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

**Annual Compliance Report, 2008** ) **Docket No. ACR2008**

# REPLY COMMENTS OF AMERICAN BUSINESS MEDIA

(February 13, 2009)

Pursuant to Order No, 161, American Business Media, the trade association for the nation's leading business-to-business media companies and an active participant in proceedings before this Commission, hereby submits these Reply Comments in response to the initial comments of Valpak and the Public Representative.

**Valpak**

Valpak seizes on the gross numbers showing no meaningful improvement during the past year in the cost coverage for Periodicals to argue, as it did in Docket No. ACR2007, that if the Commission finds that the price cap indeed "trumps" the cost-coverage factor found at 39 U.S.C. § 3622(c)(2),[1] the Commission should order the Postal Service to skew the upcoming rate increase in order to impose the burden on "copies of publications whose attributable cost far exceeds whatever they now pay in

[1] In response to Valpak's ACR2007 argument that this section required an immediate increase in excess of the price cap in order to produce 100% cost coverage, the Commission in that docket disagreed, stating that "it is most appropriate to allow the recently adopted strategy for overcoming the Periodicals revenue-cost relationship a reasonable interval of time to succeed." Annual Compliance Determination at 70. More recently, in its December 19, 2008, Report on Universal Postal Service and the Postal Monopoly, the Commission was more explicit, stating (at 134) that, under PAEA, Periodicals losses cannot be eliminated by a cap-piercing rate increase in light of "current statutory obligations."

postage." Comments at 24. Once again, American Business Media finds the result sought to be unwise, ineffective and unlawful as well as outrageous.

In offering this proposal, Valpak hypothesizes, but does not prove or provide any quantitative analysis, that a "significant portion [of Periodicals volume] more than covers its attributable cost, contributes meaningfully to institutional costs, and deserves recognition." Comments at 17. On the other hand, it continues, another "significant portion" of such volume fails to cover attributable costs, and for this portion Valpak proposes extinction, not recognition.

Even Valpak would have to agree that, if the Commission were to direct the Postal Service to impose the increase only on high cost/low revenue copies of publications (assuming that it could do so), and if all publications pay those much higher rates, costs and revenues for the class would be precisely the same as those produced by a more balanced approach that considers not only cost incurrence but impact on mailers. Any gap will remain.

Yet Valpak contends (at 24) that its rate proposal presents "the most efficacious way to increase coverage." Valpak does not explain how cost coverage would be increased, but refers the Commission in a footnote to its Reply Comments in Docket No. ACR2007 at pages 12-13 "for a discussion of how a targeted rate increase on money-losing periodicals can reduce Postal Service losses."

As Valpak requested, American Business Media revisited those pages to learn how the extreme "rate incentives" approach favored by Valpak would improve Periodicals cost coverage, and this is what we discovered. Valpak assumed a 20% increase on a hypothetical publication with a 50% cost coverage "that nevertheless is within the overall CPI cap," an assumption, we might add, that would require a significant rate decrease for other mailers, if the assumption of compliance with the price cap is to be honored. If the unfortunate mailer pays the increase, Valpak continues, the Postal Service would increase its revenues from the affected publication by 20% and "would have reduced its losses to only $8 for each $10 of revenues received from the publication."

Valpak recognizes that this scenario is "most unlikely," and its alternative, presumably more likely, scenario is more telling. In that scenario, the publication "is forced to cease publication altogether," and the Postal Service would benefit from the decline in "money losing volume." Alternatively, Valpak concludes, the publication could merely toss aside its business model and reduce its frequency.

We suppose that Valpak would applaud the disappearance of what must be thousands of small, "money losing" publications as a means of eliminating a portion of the Periodicals revenue shortfall. As a purveyor of pure advertising material, Valpak appears not to understand the special importance of the editorial content of Periodicals and the longstanding Congressional, PRC and Postal Service recognition of the need maintain a broad and diverse Periodical mailstream. As American Business Media stated in Docket No. ACR2007, what Val Pak proposes is analogous to amputating an infected limb rather than administering antibiotics. We doubt that Congress sought to require this result when it passed the PAEA.

Assuming that Valpak's discussion of price signals and efficiency signifies an unstated recognition that there is a third alternative—a change in mailer worksharing behavior that could, in theory, reduce costs more than revenues—there are three theoretical reactions by Periodicals that under Valpak's proposal would bear the entire capped increase, all of which are likely to occur in some unknown ratio: (1) they could pay the new rates (despite the burden), (2) they could change their mailing practices or (3) they could throw in the towel and terminate at least hard-copy publication. In the first of these scenarios, the principle Valpak espouses would not be advanced, because the coverage would remain the same. In the second, it is possible in theory that the revenue/cost gap would be diminished, although there is good reason to believe that the impact would be minimal (as discussed immediately below). And in the third, the gap might be narrowed, but the Periodicals class and the American people would be irreparably injured.

