

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

POSTAL RATE AND FEE CHANGES

Docket No. R2006-1

INITIAL BRIEF OF
TIME WARNER INC.

December 21, 2006

TABLE OF CONTENTS

	Page
STATEMENT OF THE CASE.....	1
STATEMENT OF POSITION.....	11
I. THE OVERRIDING ISSUE FOR PERIODICALS IS RATE STRUCTURE REFORM.....	13
II. MITCHELL'S RATE PROPOSAL, UNLIKE THAT OF THE POSTAL SERVICE, (1) ADDRESSES WEAKNESSES IN THE PERIODICALS RATE STRUCTURE THAT CONTRIBUTE TO HIGH PERIODICALS RATES, (2) EMBODIES SOUND PRINCIPLES OF RATE DESIGN, AND (3) RESPONDS TO THE COMMISSION'S ORDER IN DOCKET NO. C2004-1.....	15
a. Mitchell's Proposal Builds on His Improvements in Periodicals Rate Design in Docket No. C2004-1, While Following the Guidance Provided in Order No. 1446.....	15
b. The Postal Service Proposal Does Not Represent Progress....	21
III. THE COMMISSION SHOULD ADOPT STRALBERG'S UPDATED AND IMPROVED MAIL PROCESSING COST MODEL FOR PERIODICALS FLATS AND HIS CORRECTIONS TO THE POSTAL SERVICE'S FLATS MAIL FLOW MODEL.....	23
a. Stralberg's Model and Billing Determinants Use Newer Data and Improve Significantly upon his Complaint Case Result....	25
1. Development of extended billing determinants.....	25
2. Upgrading and improving the mail flow model from the complaint case.....	27
b. Stralberg Has Corrected Several Flaws In The Postal Service's Mail Flow Model.....	29
1. Flats preparation costs.....	30
2. The portion of flats incoming secondary sortation that is performed manually.....	33
3. Stralberg's model of UFSM 1000 sorting is much closer than Miller's model to how those machines actually were used in the base year.....	38

4.	Stralberg's model of bundle breakage is more realistic than Miller's and agrees more with statements by Postal Service operations witnesses.....	40
5.	The CRA adjustment.....	44
6.	Other issues with Miller's model.....	48
IV.	THE IMPACT OF TIME WARNER'S PROPOSED RATES ACROSS THE SPECTRUM OF PERIODICALS PUBLICATIONS IS NEITHER EXTREME NOR UNFAIR	49
V.	THE DISCOUNT FROM THE FIRST-CLASS RATE FOR QBRM LETTERS AND CARDS SHOULD BE INCREASED, AND CERTAINLY NOT DECREASED.....	58
	CONCLUSION.....	61

TABLE OF AUTHORITIES

Page(s)

ADMINISTRATIVE DECISIONS

Postal Rate Commission Opinions and Recommended Decisions

PRC Op. R71-1 (June 5, 1972).....	1
PRC Op. R77-1 (May 12, 1978).....	1
PRC Op. R84-1 (September 7, 1984).....	1
PRC Op. R90-1 (January 4, 1991).....	2
PRC Op. MC95-1 (January 26, 1996).....	16, 18-19
PRC Op. R97-1 (May 11, 1998).....	59
PRC Op. R2000-1 (November 13, 2000).....	2, 30, 42, 59
PRC Op. R2001-1 (March 22, 2002).....	2-3
Docket No. C2004-1, Order No. 1446 (October 21, 2005).....	4-10, 12-13, 21-22, 61
PRC Op. R2005-1 (November 1, 2005).....	8

STATUTES

Postal Reorganization Act of 1970, Public Law 91-375, 84 Stat. 719 et seq., 39 U.S.C. §§ 101 et seq.....	13
Section 3622(b)(2).....	18
Section 3622(b)(3).....	18
Section 3622(b)(6).....	17-19
Postal Accountability and Enhancement Act (H.R. 6407), enacted December 20, 2006.....	13-14

OTHER MATERIALS

Elcano, Mary S., German, R. Andrew, and Pickett, John T., “Hiding in Plain Sight: The Quiet Liberalization of the United States Postal System,” in Michael Crew and Paul Kleindorfer, <i>Current Directions in Postal Reform</i> , pp. 337- 52, 2000, Kluwer, Boston.....	19
---	----

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

POSTAL RATE AND FEE CHANGES

Docket No. R2006-1

INITIAL BRIEF OF
TIME WARNER INC.

Time Warner Inc. (Time Warner) hereby respectfully submits its initial brief in the above-captioned proceeding.

STATEMENT OF THE CASE

Time Warner's primary interest in this docket is to see put in place a Periodicals rate structure that begins to reflect costs in a more accurate and systematic way, that encourages mailers to adjust their mailing practices in a cost-minimizing direction, and that can be built upon in the future.

Progress towards a cost-based Periodicals rate structure has a long history of Commission support. In the first rate case, Docket No. R71-1, piece rates were introduced to recognize that not all costs are pound related. In 1978, presort discounts were introduced. In 1985, dropship discounts (on a per-piece basis) were introduced for destination-SCF entry. Tr. 37/12717-18. In its Opinion in Docket No. R84-1, the Commission noted:

The main thrust of our effort in second class has been to align rates more closely with costs, through more emphasis on piece related weights, and discounts for worksharing such as the intra-SCF discount recommended herein.

PRC Op. R84-1 (September 7, 1984), p. 315, ¶ 4143.

In that docket, the improved recognition of piece-related costs led to increases in the piece rates of approximately 77 percent. The dropship discounts approved in Docket No. R84-1 were subsequently extended to include both per-piece and per-pound elements and to apply to destination area distribution centers and destination delivery units. Saturation and high-density discounts and barcode discounts were introduced in 1991.¹

After these developments, progress slowed. Particularly disappointing have been the failure of the Postal Service to file "its long awaited Product Redesign case"² and the extreme conservatism of its recent rate proposals.

In Docket No. R2000-1, a case that expanded the number of presort tiers to four, the Commission reviewed Periodicals cost trends and observed:

The only conclusion is not comfortable: there are many reasons for believing that costs should have decreased; only a few factors that could be associated with increases; and a persistent net upward trend. It is clear that mailers and the Service must aggressively pursue the cost reduction opportunities identified on this record, and explore other aspects of the "operational realities" they face.

PRC Op. R2000-1, p. 412, ¶ 5593.

In Docket No. R2001-1, the Commission approved new DADC and pallet discounts, explaining that its "recommendations for the Outside County subclass continue to reflect a strong focus on implementing structural changes in Periodicals that may

¹ See *generally* Tr. 37/12717-18.

² See Docket No. C2004-1, Tr. 5/1430.

foster cost containment and service improvement.”³

The condition of the Periodicals class as a whole nevertheless remained parlous.⁴

In January of 2004, Time Warner and four other Periodicals publishers filed a Complaint Concerning Periodicals Rates, docketed as C2004-1.⁵ The Complainants acknowledged that the Postal Service and the Commission had long recognized and sought to address the problems in Outside County Periodicals and that some progress has been made. But they also observed that a number of fundamental issues remained unaddressed.⁶

The Complainants stated that their objective was "fundamental reform of the Periodicals rate structure." Complaint at 4. The core of their argument was:

Improvements in cost analysis in the past decade, along with advances in mechanization, have shown that costs are determined in meaningful and systematic ways by the makeup of bundles, sacks, and pallets and associated interactions, including entry points. . . . More than half of

³ PRC Op. R2001-1 (March 22, 2002), p. 104, ¶ 3164. The Commission stated that:

formal recognition in the rate structure for use of pallets is an entirely new and, for many, a long-awaited change in Periodicals. With their links to package preparation and dropshipping, the pallet discounts recommended here may prove to be a watershed development. For now, they hold out the promise that several key practices can be harnessed to control costs and improve service for the class as a whole.

PRC Op. R2001-1, ¶ 3166.

⁴ See TW-T-1 at 2-5.

⁵ Complaint of Time Warner Inc., Condé Nast Publications, a Division of Advance Magazine Publishers Inc., Newsweek, Inc, The Reader's Digest Association, Inc., and TV Guide Magazine Group, Inc. Concerning Periodicals Rates, filed January 12, 2004 (hereafter "Time Warner et al. Complaint" or "Complaint").

⁶ See Complaint at 14-18.

Periodicals mail processing costs in today's environment are incurred handling the bundles, sacks, and pallets in which mail is entered. Yet the rates provide little information concerning what these costs might be, and, accordingly, there is no way that mailers can make efficient decisions.

Complaint at 6.

An extensive record was developed in that docket. Attention centered on what had been learned over the previous decade about Periodicals cost incurrence and the efficiency of the signals provided to mailers in rates. A rate structure that would recognize important cost drivers and send more effective signals to mailers was introduced and subjected to thorough testing on the record.

In its final order in Docket No, C2004-1,⁷ the Commission expressed agreement with the thrust of the Complainants' case. It noted that “[c]ost-based rates and encouraging efficiency in postal operations have been two frequent hallmarks of Commission rate recommendations,” adding:

The Commission has recommended – and the Postal Service has adopted – rates that move all classes and subclasses of mail toward more efficient preparation through discounts for presorting, dropshipping, palletizing, and other cost-efficient measures. The Commission continues to support an economically efficient approach that encourages the optimal use of society's resources to process and deliver mail to its ultimate customers.

Order No. 1446, p. 45, ¶ 5001.

The Commission concluded, with considerable emphasis and specificity, that the record compiled by the Complainants had demonstrated the case for a more

⁷ Order No. 1446, Order Addressing Complaint of Time Warner Et Al., issued October 21, 2005.

cost-based Periodicals rate structure that would improve efficiency in mail preparation and postal operations. Among the Commission's findings were the following:

. . . the evidence of record . . . shows that progress towards a more cost-based structure is both possible and necessary. . . . The Complainants have made a major contribution by identifying and quantifying cost drivers associated with bundles, sacks and pallets.

Order No. 1446, p. 5, ¶ 1013.

