for each participating (or cooperating) piece. (4) Please explain in general the nature of the conditions that must exist for rate arrangements involving negative rates to benefit the Postal Service.

**RESPONSE:**

- a. Yes. Given the current rate structure and the proposed discount, a 100 percent passthrough would result in a negative pound rate for the editorial pounds. That is why the Postal Service is not proposing a 100 percent passthrough.
- b. The hypothetical in this question presents a logical anomaly. Processing and delivery of mail is not costless, so the Postal Service cannot pay mailers when it incurs those costs. Moreover, the subparts of this interrogatory raise questions about an unprecedented, permanent and wide ranging approach to ratemaking whose ramifications for Periodicals – let alone other classes – are well beyond the scope of the limited expansion of an experiment now being considered.

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**TW/USPS-T1-22.** Under your proposal, the mailer (or agent) would have to both create the co-pallet and dropship the co-pallet to get the proposed discount. Relative, then, to the possibility of providing a discount for co-pallets entered at the origin office, your proposal involves bundling two separate activities, a co-palletization activity and a dropship activity. Without doing both, no discount is available, even though both cause savings. Please explain the justification for bundling these two activities together instead of offering separate discounts and explain how your proposal aligns with the economic literature suggesting that it is inefficient and inconsistent with the notion of lowest combined cost to bundle separate activities.

**RESPONSE:**

This bundling of co-palletization and dropshipment was recommended by the Commission and approved by the Postal Service Governors in the current co-palletization experiment, Docket No. MC2002-3. Our proposal in this docket simply seeks an extension of the current experiment. While the existing Periodicals classification schedule contains examples that combine dropshipment with co-palletization and with palletization, and that offer palletization and dropshipment separately, the model for co-palletization which this experiment seeks to expand has them combined.

## **CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

David H. Rubin

475 L'Enfant Plaza West, S.W.  
Washington, D.C. 20260-1137  
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