We have addressed the first and third of these possibilities. The second—a possible change in mailer behavior—deserves careful scrutiny. American Business Media has never contended that the manner in which Periodicals mailers prepare and present their mail is unaffected by the prices they face, but it has contended—and continues to contend—that there are practical limits to the speed with which and the degree to which mailers may change.[2]

There comes a point when existing incentives are sufficient to promote changes at or close to the theoretical limit to changes in mailer behavior. American Business Media suggests that we are at that point. As the Postal Service so compellingly stated in its submission in this docket, the Periodicals industry is facing unprecedented financial challenges, such that publishers would not out of arrogance, ignorance or

[2] For a thorough discussion of the impediments to such changes, see American Business Media's initial and reply briefs in Docket No, R2006-1.

stubbornness continue to mail in sacks if they could mail on pallets and would not refuse to participate in available co-mail programs on philosophical grounds. The oppressive rate increases recommended by the Commission and, unfortunately, accepted by the Governors of the Postal Service in R2006-1 made sure of that.

As a result, in part, from those increases and in part from trends that were already underway in 2007 when the R2006-1 rates were imposed, there has been a meaningful and steady decrease in those mailing practices that cause the Postal Service to handle mail inefficiently and a steady increase in the amount of worksharing and co-mailing, which represents the epitome of changed mailer behavior that price signals are designed to induce.[3] The amount of co-mailing will continue to increase, as printers add more high-cost capacity and develop better practices, but that increase does not depend on still stronger price signals. Those already in existence are adequate to the task. Periodicals publishers are constantly requesting co-mailing services that the industry cannot provide.

American Business Media will not repeat the compelling case it made with the testimony of three industry witnesses in Docket No, R2006-1. But we will back up our claims with up-to-date information. One American Business Media member company, Nielsen Business Media,[4] has like most others been aggressively pursuing co-mailing opportunities for its publications. At this point (based on 2008 data), it is co-mailing

[3] That change in behavior should have reduced the Periodicals revenue gap, but apparently did not, as American Business Media will discuss later.

[4] Nielsen provided witness Lou Bradfield, who testified extensively about its mailing efforts in Docket No. R2006-1.

some or all of the copies of 21 of its 33 publications and will add one more in 2009. One publication is co-palletized. Another 3 are co-stitched, and 3 (weeklies) are dropshipped individually. Two publications produce fewer than 2,000 copies per issue and are not viable candidates for co-mailing, and 1 cannot be co-mailed because of its trim size.[5] Unfortunately, not all copies, and not even all issues, of the co-mailed publications are in fact co-mailed, because of printer limitations. Nevertheless, as a result of Nielsen's efforts, 59% of its total of 15 million annual copies are co-mailed, another 3% are co-palletized, 10% are co-stitched and 26% are dropshipped individually.

The inability to co-mail more is not a function of Nielsen's desire but of printer capability. Nielsen's printers will not co-mail publications or versions of publications with circulations below 10,000 in one case and 5,000 in another. They have yet to devise an effective means for co-mailing weeklies, primarily because the building of the 1,000,000 to 1,500,000 piece pools necessary to achieve meaningful overall savings typically takes from 4 to 7 days, which is problematic for many monthlies but fatal for all weeklies. And co-mailing of non-standard trim sizes remains largely unavailable.

Valpak states (at 23) that "meaningful incentive effects are overdue," which understates the effects to date but incongruously leads Valpak to propose more incentives, not more effects. American Business Media is confident that, over time, at least some of these impediments to responses to price signals will lessen, but (except perhaps at the extreme margins where volumes are insignificant) strengthening the

[5] Its trim size is between tabloid and standard.

existing price signals will have little impact on mailing practices but a major impact on the number of Periodicals that are able to survive these parlous economic times.[6]

Although American Business Media firmly believes that pricing changes will do little to close the revenue gap, unless they drive many thousands of publications from the mail, it appears from the data offered to the Commission that the problem may not be as serious as first appears. The available data show that Outside County Periodicals attributable costs increased by 7.3% per piece over FY 2007, even though weight per piece declined, the number of pieces per pallet increased, the number of carrier route bundles increased and the CPI rolling average increased by only 4.4% for the 12 months ending September, 2008. What's more, total Outside County attributable costs increased by 3.4% while volumes were dropping.