Stralberg's model . . . appears to have accurately captured the cost causing characteristics of containers and provided the Postal Service with a sound framework for further study. . . . [H]is contribution can not be overstated.

Order No. 1446, p. 22, ¶ 4013.

It appears from the costing evidence presented on the record of this docket that a portion of Periodicals costs is, in fact, bundle and container oriented, and that the linkages to presort level and entry point cited by witnesses Mitchell and Stralberg affect costs in a meaningful way. Moreover, Stralberg's model appears to be a sound theoretical starting point for developing rates based on heretofore unrecognized cost elements. Witness Mitchell makes a reasoned attempt to align rates for Periodicals mail more closely with costs incurred in the postal operating environment.

This effort represents a substantial step forward in the process of redesigning rates to keep pace with changing technology in the processing and transportation of Periodicals mail.

Order No. 1446, p. 29, ¶¶ 4032-33.

The components that form the foundation of the Complainants' proposed restructuring entail major changes for mailers of Outside County flats. The Commission does not view these changes as radical, as some participants contend, because they reflect existing mail preparation practices and mail flows and constitute only partial de-

averaging. . . . [T]he Complainants have . . . made major progress in identifying and quantifying cost drivers associated with bundles, sacks and pallets.

It is clear that there is room for improvement in the Periodicals rate structure, especially in light of the new insights that the Complainants provide into the costs of bundles, sacks and pallets. At a minimum, the Time Warner et al. proposal is a more cost-based rate structure than the current structure. If it were fully implemented, it would provide financial incentives to mailers to engage in lower cost mailing practices by encouraging mailers to use more efficient bundling, containerize more efficiently, change to a more efficient zone distribution, and increase the proportion of machinable pieces.

Order No. 1446, pp. 45-46, ¶¶ 5003-04.

The Commission urges the Postal Service to proceed forthwith to develop a rate design for Periodicals that better serves the needs of all interested stakeholders and thereafter file a request for a recommended decision with the Commission. It is hoped that this Order will further inform the Postal Service and spark prompt action.

Order No. 1446, App. B at 7, ¶ 13 [footnote omitted].

The Commission also detailed further steps that it said *should* be taken. It said the Postal Service *should*: update witness Stralberg's cost analyses; "evaluate the impact of potential rate changes on various categories of Periodicals mail";⁸ "suggest incremental changes that will foster efficient mailer practices without undue disruption" (p. 5, ¶ 1016); "review each of the rate design features in the context of the current and planned processing and transportation network for Periodicals"; and

⁸ In an appendix discussing its suggested "opt-in system," the Commission said "it is clear that the Postal Service has the capability of identifying the billing determinants for each of the 29,979 publications and calculating before and after rates postage charges. The Postal Service could begin to create an environment for Periodicals that would encourage more efficient mailing practices by conducting the study required to implement the opt-in system." *Id.*, Appendix C, p. 11, ¶ 20.

focus “on quickly incorporating the most promising and least disruptive components” (p. 30, ¶ 4035).⁹ The Commission was particularly specific on several proposals relating to machinability, presortation, and dropshipping, including them in a list of “many possibilities for positive action that should not cause undue disruption” (*Id.*, p. 5, ¶ 1015).¹⁰

One proposal made in the Complaint was to deaverage the basic presort category into a mixed ADC category and an ADC category. This had already been done in Standard Mail and in First-Class Mail, and was another cost-based proposal. Many small mailers can separate mail for an ADC area, particularly if they are local or regional mailers, and there is certainly something to be gained by not having to process the pieces in an origin office. The Commission concluded that “the proposed adjustments appear to reflect the mail flows, and that these

⁹ The effects of supplemental mailings are another matter that received Commission attention: “There is ample evidence that supplemental mailings are more costly to process than main file mailings. It is also the case that supplemental mailings exhibit characteristics similar to those of low-circulation publications. The Postal Service should examine these mailings to determine the extent to which witness Mitchell’s allegation that they are below cost is true.” The Commission went on to say: “The Postal Service may find it feasible to develop classification language or a partial restructuring of Periodicals rate design to treat these mailings in a different manner than main file mailings.” *Id.*, p. 52, ¶ 5017.

¹⁰ The Commission said that “machinability distinctions in piece charges would recognize the additional costs of processing nonmachinable mail.” It observed that “[t]hese distinctions exist in other classes and as flats automation progresses they will become more important. They should be seriously considered within the context of changing operations.” (*Id.*, p. 5, ¶ 1015). The Commission elaborated further on the issue of machinability, saying:

The Commission has long recognized the operational difficulties the Service faces in processing nonmachinable mail. These difficulties and their attendant costs come into sharper focus in an increasingly automated environment. The rate structures for First-Class Mail, Standard Mail, and Package Services mail already contain rate elements for mail that is more costly to process because of physical or other characteristics that prevent machine processing. Periodicals mail is the only traditional class in which machinability is not explicitly recognized in the current rate schedule.

Id., p. 33, ¶ 4040.

refinements would be an improvement for that reason.” *Id.*, p. 36, ¶ 4048.¹¹

In Docket No. R2005-1, the Postal Service elected to put off attending to these recommendations, indicating that “additional rate adjustments were currently under consideration and likely would be submitted in the near future.” PRC Op. R2005-1, p. i. The Commission's opinion in that docket took note of the Postal Service's new 24-piece minimum for sacks, as well as “well-documented cost increases in [the] Outside County subclass.” *Id.*, p. 155, ¶ 6123, and *generally* pp. 154-55, ¶¶ 6120-24. The Commission pointed out that

the proposed sacking and other changes in Periodicals preparation practices have not emerged in a vacuum; to the contrary, they occur in the much broader context of Docket No. C2004-1, a formal complaint filed by five senders of Periodicals mail prior to the current rate request. The Complaint, in turn, is an outgrowth of concern over escalating cost trends discussed in earlier cases, dissatisfaction with the Postal Service's progress on promised classification reform, and new insights on cost causation as it relates to the continued efficacy of the longstanding Periodicals rate structure.

Id., ¶ 6122.

The Commission cautioned that “[p]arties should be aware that the Commission will seek to obtain economically efficient cost-based rates [in the next proceeding].”

PRC Op. R2005-1, p. 92.

¹¹ An option to dropship Periodicals at BMCs with rate recognition was proposed by the Complainants, who explained that BMCs are well positioned to serve broad territories efficiently and that even relatively small mailers might have enough mail to make the use of BMCs practical. Noting that Standard Mail has a BMC discount and that some Periodicals are already entered there, the Commission indicated that it “encourages the Service to investigate the feasibility of incentives for entering Periodicals mail at destination BMC facilities in terms of both internal operations and service considerations.” *Id.*, p. 38, ¶ 4054.

But again in the current docket, the Postal Service has failed to propose changes that reflect the current needs and opportunities of Periodicals mailers, that are aligned with cost incurrence, or that are responsive to the Commission's conclusions in Order No. 1446. Time Warner has therefore again proposed an alternative Periodicals rate structure that recognizes the costs of bundles, sacks, and pallets, and associated interdependencies (including entry points), in a way that aligns operationally with decisions mailers make.

But because of concerns expressed by the Commission in Order No. 1446 about the potential impact of such rates on small publications, the rates proposed by Time Warner in this docket have been moderated substantially. A proposal to zone the editorial pound rate, which was responsible for a large part of the increases that caused concern in the complaint case, has been withdrawn. A proposal to pass through in rates the full costs associated with bundles, sacks, and pallets has been moderated—Time Warner now proposes to pass through only 60% of these costs.

Unlike the Postal Service's proposal, Time Warner's: (1) *does* reflect what is now understood about the role of bundles, sacks, and pallets in driving costs; (2) in recognizing these costs, *does* recognize container makeup and entry point; (3) *does* recognize machinability; (4) *does* deaverage the basic presort tier into mixed ADC and ADC; (5) *does* provide a BMC dropship discount; (6) *does* recognize the costs of firm bundles; and (7) *does* result in rates for supplemental mailings that recognize their costs. That is to say, the Time Warner proposal constitutes substantial progress toward a more cost-based Periodicals rate structure, which can be built on in the future to help restrain the growth of costs and improve the efficiency of the

Periodicals mailstream.

As in the complaint case, the Time Warner proposal is presented in this docket by witness Robert W. Mitchell (TW-T-1) and is based on costs developed by witness Halstein Stralberg (TW-T-2).

STATEMENT OF POSITION

Time Warner supports adoption of the Periodicals Outside County rate schedule proposed by witness Mitchell (TW-T-1), which adopts several non-controversial aspects of the Postal Service proposal and proposes bundle charges, sack charges, and pallet charges. These charges vary with the makeup and the entry points of the bundles and containers, thus supporting cost-based dropship discounts. The schedule presents mailers, from the smallest to the largest, with preparation alternatives that are aligned with Postal Service costs. The final version of that rate schedule appears in the Revised Response of Witness Mitchell to POIR No. 18, Item a, Part 1 of 2, filed November 14, 2006.¹² Mitchell's workpapers may be found in TW-LR-5 Revised, filed November 14, 2006.

If the Commission concludes that the rate schedule proposed by Mr. Mitchell would have an unacceptably large impact on some publications, Time Warner urges the Commission to recommend Mitchell's proposed rate structure with additional tempering.¹³

If the Commission decides to recommend a rate schedule along the lines proposed by witness Tang (USPS-T-35), Time Warner urges the Commission to

¹² Designated for inclusion in the evidentiary record by Presiding Officer's Riling No. R2006-1/124, issued December 13, 2006.

¹³ Mitchell's testimony states (TW-T-1 at 13):

In order to provide the Commission with the tools necessary to make adjustments in the proposed rates (e.g., by setting different passthrough levels), if it so determines, I have also designed my spreadsheets to make it easy to change any rate element and to see what the effects of the change would be on all other elements in the schedule.

adopt the improved and corrected mail flow model presented by witness Stralberg (TW-T-2).¹⁴

Time Warner urges the Commission to recommend discounts for Qualified Business Reply Mail letters and cards of 4.0 cents and 3.5 cents, respectively, as proposed by witness Mitchell, and certainly not to decrease the current discounts of 3.2 cents and 2.9 cents. See TW-T-3.