Although the Postal Service attributes the failure of so-called volume variable costs to decline with volume to an inability to restructure operations quickly enough in the face of declining volumes, there is another explanation: the attributed costs are not volume variable to the extent claimed by the Postal Service. This possibility does not exist in a vacuum. The Postal Service along with American Business Media, Magazine Publishers of America and others, have long contended, although the Commission has denied, that mail processing and highway transportation costs are not 100% volume

[6] The rate changes just announced by the Postal Service do in fact increase incentives for mailer changes, but, American Business Media fears, they will not produce much in the way of changes but will simply drive up costs for its members. It appears from an initial look at the rates that smaller circulation weeklies will suffer increases significantly larger than average, yet for service reasons and because of printer limitations they cannot respond to the enhanced "price signals" by co-mailing or by increasing their bundle or container sizes. In addition, it appears that publications with a high percentage of "firm bundles" will experience double-digit increases about which they can do nothing.

variable, an issue that received a good deal of attention in Docket No. R-2000.[7] Although the Postal Service has now acceded to the Commission's views for purposes of its compliance report, American Business Media does not, and we contend that there is now greater proof that the variability of these costs—and thus the costs attributed to Periodicals—is almost certainly overstated.[8]

Not only may costs attributed to Periodicals be overstated, but it also appears that the ability of Periodicals to increase their cost coverage despite greater worksharing and above-average rate increases may in the short term have fallen victim to new or questionable cost attributions. Due in part to changes in attribution methods, changes that are presumably one-time events, particular costs attributed to Periodicals have risen in a one-year period by seemingly anomalous amounts. For example, the Postal Service shows vehicle driver costs attributed to Periodicals increasing by 28.6% and city carrier in-office costs increasing by 9.4%, with many others rising more quickly than the CPI. Even if the new methodologies are more accurate than those they replaced, the fact that in the face of these increases Periodicals cost coverage has been maintained shows that prospects for closing the gap once attributions are stable are good.

Finally, as the Commission suggested in Docket No. ACR2007, the task of bringing Periodicals attributable costs more in line with revenues will take time and

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[7] American Business Media submits that, given the new relationships created by the PAEA, it is time for the Commission and the Postal Service to revisit the briefs submitted on the variability issue in that docket and to undertake a new study of the issue. Reclassifying costs, of course will do nothing for the overall postal revenue deficit, but it will show that Periodicals are not as significant a contributor to that deficit as now appears.

[8] In Docket R97-1, the Commission correctly stated that "[o]ver attribution can be just as much an error as the under-attribution proscribed by section 3622(b)(3)." Opinion and Recommended Decision at III-195, aff'd United Parcel Service v. United States Postal Service, 184 3d 827 (D.C. Cir. 1999).

effort. American Business Media recognizes that past efforts have fallen short of their goals, but it appears that the Postal Service's determination to cut costs now, as exemplified in the Postmaster General's latest statements, show at an entirely new resolve. Those efforts, combined with the very substantial benefits predicted for the FSS equipment now being deployed, will improve the cost/revenue relationship substantially without the need to drive thousands of Periodicals from the mail, which is Valpak's preferred route.

**Public Representative**

The Public Representative recognizes (at 17) that attributable costs increasing more rapidly than inflation "plagues" Periodical mailers but blithely assumes in a series of straight-line trend lines and projections that this plague will continue. The main point of PAEA with its price cap regulation as a replacement for cost-of-service regulation was to provide the Postal Service with both the incentive and the means to reduce costs to or below the level of inflation. The Postal Service's recently announced and very aggressive cost-reduction steps, while perhaps a bit late, show that the message has been received. Combined with the effects of FSS, which represents a major modification to flats processing and the costs thereof, these efforts will change the postal cost landscape and reveal that the Pubic Representative's attempt to forecast years into the future on the basis of three years' worth of unrepresentative data produce little of use in this proceeding.

**Conclusion**

The continuing failure of Periodicals to cover attributable costs ought to be a concern, but not one that leads to decimation of the Periodicals class. The Postal

Service, at last, appears to be on the right track with cost-cutting and serious attention to flats processing. Combined with a continuing increase in work sharing by mailers, spurred on the by the incentives built into today's rates, these Postal Service efforts will produce results that close the gap. Meanwhile, notwithstanding Valpak's claim to the contrary (at 23), the Periodicals shortfall is not harming mailers in other classes, because the postal deficit would require the maximum permissible, price cap constrained rate increases for those classes even if Periodicals turned a profit.

In addition, for the purpose of assessing the overall impact of carrying Periodicals mail below cost, Periodicals mail cannot be viewed in isolation but must be examined along with the volumes of First-Class and Standard mail that are directly related to the mailing of Periodicals. Although consumer magazines typically do more ancillary mailing than business and professional publications, data recently obtained from three American Business Media members show that, combined, they spent $31 million on Periodicals postage in 2008 and $6 million on related Standard and First-Class postage (including business reply mail). Especially because nearly all of that additional mailing was high-markup, letter-sized mail, it is apparent that even business publications make up through other mailing a significant portion of the "loss" on the Periodicals mailings.[9]

For all of these reason, American Business Media respectfully requests that the

[9] For example, if there is a 20%, or $6.2 million, "loss" on the Periodicals mail, and if the other mail averages a conservative 100% markup over attributable costs, the "loss" is cut in half.

Postal Regulatory Commission abide by the Postal Service's recommendation (Annual Compliance Report at 33) that it withhold definitive action with respect to the Periodicals revenue gap pending results of the efforts that are now underway.

Respectfully submitted,

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