¹⁴ Mitchell states (TW-T-1 at 13-14):

Stralberg's testimony demonstrates that some of the most significant deficiencies in the Postal Service's rate design result from errors in its cost analysis. He provides a comprehensive analysis and demonstration of those errors, and gives careful consideration to determining the best approaches to correcting them. Whatever other action the Commission decides to take in this case with respect to, in its words, "areas where improvements in the Periodicals rate structure may be both possible and warranted" (Order No. 1446, p. 5, ¶ 1014), it should at the least take cognizance of the serious errors in the Postal Service's cost analysis, in particular in witness Miller's mail flow model, some of which have been documented by Stralberg repeatedly over a series of cases.

ARGUMENT

I. THE OVERRIDING ISSUE FOR PERIODICALS IS RATE STRUCTURE REFORM

The overriding issue is the need to reform the Periodicals rate structure, a need that was recognized by the Commission in Order No. 1446, disregarded (except for lip service) by the Postal Service in its rate request in this docket, and that has been made more compelling by the passage of the Postal Accountability and Enhancement Act.¹⁵

There are three proposals in this docket for Outside County Periodicals, one made by the Postal Service, one made by the Alliance of Nonprofit Mailers and the Magazine Publishers of America (ANM/MPA), and one made by Time Warner. Only Time Warner's is responsive to the Commission's Order in Docket No. C2004-1 and embodies sound principles of rate design and a thoughtful application of the statutory factors.

The proposal of the Postal Service features a simple flat container charge of 85¢ applied to each sack and pallet, despite dramatic differences in the costs of sacks versus pallets and among different types of sacks and different types of pallets. See TW-T-1, p. 15ff, *especially* p. 19, l. 17 – p. 21, l. 20; see *also* Tr. 39/13536-37. The apparent goal of the Postal Service is to minimize differences in the percentage increases experienced, a goal without any discernible basis in the policies of the Postal Reorganization Act. See USPS-RT-12 (Taufique) at 5 (Tr.

¹⁵ HR 6407, passed by the House of Representatives December 8, 2006, by the Senate December 9, 2006, and signed into law by the President December 20, 2006.

39/13457). The proposal of ANM/MPA does not even pretend to move in the direction of recognizing the cost drivers that the Commission has said should be recognized. Its goal is to retain and enlarge a per-piece pallet discount, even though pallet costs are not piece-related. See Tr. 31/10524, l. 25 – 10525, l. 24.

As in the complaint case, the main objection to Time Warner's proposal is not that it is ill conceived or ill executed, nor that it would fail to promote a more efficient, lower-cost Periodicals mailstream, nor that it runs contrary to the Commission's view on the direction in which Periodicals rates should go, but that it would have an allegedly excessive rate impact on certain small publications whose interests are not directly represented in this proceeding. Time Warner believes that this argument has been refuted. See Section IV below.

If the Commission continues to have concerns about impact, it should recommend Time Warner's proposed rate structure with additional tempering, as discussed above. The long deterioration in the financial health of the Periodicals class is in substantial part the consequence of an outmoded and inefficient rate structure. The class needs a sound rate structure, and this case may be the Commission's last chance to recommend one.¹⁶

¹⁶ The Postal Accountability and Enhancement Act (PAEA), it should be noted, includes the same statutory factors currently found in sections 3622 and 3623 of the Postal Reorganization Act. Under the PAEA, however, there is considerable ambiguity as to how much authority the Postal Regulatory Commission will have to further influence the rate structure inherited from the previous statutory regime.

- II. MITCHELL'S RATE PROPOSAL, UNLIKE THAT OF THE POSTAL SERVICE, (1) ADDRESSES WEAKNESSES IN THE PERIODICALS RATE STRUCTURE THAT CONTRIBUTE TO HIGH PERIODICALS RATES, (2) EMBODIES SOUND PRINCIPLES OF RATE DESIGN, AND (3) RESPONDS TO THE COMMISSION'S ORDER IN DOCKET NO. C2004-1
- a. Mitchell's Proposal Builds on His Improvements in Periodicals Rate Design in Docket No. C2004-1, While Following the Guidance Provided in Order No. 1446

For a score of years and counting, the rates for Periodicals have been increasing unduly.¹⁷ At the same time, as witness Mitchell stated in his testimony in Docket No. C2004-1, "[o]ur understanding of cost incurrence has improved substantially, especially in recent years." Tr. 37/12718. He explained:

For many years, attention centered on whether costs were piece-oriented or pound-oriented, with some recognition of cubic measures in parcel post. . . . More recently, attention has focused increasingly on cost drivers and on linkages among cost drivers and volume. Part of the interest in cost drivers derives from the increased use of mechanization and automation by the Postal Service. For example, with bundles now being sorted on small parcel and bundle sorters (SPBSs), the cost of sorting bundles is virtually independent of the weight of the bundles and the number of pieces in them. Similarly, with the use of sack sorters and lift trucks, the costs of sorting sacks and pallets are virtually independent of the nature of their contents. Moreover, the processing these receive depends on their makeup and their entry point.

Tr. 37/12710-11 [footnotes omitted].

¹⁷ See TW-T-1, pp. 2-5; and TW et al.-T-1, C2004-1, pp. 9-11. Such results are consistent with a phenomenon that Mitchell has referred to as *negative technological change*. That is, mailers make cost-reducing adjustments (such as dropshipping and the use of pallets), the Postal Service invests in advanced technology (such as flat sorting machines and barcode readers), economies of scale are realized (consistent with the Service's analysis of mail processing costs), and costs, even corrected for inflation, do not decline but *increase*. *Id.* at 11.

And just as our understanding of cost incurrence has improved, so, Mitchell testified, has the ability of mailers to respond to such incurrence. Today's mailers are sophisticated, and are capable and willing to analyze their operations and to respond to signals in rates. Today, fractions of a cent can bring about meaningful alterations in the way mail is prepared, entered, and delivered. Accordingly, as a way of countering the cost increases, as encouraged by the Commission in the Complaint, it is emphatically appropriate and past time to improve the signals and take further steps in the direction of recognizing costs in rates.

Mitchell's Periodicals rate design builds on the facts that a cost is incurred each time a bundle or a sack or a pallet is handled, that this cost is relatively independent of both the weight of the item and its number of pieces, that the level of these costs depends on makeup and entry point, and that mailers have options concerning bundle and container makeup. He proposes that these costs be recognized in rates.

In Mitchell's proposed rates, these costs are all displayed as separate charges, so that each mailing pays piece charges, bundle charges, pound charges, and sack and/or pallet charges. The differences among these charges reflect costs just as discounts traditionally have, and are therefore appropriately viewed as discounts of the traditional kind. The established policy that a discount should not exceed the estimated costs avoided, which the Commission stressed in its MC95-1 Opinion, is met by all charges and implied discounts in the proposed rates. TW-T-1 at 11-12.

Mitchell's approach is comprehensive in that it recognizes the full set of cost

drivers that are now understood and for which costs are available. TW-T-1 at 11. A number of objectives are reflected in his proposal:

1. To recognize mail preparation "and its effect upon reducing costs to the Postal Service," in accordance with factor (b)(6) of section 3622 of the Act.
2. To recognize the major cost drivers of the Periodicals subclass, as now understood and acknowledged by the Commission.
3. To apply to the Periodicals rate structure improvements that already exist in other subclasses.
4. To recognize the importance of machinability to controlling Periodicals costs and creating a more efficient Periodicals mailstream.
5. To provide signals to mailers that bring about decisions that will improve national efficiency and the effectiveness of the Postal Service.
6. To provide a comprehensive set of dropship signals.
7. To preserve existing discounts for presortation and automation compatibility.
8. To continue all current recognition of editorial matter.
9. To move at a measured pace toward a more cost-based Periodicals rate design.

TW-T-1 at 22.

The rates proposed by Mitchell recognize costs in the same way as do current rates. All appropriate cost differences are associated with rate differences that are equivalent to discounts, and all rate differences are designed to send efficient price signals to mailers and to move toward a situation where the pieces make the same contribution to institutional costs.

Mitchell's entire rate design is consistent with and guided by notions of

efficient component pricing and lowest combined cost. These are the principles that the Commission espoused in Docket No. MC95-1, an approach that it said results in equal per-piece markups.

Mitchell also explains the ways in which his proposed rates are more consistent than current rates with the ratemaking policies set out in the Act. The increased congruity of rates with costs (factor b(3)) is obvious, as are the incentives for improved preparation of the mail (factor b(6)). These factors are central to the development of the proposed rates. Similarly, the value of the mail service (factor b(2)) is more thoroughly recognized and more effectively enhanced under the proposed rates, which would empower individual mailers, who understand what value they place on bundles, sacks, and pallets and who know their own costs, to make properly informed decisions about the number of them they wish to purchase.

Mitchell explains:

The proposed rates provide mailers with a broader range of signals relating to costs and resource usage. The rates place a little more of the outcome in the hands of the mailers themselves, so they can do more than stand and watch. I believe this is an inherently fair thing to do.

Tr. 3/846.

The importance of § 3622(b)(6) and the role it has played is great. It has been the basis and justification for a wide and still evolving range of worksharing discounts, which have set the United States apart from most countries of the

world.¹⁸

The impacts on particular mailers that concerned the Commission in Docket No. C2004-1 were caused primarily by three things: (1) the proposal to zone the editorial pound charge; (2) the extensive use by some mailers of sacks with a small number of pieces ("skin sacks"), sometimes as low as one or two; and (3) full recognition of costs in the proposed rates.

Mitchell takes three steps in this docket to limit disproportionate impacts on small publications, while still providing them with incentives to improve mail preparation and reduce overall costs:

1. The unzoned editorial pound rate is retained.
2. Only 60 percent of the bundle and container costs are proposed to be reflected in the associated charges.
3. The container charges associated with origin entry have been averaged over three categories. Specifically, costs are shown in Mitchell's workpapers for containers entered at origin SCFs, origin ADCs, and origin BMCs. However, since mailers using an origin SCF may tend to be small mailers, or mailers who are not well positioned to shift to a higher-level facility, a weighted average of the three costs is treated as one category.

TW-T-1 at 11-13.

Another notable feature of the proposed rates is that the sack charges vary with the entry office, i.e., with whether the sacks are dropshipped. This means that

¹⁸ See: Elcano, Mary S., German, R. Andrew, and Pickett, John T., "Hiding in Plain Sight: The Quiet Liberalization of the United States Postal System," in Michael Crew and Paul Kleindorfer, *Current Directions in Postal Reform*, pp. 337-52, 2000, Kluwer, Boston. Also, the Commission said: "The concept of worksharing has been widely applied and is credited with helping the Service to attract expanding volumes of mail and to improve its productivity." PRC Op. MC95-1, p. III-26, ¶ 3068.

the dropship discounts tend to be larger for sacks than for pallets, whereas they are smaller under the current rates. The larger dropship discounts for sacks make sense, because the postal savings for dropshipping sacks are larger. Time Warner's proposed rates would thus provide an incentive to get expensive sacks out of the system and would be more fair to mailers who dropship sacks, sometimes by air freight, or who otherwise enter sacks in destination facilities. Moreover, the smallest publications of all tend to be entered in sacks at destination offices, and the number of such publications is very large.¹⁹

Piece handling costs are recognized fully for presortation, pre-barcoding, and machinability. Also, the basic category has been deaveraged into mixed ADC and ADC, as has been done in other subclasses. There are several reasons for full recognition. (1) Presortation and pre-barcoding have been recognized in Periodicals rates for some years. They should continue as key rate elements. A decision to temper their recognition would be a step backwards. (2) The rate differences associated with presortation are critical in decisions by mailers to co-mail. Co-mailing is inherently efficient, in the sense of bringing about lowest combined costs, and it would be wrong to lessen its recognition in rates. (3) The recognition of machinability is new, but it has long been expected. In its Order in the complaint case, as also discussed above, the Commission emphasized the importance of machinability and said the Postal Service "should look toward a rate structure that

¹⁹ It should also be noted that the revenue from the proposed charges for non-machinability and firm bundles is used to reduce all other Periodicals rates, including those of small mailers. See especially TW-T-1 at 23-25; Response to ABM/TW-T1-2, Tr. 31/10464; and Response to ABM/TW-T1-6, Tr. 31/10469.

recognizes the machinability of Periodicals mail, along the lines suggested by Complainants.” Order No. 1446, p. 34, ¶ 4045.

Because Mitchell's development of rates follows traditional rate design procedures, including all those common to Periodicals, it is easy to follow. The costs and cost differences relevant to ratesetting are displayed clearly, as are the decisions made on how the rates should reflect them.²⁰

In order to provide the Commission with the tools necessary to make adjustments in the proposed rates (e.g., by setting different passthrough levels) if it so determines, Mitchell's spreadsheets make it easy to change any rate element and to see what the effects the change would have on all other elements in the schedule.

b. The Postal Service Proposal Does Not Represent Progress

The Postal Service does not appear to have taken seriously the Commission's findings in Order No. 1446. Its Periodicals rate proposal does not represent progress toward a more cost-based rate structure. It proposes to withdraw a pallet discount of 0.5 cents (per piece), a dropship pallet discount of 1.6 cents, and a co-palletization discount of as much as 1.1 cents. Since pallets normally contain a considerable number of pieces, the cost in dollars at issue in these withdrawals is substantial. When discounts this large are withdrawn, some

²⁰ Mitchell's workpapers contain a presort tree on the 'Inputs' sheet showing all costs and rate relationships associated with the piece charges. The costs for bundles and containers are also shown. The spreadsheet makes it easy to adjust all passthroughs and all degrees of cost recognition, and to see the effects on the rates.

new accommodation is needed, and it should take the form of an improvement.

The “improvement” proposed by witness Tang is a flat container charge of 85 cents for each sack or pallet. USPS-T-35 at 16. Mitchell shows that this charge has virtually no relation to costs, would send inefficient price signals, and would make some mailers worse off who have come to rely on the pallet discounts (adopted only in R2001-1). See TW-T-1 at 17-21; USNews-T-1, *passim*.

It might be argued that any container charge which is below the cost of handling the containers is a step in the right direction, even if the uniformity of the charge appears perverse in view of the dramatic cost differences among containers, and as long as secondary effects are ignored (such as a reduction in the quality of bundle makeup and an increase in bundle sorting costs). But more should be expected of ratemaking than a step of this kind. Witness Tang's assertion that the container charge constitutes the "progress toward a cost-based structure" that the Commission has declared "both possible and necessary" cannot be taken seriously.

III. THE COMMISSION SHOULD ADOPT STRALBERG'S UPDATED AND IMPROVED MAIL PROCESSING COST MODEL FOR PERIODICALS FLATS AND HIS CORRECTIONS TO THE POSTAL SERVICE'S FLATS MAIL FLOW MODEL

Many of the advances in cost analysis that have improved our understanding of Periodicals cost incurrence have been the work of Halstein Stralberg. As he states in his testimony in this docket, Stralberg has " a long history of analyzing and critiquing the mail flow models that the Postal Service uses to support its rate proposals," and "[s]ince Docket No. R87-1 [he has] focused particularly on the various generations of models used to determine presort and barcode related cost differentials for Periodicals flats." TW-T-2 at 8.

Stralberg has explained that, because Periodicals flats are prepared in presorted bundles, which are then placed either in sacks or on pallets, many processing costs are incurred in handling not individual flats but bundles, sacks, and pallets (or other containers used to transport sacks and bundles). He has described the types of handling that are performed on bundles, sacks, pallets, and individual flats and shown that most of the costs of such handling occur on a per-unit basis.

Stralberg's analysis is characterized equally by meticulousness and deep knowledge and experience of postal operations. There seems, in fact, to be no serious disagreement that the numbers of bundles, sacks, and pallets are important drivers of Periodicals mail-processing costs, or that mailpiece machinability also affects costs. No attempt has been made to rebut any part of Stralberg's development of the expanded billing determinant data and not a single question about his methodology was raised in either his written or oral cross examination.

In this docket, as in the complaint case, Stralberg supports Mitchell's rate design by: (1) identifying the mail processing cost drivers that should be used in a cost-based rate design (TW-T-2 at 4); (2) developing unit costs for each cost driver (TW-T-2 at 35-47); and (3) developing an extended set of billing determinants necessary for rate design (TW-T-2 at 29-34).

The identified cost drivers are the same as in the complaint case with the one exception that the two entry point categories "originating AO" and "originating SCF" had to be combined into one in order to be consistent with the Postal Service's new mail characteristics data. TW-T-2 at 30-31.

In order to determine the required unit costs, Stralberg developed a mail flow model that is an updated and improved version of the model he presented in the complaint case and includes almost all mail processing functions performed on flats. TW-T-2 at 35-36. He also developed an improved version of the mail flow model presented in this docket by witness Miller (USPS-T-20), which determines unit costs for the traditional Periodicals rate categories and can be used as a replacement for Miller's model should the Commission decide to retain the traditional Periodicals rate design. TW-T-2 at 4, 8-9.

Stralberg's cost model and the sub-model that replaces Miller's model can be adapted for use with either the Postal Service's or the PRC's costing methodology by changing a single cell in the model spreadsheet. Witness Mitchell uses the PRC version of Stralberg's results.

The extended billing determinants Stralberg developed in this case are based on new data provided by witness Loetscher. TW-T-2 at 29. To create test-year

billing determinants from base-year data, Stralberg developed a method to simulate the migration from smaller to larger sacks caused by the new 24-piece sack minimum requirement that took effect in May 2006. TW-T-2 at 31-32.

Section a. below describes Stralberg's development of his extended mail processing cost model and his extended test year billing determinant data, focusing on the parts that have changed since the complaint case. Section b. describes the major correction Stralberg proposes in Miller's mail flow model and reviews Miller's attempted rebuttal.

a. Stralberg's Model and Billing Determinants Use Newer Data and Improve Significantly upon his Complaint Case Result

1. Development of extended billing determinants

In Docket No. C2004-1, Stralberg was able to assemble a set of extended billing determinants, as required by Mitchell's rate design, using the available data from an R2000-1 mail characteristics study in combination with an R2001-1 container study. In this docket, most of the needed data was supplied by witness Loetscher at the beginning of the case in response to Time Warner interrogatories.²¹ Loetscher had performed an extensive the results filed with the Postal Service's rate request were limited to the much smaller volume of data that Postal Service witnesses use in their testimonies. From the 17 spreadsheet tables filed by Loetscher in response to Time Warner's interrogatories, almost all the data needed by Stralberg could be extracted.

²¹ See Loetscher response to TW/USPS-T28-1-11 (Tr. 7/1507-18).

There were only a few difficulties. First, as mentioned above, the Postal Service data collection had combined the OAO and OSCF entry point categories into one, and it became necessary to do the same both in Stralberg's model and Mitchell's rate design.

A more serious difficulty was presented by the fact that there will be significantly fewer Periodicals sacks in the test year than in the base year, because of the 24-piece per sack limitation that took effect in May 2006. Furthermore, the sacks that will remain in the test year are expected to have different characteristics, containing more mail and generally having lower levels of presort. Stralberg devised a logic that effectively simulates the migration of bundles to the larger but less presorted sacks that will result from the expected skin sack consolidation. TW-T-2 at 31-32. He constrained his simulation in such a way that the number of remaining sacks in the test year would be exactly the same as had been assumed by witness Tang (USPS-T-35).

A third challenge was presented by Presiding Officer's Information Request No. 18 (POIR No. 18). Most of the mail characteristics data obtained from Loetscher combines the volumes of regular rate, nonprofit and classroom periodicals, but POIR 18 requested billing determinant data that are broken down by the three former subclasses that today form Outside County Periodicals. Stralberg's response explains how he was able to estimate separate billing determinants for the former subclasses, using data from current as well as earlier dockets. Tr. 31/10558-67.

Stralberg's development of extended billing determinants for Outside County

Periodicals has drawn no rebuttal and only one Postal Service interrogatory.

2. Upgrading and improving the mail flow model from the complaint case

The cost model presented by Stralberg in this docket produces unit costs for all major drivers of flats mail processing costs and is meant to facilitate the alternative rate design proposed by witness Mitchell. It is a modified and improved version of the model Stralberg presented in Docket No. C2004-1, which in turn was an updated and improved version of the LR-I-332 mail flow model produced by Christensen Associates, with considerable industry and Postal Service input, during the R2000-1 rate case.

Rather than repeating the documentation provided in his C2004-1 testimony, Stralberg's testimony in this docket focuses on improvements and updates made in his present model. They include:

- (1) use of current wage rates, piggyback factors, and, when available, productivity rates from the current docket;
- (2) the model is linked to and derives its per-piece unit cost estimates from Stralberg's modified flats mail flow model, offered as an alternative to witness Miller's model and described below in Section b.;
- (3) extensive changes in the logic to determine the flow of sacks and pallets from their entry points through intermediate facilities and to the destinating facilities, based on USPS interrogatory answers;
- (4) inclusion of APPS machines as a bundle sorting option;
- (5) an update of the CRA adjustment used in the C2004-1 model to conform to the current configuration of mail processing cost pools;
- (6) a substantial simplification of the model through elimination

of many redundant worksheets and formulas;

- (7) origin associate office or station/branch (OAO) was eliminated as a distinct type of entry point, due to lack of current data and Postal Service testimony that this entry point is little used; and
- (8) a flag has been included to allow the model to be switched between PRC and USPS costing methods.

It is not necessary to go into further details here about the above improvements, which are described in Stralberg's testimony. TW-T-2 at 35-47. But it is worth mentioning that the third of the above items refers to Stralberg's ability to use data from a Postal Service container flow survey, whose existence and results were revealed through interrogatory answers.²² This data allowed him to replace and improve perhaps the weakest and least empirically based part of his Docket No. C2004-1 model, which concerned the flows of sacks and pallets entered at origin facilities. Stralberg reports as follows on what he found when using the new and more accurate container flow data:

The new Postal Service survey data indicate that non-dropshipped sacks and pallets on the average pass through *more* intermediate facilities than followed from my C2004-1 assumptions. Consequently, they receive more handlings and incur more costs than I previously assumed.

TW-T-2 at 38.

Stated differently, the recognition of containers and their entry points into the postal system as drivers of Periodicals mail processing costs is even more important than it appeared from Stralberg's C2004-1 results.

²² See responses to MPA/USPS-T25-2b (redirected from witness Mayes, filed June 19, 2006) and to MPA/USPS-2b (filed July 13, 2006).

As in Docket No. C2004-1, Stralberg applied a “CRA adjustment” to his model in order to ensure that it was consistent with attributed costs at the operations he had modeled. TW-T-2 at 46. The average adjustment factor was 0.971 (PRC costing), indicating a much closer agreement between his model and overall CRA costs than did the adjustment he applied to his complaint case model.

Not a single interrogatory was filed by the Postal Service and only one from other parties regarding Stralberg’s analysis of bundle, sack, and pallet costs. Miller’s rebuttal testimony (USPS-RT-8) fails to address that part of Stralberg’s analysis, except by way of a reference to Miller’s complaint case testimony.

b. Stralberg Has Corrected Several Flaws In The Postal Service’s Mail Flow Model

extended model described above.

Due to settlements in the two previous rate cases, the Postal Service has faced no opposition to its flats mail flow models since Docket No. R2000-1. In that docket, Stralberg proposed an alternative model for Periodicals flats that was adopted by the Commission as a basis for setting worksharing discounts. PRC Op. R2000-1 at 427-29. Starting with Docket No. R2001-1, the Postal Service has left the modeling of Periodicals flats mailflows to witness Miller. Stralberg identified and corrected several flaws in the current version of Miller’s model before incorporating it in the extended model described above. TW-T-2 at 8-9.²³

²³ The Postal Service’s R2000-1 flats model was presented by witness Yacobucci (USPS-T-25). It was a single model that could be adapted to either First Class presort, Regular Rate Periodicals, Nonprofit Periodicals, Standard A regular, or Standard A nonprofit. Stralberg’s alternative model,

Miller's rebuttal of Stralberg's testimony focuses exclusively on the changes Stralberg has proposed to Miller's model. In most cases, he offers little more than dismissal and hints that the data Stralberg relied on somehow are not suitable. Described below are the specific changes Stralberg proposes to Miller's model, along with a discussion of Miller's attempted rebuttal.

1. Flats preparation costs

In recent years "flats preparation" has been identified as a separate cost pool with MODS number 035. It consists of preparing bundled flats for processing on flats sorting machines by removing the bundling material, orienting the flats, and stacking them neatly on special carts from which they can be loaded into the AFSM-100 machines. It is a time-consuming operation. Stralberg points out that for Periodicals flats more clerk/mailhandler costs are incurred in the "flats preparation" operation than in the subsequent processing on the AFSM-100. TW-T-2 at 10. Witness McCrery stated that flats preparation as a separate operation is performed only for flats that are bound for machine processing. Response to TW/USPS-T42-30 (Tr. 10/3071-73). If the flats are to be sorted manually, the removal of bundling material is performed by the clerk who does the sorting, in a single operation, and is therefore included in the productivity rate for manual sorting. Similarly, for carrier route presorted flats, those costs are included in the cost segment 6 carrier in-office

adopted by the Commission, was therefore used as a basis for worksharing discounts for all the above categories of flats. In the present docket, witness Miller has presented separate flats mail flow models for First Class presort, Outside County Periodicals and Standard (non-ECR). Due to time constraints, Stralberg focused exclusively on the model for Outside County Periodicals. The Periodicals model is the most complex, because it also extends to carrier route presorted flats. In principle there is no reason why the specific changes Stralberg proposes could not be extended to

costs. See responses to USPS/TW-T2-3-4, Tr. 31/10570-73.

Stralberg concluded that the costs in the flats preparation pool are incurred in order to facilitate machine sorting and therefore should be attributed to the flats that receive machine sorting. TW-T-2 at 11. To exclude them, as Miller's model does, overstates the benefit of flats automation and understates the cost differential between machinable and non-machinable flats. Stralberg therefore distributes the test year Outside County flats preparation costs, as forecast by witness Smith, among the flats that do receive machine sorting. TW-T-2 at 11.

Miller raises two types of arguments against inclusion of flats preparation costs in the model. Stralberg disposes of both in his responses to Postal Service interrogatories USPS/TW-T2-3-5 (Tr. 31/10570-75), but we address them again below.

First, Miller argues that this is a bad time to consider including flats preparation costs in the mail flow model, because a portion of flats preparation in the test year will have been moved to the new automation induction (AI) units that will be attached to many AFSM-100 machines. USPS-RT-8 at 13. To support his view, he filed with his rebuttal testimony, as library reference L-194, a redacted version of a Decision Analysis Report (DAR) supporting the Postal Service's purchase of 210 AI systems expected to be operational in the test year.

Because it is redacted, LR-L-194 does not show by exactly how much moving some flats preparation work to the AI is expected to reduce manual labor. Nor does

Miller's First Class and Standard models. This issue is addressed further below in section b.5.

it show the capital costs or added maintenance and other costs that inevitably accompany deployment of new technology. However, as Stralberg points out in his response to USPS/TW-T2-5 (Tr. 31/10574-75), most of the relevant information is available in LR-L-49, which lists all cost reductions used in the Postal Service's roll-forward estimates of test-year costs.

Witness Van-Ty-Smith's testimony (USPS-T-11) shows clerk/mailhandler costs in the flats preparation cost pool equal to \$254.106 million (USPS costing, not including piggyback costs). USPS-T-11 at 40. But LR-L-49 shows total cost reduction expected from the AI deployment equal to \$80.516 million. In other words, even assuming that all the AI-related cost reductions will apply to the flats preparation cost pool, most of those costs will remain. And as Stralberg also points out, some of the reductions in clerk and mailhandler costs will be offset by higher piggyback costs such as added maintenance and capital costs. Tr. 31/10575.

In any case, Stralberg simply distributed the flats preparation costs that the Postal Service itself has forecast for the test year. Those costs already include the effects of cost reductions such as the deployment of AI systems. Tr. 31/10575.

Miller's other argument, also already disposed of in Stralberg's interrogatory responses (USPS/TW-T2-3 and 4, Tr. 31/10570-74), is that he believes the costs incurred in the flats preparation pool for flats that will be machine sorted must be incurred elsewhere for other flats, including flats in carrier route bundles. USPS-RT-8 at 14. Regarding carrier route bundles, which typically are broken by the carriers, Miller does not seem to have grasped that his task was limited to modeling mail processing costs, not how carrier costs are distributed among the different rate

categories.²⁴

Another fact that seems to have escaped Miller's attention is that the Postal Service's intention to integrate flats preparation with AFSM-100 processing confirms Stralberg's conclusion that these costs are incurred to facilitate machine sorting. Response to USPS/TW-T2-5b, Tr. 31/10574.

2. The portion of flats incoming secondary sortation that is performed manually

Miller's mail flow models assume that flats are always sorted by machine when they are in a facility that has an appropriate machine, regardless of machine capacity and scheduling issues. Response to TW/USPS-T20-8 (Tr. 3/280). In reality, however, many other factors can and do cause flats to be sorted manually.²⁵ Ignoring those factors, as Miller's model does, has the effect of overstating the value of flats automation and understating the value of presorting performed by mailers.

In addressing this issue, Stralberg focused on the incoming secondary sorting operation, which sorts flats already at the 5-digit sort level to carrier routes. This sorting operation is by far the most important for Periodicals flats, and it is also the one where mail is most likely to be diverted to manual sorting. TW-T-2 at footnote

²⁴ Miller also does not acknowledge and seems not to have grasped Stralberg's explanation (with which witness McCrery agrees in response to TW/USPS-T42-d) that the type of flats preparation performed for machine-bound flats is inefficient for flats that will be manually sorted or carrier sequenced. In other words, the flats preparation costs in the 035 cost pool are not duplicated for flats that are manually sorted. In fact, manual distribution or carrier sequencing is considerably more efficient when the carrier or distribution clerk can work directly from a mailer-prepared bundle of identical flats, rather than with a miscellaneous collection of flats with different sizes, different locations of the address label, etc.

²⁵ See response of witness McCrery to TW/USPS-T20-9, redirected from witness Miller (Tr. 11/3091-92).

9. Stralberg found, and Miller confirmed in response to an interrogatory, that according to Miller's model assumptions, only 20% of Periodicals non-carrier route flats and 15% of Standard non-carrier route flats are sorted manually in the incoming secondary operation. Response to TW/USPS-T20-8 (Tr. 3/280).

Miller's results were clearly incompatible with witness McCrery's testimony that 44.7% of all flats receive manual incoming secondary sorting. Standard and Periodicals are the two largest flats categories. Of the two, Periodicals flats are far more likely to be diverted to manual sorting. Stralberg concluded that the percentage of Periodicals flats that are sorted manually in the incoming secondary was likely to be considerably higher than the average, i.e., higher than 44.7%, and certainly much higher than the 20% that Miller's model indicates.²⁶

Stralberg also discovered that correcting a mistake in Miller's modeling of the use of UFSM 1000 machines for incoming secondary raised the percent of manual incoming secondary to 29% for Periodicals. TW-T-2 at 13. He reasoned, however, that the real percentage must be considerably higher, and that a correct model needs to reflect this fact, but that some allowance must be made for the likelihood that continued Postal Service efforts to put more flats on the machines will bear some fruit. TW-T-2 at 13-14. He placed in his model a variable that reflects an assumption about the percentage of machinable flats in an incoming secondary operation really will be machine sorted. The net result is that in his model about

²⁶ Witness McCrery indicated a total of ten different reasons why flats may be sent to manual incoming secondary sortation even in situations where Miller's model indicates they would always be sorted by machine. Response to TW/USPS-T20-9, redirected from witness Miller (Tr. 11/3091-92). Several of those reasons apply to Periodicals flats but do not apply to Standard flats.

40% of non-carrier route Periodicals flats are sorted manually. TW-T-2 at 13-14.²⁷

Miller's rebuttal focuses on McCrery's 44.7% estimate. McCrery relied on MODS data showing 16.3 billion flats receiving incoming secondary sortation by machines and "Flash" reports showing 13.2 billion flats sorted manually. Response to MPA/USPS-T42-1 (Tr. 11/2853). Flash reports are used in postal operations to estimate volumes sorted in delivery units, based on sample volume readings. Miller claims they tend to overstate volume. To support this view he provides an exhibit that lists all the flats volumes he could think of, from the RPW system, that would require incoming secondary sorting. He concludes that the total annual volume of such flats is not 29.5 billion, as McCrery estimated, but only 23.6 billion, and that the volume sorted manually is not 13.2 billion but 7.3 billion. USPS-RT-8, Attachment 2

The transcript of Miller's cross examination, both by MPA/ANM counsel and by Time Warner counsel, demonstrates that Miller had forgotten about some of the flats volumes that do receive incoming secondary sorting. Including those volumes would raise the average manual percentage for incoming secondary flats sorting to more than the 30.87% that Miller's exhibit indicated.²⁸

Throughout his cross examination, Miller insisted that the volume data in his Attachment 2 had nothing to do with his testimony. He did not seem at all troubled

²⁷ Note, however, that if the Commission believes there really is less manual sorting than results from Stralberg's model, it need change only a single spreadsheet cell which he identifies in his testimony. TW-T-2 at 13 and footnote 11.

²⁸ In his response to USPS/TW-T2-6 Stralberg provided a table of IOCS direct tallies, by subclass, of employees working at AFSM-100 incoming secondary sorting operations. Those tallies show employees spending time on Standard ECR, International mail, Priority, Penalty mail and even free for the Blind, all flats categories missing from Miller's exhibit that purports to represent all flats categories receiving incoming secondary sorting. Tr. 31/10578.

by the fact that these volumes demonstrate that his own testimony vastly understates the extent to which incoming secondary flats sorting is performed manually. Nor did he acknowledge that Periodicals flats are much more likely than, for example, Standard flats to be diverted to manual sorting. Even if the average manual percentage is “only” 30.87% (and it clearly is higher, considering the several volumes that he had neglected to consider), the percentage for Periodicals clearly is higher still, probably closer to the 40% that results from Stralberg’s model, or at least equal to the 36% in witness Glick’s model. It certainly is much higher than the 20% in Miller’s model.

One reason Periodicals flats are more likely than Standard flats to be diverted to manual sorting in the incoming secondary is that more of them are non-machinable. TW-T-2 at 13. But there are other reasons. Among the ten reasons McCrery that indicated could cause diversion to manual sorting (none of which are allowed for in Miller’s model) two are specific to Periodicals. Perhaps more significant is the following reason why Standard flats, the dominant category, is far more likely to be machine sorted than Periodicals:

[M]ail for a class with significantly higher volume (e.g., Standard Mail) could be given processing precedence over mail for a class with lower volume if the classes are processed to maintain a separation and the equipment cannot be used to finalize both mail classes within the processing window.

Response of McCrery to TW/USPS-T20-9, redirected from witness Miller (Tr. 11/3091-92).

Stralberg also reported his own observation from visits to numerous postal facilities that Periodicals flats are always the most likely to be sent to the delivery

units for manual incoming secondary sorting. TW-T-2, footnote 10. Yet another reason, not mentioned by McCrery, is that because they are heavier, Periodicals flats tend to have lower productivity on the flats sorting machines, facilities often favor the lighter and faster Standard flats in order to show maximum use of their AFSM-100 machines.²⁹

3. Stralberg's model of UFSM 1000 sorting is much closer than Miller's model to how those machines actually were used in the base year.

Perhaps nowhere is the discrepancy between Miller's model and operational reality more pronounced than with regard to the utilization of UFSM machines. An easy way to see this is in Miller's Attachment 3 in his rebuttal testimony. Tr. 33/11024. As that exhibit shows, by Miller's own estimate only 4.4% of all flats incoming secondary sorting is performed on UFSM machines.³⁰ But the aggregate of Miller's First Class, Periodicals, and Standard flats models indicates 13.09%, almost three times as much. Miller's Periodicals model shows 19.46% of Periodicals flats sorted on UFSM machines. *Id.*

²⁹ Miller appears to believe that First Class single piece flats (which he did not model) are most likely to be sorted manually. His main reason appears to be that many such flats have hand-written addresses. USPS-RT-8 at 6-7 and n17. Even if Miller's assumption about First Class single piece flats were true, there are not enough such flats to substantially affect the total percentage of manually sorted flats. See the volumes in Attachment 2 to USPS-RT-8. Furthermore, as can be seen from the table of IOCS tallies that Stralberg provided in response to USPS/TW-T2-6 (Tr. 31/10578), First Class flats occupy more than twice as much time in AFSM-100 incoming secondary operations as do Periodicals non-carrier route flats, even though their volumes are roughly the same. In fact, First Class and Standard Regular flats account for almost 80% of those tallies, versus only 14.8% for Periodicals.

³⁰ The real percentage may be even a little lower. Because Miller, in his Attachment 2, had forgotten about some categories of flats that do receive incoming secondary sorting, it is likely that the total volume of such flats is higher than Miller's estimate. That would make the UFSM portion of the total a little under 4.4%.

Stralberg discovered this large discrepancy by analyzing MODS data provided by witness Bozzo. He also discovered that whereas almost all the flats that Miller's model routes to the UFSM for incoming secondary sorting are non-machinable, in reality almost all flats that are sent to those machines for incoming secondary are being sorted in the fast automated mode, which indicates they are machinable. TW-T-2 at 15. The MODS-based productivity rate that Miller applies to incoming secondary sorting on the UFSM is quite high (1436 pieces/workhour) because most of the flats to which this sorting is in reality being applied are machinable, but Miller applies it to mostly non-machinable flats that in reality are being sorted manually. TW-T-2 at 16-17.

This discrepancy was of particular concern to Stralberg because it distorts not only the relationship between different levels of presort but also the cost differential between machinable and non-machinable flats, which Stralberg, unlike Miller, sought to determine. *Id.*

Stralberg corrected most of the distortion by simply routing non-machinable flats in 5-digit bundles directly to manual sorting. *Id.* With that change, his model, according to Miller's Exhibit 3, shows 8.68% of Periodicals incoming secondary sorting being performed at UFSM machines. That is still almost twice the real average percentage, but given the higher percentage of non-machinability for Periodicals flats one would expect the percentage to be above the average.

In his rebuttal testimony Miller acknowledges that his model exaggerates the use of these machines. USPS-RT-8 at 7. He appears, however, to reject totally the idea that something could be done about this and insists it was inappropriate of

Stralberg to make any change to his model. *Id.* As his cross examination showed, he had not understood what MODS data Stralberg had relied on, or that it was more detailed than the data he himself had extracted from LR-L-56, or that Stralberg used “un-scrubbed” MODS data that represent the totality of all base year volume and workhour readings for the UFSM and AFSM machines.³¹

According to Miller, Stralberg’s changes to his model should have been preceded by a comprehensive study based on on-site observations of how the UFSM 1000 is actually used. *Id.* He says no such study has been performed since the Postal Service changed its UFSM strategy.³² *Id.* Miller, however, does indicate that perhaps the Postal Service should undertake such a study. He must know that only the Postal Service can do such a study, or at least that it would have to be done with the Postal Service’s full cooperation. So his claim that someone like Stralberg should not propose any model change before having done such a study would mean in practice that no outsider could ever present a challenge to any Postal Service model. But evidently the Postal Service needs someone from outside its

³¹ See Tr. 33/11098-100, See also witness Bozzo’s confirmative answer, filed December 6, to the question posed during witness Miller’s hearing.

³² There have been several changes in UFSM “strategy” as the Postal Service has continued to reconfigure and redeploy these basically outdated machines. According to McCrery, some are being deployed in smaller facilities that have no AFSM-100, while others are being used as backup for AFSM-100 machines in cases of capacity overload. USPS-T-43 at 19 and response to TW/USPS-T-42-37. The machines are unique in that they can be used in two modes simultaneously, where the automated mode, almost as fast but less reliable than sorting on the AFSM-100, is applied to flats that could have been processed on an AFSM-100 if one were available. Non-machinable Periodicals flats are typically sorted in the much slower manual feed/manual key mode, which is not much faster than manual sorting. Response to TW/USPS-T-42-37. While Miller might have learned something from the type of on-site observations that he argues should have been done before correcting his model, he could also have learned quite a bit about the use of UFSM machines by analyzing the same data that Stralberg analyzed and by asking the types of questions that Time Warner did of the Postal Service’s operations witness.

own organization, , either an intervenor or the Commission, to challenge its model assumptions.

4. Stralberg's model of bundle breakage is more realistic than Miller's and agrees more with statements by Postal Service operations witnesses

Bundles of flats do break prematurely, causing extra mail processing costs. The cost impact differs, depending on bundle and container presort level, type of container, and the method used to sort the bundles. TW-T-2 at 19-20. Sacked bundles are known to break far more frequently than palletized bundles.

Accurately modeling the impact of bundle breakage requires both: (1) an understanding of the factors that cause breakage and the cost consequences of breakage; and (2) empirical data on the probabilities of breakage under different circumstances. Stralberg uses the same bundle breakage data that Miller's model relies on, but explains why he believes it may be outdated, both because of severe flaws in the "survey" reported in LR-I-88, one of Miller's sources, and because of the many initiatives in recent years to reduce bundle breakage and recover broken bundles. TW-T-2 at 22.

Stralberg does, however, propose an essentially commonsense modification in the way that the available bundle breakage data is applied. His extended model, on which the unit costs used in witness Mitchell's rate design are based, uses the same bundle breakage logic as his complaint case version. That logic was developed by Christensen Associates as a part of LR-I-332 in Docket No. R2000-1. See TW et al.-T-2 at 21-22. Stralberg makes an equivalent change in his revised version of Miller's model. This change is simply to recognize that when bundles are

sorted manually by lifting the bundles from a pallet or a rolling container, any breakage will occur only after the pieces in the bundle have reached the next sort level, which therefore reduces the extra piece sorting required by the flats in the broken bundle. TW-T-2 at 21-22. That change is particularly important with respect to bundle sorting at delivery units, which is almost always performed manually. It is also consistent with statements from postal operations witnesses.³³

In his rebuttal testimony, Miller appears to have misunderstood Stralberg and to have thought that he was referring to manual sorting of sacked bundles. He argues that when more than one person is manually sorting bundles from a container, the container is likely to be dumped on a belt before the sorting begins. USPS-RT-8 at 18. That may be true in the case of sacks; in fact, it is difficult even to envision two employees sorting directly from the same sack. But when the manual sorting occurs from a pallet or a hamper, for example in delivery units, it is quite common that more than one person sorts bundles directly from the same container.

Stralberg's current testimony refers to a more detailed discussion of many aspects of the dynamics affecting bundle breakage in his R2000-1 testimony, which accompanied the model that the Commission at that time decided to adopt. When cross-examined on his testimony purporting to rebut Stralberg (USPS-RT-8), Mr.

³³ For example, in response to an R2001-1 AOL Time Warner interrogatory, witness Kingsley stated, with respect to bundle sorting from pallets, hampers or other rolling containers at a delivery unit, that "bundle breakage should not be an issue at this point." See Docket No. R2001-1, response to AOL-TW/USPS-T39-14 (Tr. 2179-80).

Yet Miller's model shows a very substantial amount of breakage of carrier route bundles precisely at that point. TW-T-2 at 20.

Miller's attention was directed to Stralberg's statement that

My direct testimony in Docket No. R2000-1 included a quite detailed analysis of the dynamics and cost effects of bundle breakage (TW-T-1 at 43-53). I repeat below only as much of that discussion as I believe necessary to explain my present model.

Tr. 33/11111-12.

When asked whether he had reviewed that discussion in preparing his rebuttal testimony, Miller answered "I did not review that testimony." *Id.* at 11112. The section of Miller's rebuttal testimony dealing with this issue was captioned "WITNESS STRALBERG'S BUNDLE BREAKAGE COMMENTS SHOULD BE IGNORED." At least Miller cannot be faulted for failing to practice what he preaches.

Stralberg also describes other issues related to bundle breakage that he did not address in depth in his testimony in this docket. One concerns the impact of the Postal Service's considerable (albeit not complete) success in its efforts to recover broken bundles. TW-T-2 at 26. Some extra costs are incurred in the process of repairing a broken bundle, but according to McCrery, when possible, "bundle recovery is always the preferred option." Response to TW/USPS-T42-35e, Tr. 11/3079-80. Additionally, as Miller admitted, bundle recovery changes the relative cost impact on bundles with different levels of presort.³⁴

³⁴ See response to TW/USPS-T20-6, Tr. 3/278. Assume, for example, that after being dumped from a pallet, a carrier route bundle and a 5-digit bundle both break. If neither is recovered, then the cost impact due to lost presortation will be higher for the pieces that were in the carrier route bundle. But if they are recovered, then the cost impact of breakage is the same on both bundles.

The Commission should adopt Stralberg's improvements in the bundle breakage logic for purposes of this docket. It should also urge the Postal Service to collect the necessary data and develop the necessary modeling capability to: (1) accurately determine the impact of bundle breakage on each rate category in its worksharing models; and (2) accurately assess the effectiveness of the numerous initiatives to reduce bundle breakage that have been undertaken both by mailers and by the Postal Service itself.

5. The CRA adjustment

It has become established practice that witnesses who present worksharing related mail flow models also include a "CRA adjustment," meant to bring a model closer to reality by assuring that the total modeled costs correspond to the CRA costs for the activities being modeled.

These witnesses, including Miller, first designate each of the 63 "pools" into which mail processing costs are currently divided as either "proportional" or "fixed" relative to their particular model. A pool is considered "proportional" if it represents activities that the given model is meant to include, but "fixed" if it represents activities not covered by the model. The CRA adjustment consists of multiplying all modeled costs with a factor so that the adjusted model costs add up to the total CRA costs for the pools that have been designated as "proportional."³⁵

Because Miller's model represents piece sorting and bundle sorting activities but not container operations there are many cost pools, such as the "platform" pool,

that are considered “fixed” relative to his model. But relative to the extended model presented by Stralberg, which includes all container handling as well as bundle and piece handling costs, the “platform” pool would be considered “proportional”. TW-T-2 at 23-25 and 46. In addition to the adjustment he applied to his extended model, Stralberg also proposed changes in the CRA adjustment used in witness Miller’s mail flow model. *Id.* Stralberg’s disagreement with Miller on this subject, which we discuss below, concerns precisely which cost pools and which costs within those pools should be considered “proportional” relative to his (Miller’s) model.³⁶

There are three general areas of disagreement.

First, while periodicals are predominantly either letter- or flats-shaped, a few end up being considered as “parcels” in the Postal Service’s cost system.³⁷ A periodical classified as a parcel is most likely a very thick magazine. Even if it has been called a parcel by an IOCS clerk, such a magazine is going to pay the rates that apply to Periodical flats, there being no parcel rates for Periodicals. The flats rates are set in such a way as to recover all costs incurred by Periodicals other than letters, including those incurred by Periodicals that were classified as parcels. Stralberg concluded, therefore, that his CRA adjustments must include “parcel” as well as flats costs. TW-T-2 at 24. See also Docket No. C2004-1, TW et al.-T-2 at

³⁵ See, for example, USPS-T-20 at 6 and 11.

³⁶ MPA/ANM witness Glick also proposed considerable changes to the CRA adjustment in Miller’s Periodicals model. Glick’s proposed changes go quite a bit farther than Stralberg’s and include cost pools that Stralberg did not consider including. In the following we focus only on the disagreements between Stralberg and Miller.

³⁷ See for example LR-L-53, sponsored by witness Smith, which provides estimates of test year unit costs for letter-shaped, flat-shaped and parcel-shaped Periodicals at each cost pool.

33-36.

Second, the costs developed by witness Smith (USPS-T-13) have a letter, flat and parcel component at every single cost pool, even at pools presumed to be dedicated to processing one shape only. For example, at every cost pool dedicated to piece sorting of letters, the costs measured include both a letter, a flat, and a parcel component, with the letter component of course being the largest. *Id.* The same is true at each flats sorting cost pool, where of course the flats component is largest, and at each parcel sorting pool. While all this may appear counterintuitive, the explanation becomes obvious if one considers the way that IOCS tallies, on which all these costs are based, are recorded. If, for example, an employee is observed as sorting flats, but that employee is “logged in” at a letter pool where he worked earlier in the day, the inevitable consequence is a tally of flats being sorted at a letter pool. *Id.*

Miller’s approach to the CRA adjustment for his flats models is to include as “proportional” only the flats components of costs incurred at flats pools. TW-T-2 at 24-25. He includes neither letter-related costs measured at flats pools nor flats-related costs measured at letter pools. If the Postal Service’s letter- and parcel-related models are adjusted in a similar manner, then certain piece sorting costs (those recorded in unexpected cost pools) will be excluded from all worksharing models. Stralberg concluded that it was appropriate to include as “proportional” the flats related costs recorded as having been incurred at manual letter and parcel operations. *Id.*

It is unclear what exactly Miller objects to in any of the above arguments,

except that he believes similar changes would logically apply to the worksharing models for all other subclasses. But Miller cannot seriously believe that an intervenor who proposes changes in a model which concerns that intervenor should be obligated to simultaneously study and propose similar changes to all other Postal Service models.³⁸

Miller's opposition is more specific, though hardly more credible, with regard to the third change Stralberg proposes to his CRA adjustment. This concerns the "allied" pool for post offices, stations, and branches. Stralberg observed that this pool incorporates both platform operations and opening unit/bundle sorting operations performed at delivery units. An interrogatory answer from witness Van-Ty-Smith, redirected from Miller, confirmed that 37% of the costs attributed to Periodicals in this pool are in fact related to bundle sorting, which is part of Miller's modeled costs.³⁹ Stralberg therefore proposed that the pool be considered 37% proportional in the CRA adjustment to Miller's Periodicals cost model. TW-T-2 at 24.⁴⁰

Miller opposes considering a cost pool anything other than either fully "proportional" or fully "fixed" He argues that by the same logic the "1OPBULK" and "1OPPREF" cost pools should be considered less than 100% proportional, because

³⁸ In fact, Stralberg's testimony stated: "I believe some of the improvements I am proposing would also apply to Miller's Standard and First Class flats models. I have, however, not studied those models in sufficient detail to be able to propose specific changes." TW-T-2 at 8, n. 2.

³⁹ Response to TW/USPS-T20-13, redirected from witness Miller (Tr. 10/2474-75).

⁴⁰ This issue, and Miller's attempted rebuttal, have no relevance to the CRA adjustment Stralberg applies to his extended cost model. In that model, which includes platform operations, the "allied" pool at post offices, stations, and branches is 100% proportional.

they include some container handling, which his model does not include. USPS-RT-8 at 15.

But Stralberg refuted this argument in his response to USPS/TW-T2-14, which suggested the same line of reasoning. He points out in that response that bundle sorting operations always include some container handling because the bundles are brought to such an operation in containers; the containers are emptied and the bundles sorted into other containers, which must be replaced and removed when they are full. This is different from operations that only handle containers, such as platform operations and sack sorters. The latter are clearly outside the scope of Miller's model, whereas container handling that is incidental to bundle sorting is within the scope of that model. Stralberg also noted that he included the NonMODS allied pool because bundle sorting is a predominant activity in that pool. Tr. 10593-94.⁴¹

6. Other Issues with Miller's model

Stralberg also criticized and corrected Miller's treatment of firm bundles and his treatment of flats in carrier route sacks. No interrogatories were asked and no rebuttal was offered on any of these issues. We refer to Stralberg's testimony for further details. TW-T-2 at 26-28.

⁴¹ Miller makes one curious and clearly mistaken argument when he states, in reference to the "1OPBULK" and "1OPPREF" cost pools, that: "The opening units are often the first stop for containers when they enter a facility." This claim runs counter to what everyone who has visited a postal processing plant has observed, namely that the first stop for arriving containers is the platform. Opening units such as the "1OPBULK" and "1OPPREF" are not on the platform; they are inside the building and if a container is sent there it is because a determination was made at the platform that it, or some of its contents, needs further processing in the particular facility.

IV THE IMPACT OF TIME WARNER'S PROPOSED RATES ACROSS THE SPECTRUM OF PERIODICALS PUBLICATIONS IS NEITHER EXTREME NOR UNFAIR

The question of the impact of different rate proposals on different types of Periodicals came, in the later stages of this docket, to be focused around a sample of 259 publications, about which the Postal Service provided volume and mail characteristics data in response to Presiding Officer's Information Request No. 19 (POIR 19).

The 259 include 52 "large" publications with mailed circulation over 100,000 per issue, 100 "medium sized" publications with circulation between 15,000 and 100,000, and 107 "small" publications with circulation under 15,000. In his analysis of this data,⁴² Stralberg identified 42 of the 107 publications in the lowest stratum, those with circulation under 1,000, as "very small" and the remaining 65 with circulation between 1,000 and 15,000 as "small." His reason for isolating the "very small" publications in a separate stratum was that, as revealed in the complaint case, more than half of all Periodicals titles have circulation below 1,000.⁴³

This particular sample of publications goes back to the complaint case. Stralberg's analysis of the original version in that case showed that, as one might have expected, publications that used "skin sacks" extensively would have experienced large increases in postage under the rate proposal then presented by Time Warner et al. Docket No. C2004-1, TW et al.-RT-2 at 9 (Tr. 5/1548). When

⁴² Revised Response of Time Warner Inc. to Presiding Officer's Information Request No. 19 (Errata), filed November 17, 2006 (designated for inclusion in the evidentiary record by Presiding Officer's Riling No. R2006-1/124, issued December 13, 2006) (hereafter "Revised Response to POIR 19").

asked in this docket to estimate the impact of Time Warner's current rate proposal on the same set of publications, Stralberg pointed out that this was impossible, given that: (1) the Postal Service had done nothing to update the data base; and (2) the 24-piece sack minimum had recently taken effect, so that many of the publications must now have mailing characteristics much different from what they were in 2004. He stated that applying the rates proposed in this docket to such outdated data would therefore be meaningless and misleading. Tr. 31/10541.

Time Warner subsequently requested updated information on the publications in the C2004-1 sample from the Postal Service, so that a meaningful analysis of the impact of current rate proposals could be performed. The Commission adopted this request in POIR 19, in response to which the Postal Service provided current data.

The POIR 19 sample does not purport to be statistically representative of the Outside County subclass, nor could it be without the application of appropriate weighting factors to different strata within the sample.⁴⁴ It can, however, be useful for better understanding how the different rate proposals in this docket would affect different types of publications, and the extent to which each rate proposal would or would not bring about lower costs through more efficient mail preparation. In his

⁴³ See Revised Response to POIR 19 at 4, and Tr. 31/10604, 10644-46.

⁴⁴ For example, if one wishes to study the impact on all Periodicals publications, where a publication with several million readers counts the same as one with 100 readers, then one would have to give greatest weight to the 42 publications that Stralberg refers to as "Very Small," since there are more than 15,000 other publications in the same stratum. In this case very little weight would be given to the stratum of "large" publications. On the other hand, if one were analyzing the impact on Periodicals pieces, then clearly most of the pieces belong to the "large" stratum.

response to POIR 19, Stralberg compared the percentage impact of Tang's and Mitchell's proposed rates and tabulated the results of his comparison according to size. He noted that almost all the very small publications that are machinable would fare better under Mitchell's proposed rates than under Tang's, in some cases much better. On the other hand, very small publications with non-machinable format would pay higher postage under Mitchell's rates, assuming that they continued to have a non-machinable format despite a rate incentive for machinability.⁴⁵

Size (Mailed circulation)	Machinable?	Largest Increase?		Total
		Tang	Mitchell	
LG (>100K)	Yes	25	21	46
	No	1	5	6
MD (>15K, <100k)	Yes	26	46	72
	No	2	26	28
SM (>1K, <15K)	Yes	19	35	54
	No	1	10	11
VS (<1K)	Yes	26	4	30
	No	0	12	12
Total:		100	159	259

Source: Revised Response of Time Warner Inc. to Presiding Officer's Information Request No. 19 (Errata), filed November 17, 2006. p. 5.

On the other hand, a majority of the small (1,000 to 15,000 circulation) and medium-sized (15,000 to 100,000) publications in the sample would do better under the Postal Service's rates, again assuming no changes in mail piece characteristics or mail preparation. For the large (over 100,000) publications, the number that

⁴⁵ Stralberg points out, however, that although 12 of the 42 "very small" publications in the POIR 19 sample (28.6%) are characterized by the Postal Service as non-machinable, the true percentage of non-machinability in this stratum is likely to be much lower. He reaches this conclusion by noting that according to the LR-L-91 mail characteristics data provided by witness Loetscher (USPS-T-28), only 6.6% of the mail pieces in the stratum with circulation less than 1,000 are non-machinable. See Response of Time Warner Inc. Witness Stralberg to Questions Posed at Hearing by McGraw-Hill, filed November 20, 2006, at 8 -9 (hereafter, "Response to Questions Posed at Hearing").

would do better under Tang's rates is about equal to the number that would do better under Mitchell's.

What most distinguishes the Time Warner rate proposal from the others in this docket is the considerably greater variation in impact, especially among the smaller publications. As Stralberg explained, this is what one should expect from a rate proposal that represents a serious effort to align rates more closely with costs:

Since the Time Warner proposal identifies several new cost drivers not previously used in Periodicals rate design, it was to be expected that it would result in somewhat wider differences in percent increases among publications, relative to current rates, than the more conventional rate proposal presented by Tang. While the impact on most publications of Time Warner's rate proposal differs only by a few percentage points from the impact of Tang's rates, for some the difference is considerably greater.

Tr. 31/10603.

During Stralberg's cross examination, counsel for McGraw-Hill requested an explanation for just about every example of a larger than usual percentage increase. Tr. 31/10647-69. Since it was impossible to provide answers on the stand without protracting the hearing beyond reasonable time limits, it was agreed that Stralberg would respond to these numerous questions in writing. Tr. 31/10650-51, 10655, 10664-65. In preparing his response, Stralberg analyzed the characteristics of all POIR 19 publications whose increase under Time Warner's rate proposal would be significantly higher than average, as well as those whose average increase would be much lower, including some that would pay less postage than currently.

Stralberg's response identified many ways in which Periodicals costs could, and likely would, be reduced, if mailers were given the right incentives. For some

publications whose projected percentage increases under Time Warner's proposed rates are high, Stralberg points out changes in mail preparation and entry that would greatly reduce their increase, in many cases to a level lower than under the Postal Service's proposal. Without proper incentives, such changes are unlikely to occur.

Stralberg also pointed out some publications that would get a higher than average increase because until now they have been able to pay below-cost rates.

Non-machinability is perhaps the most common reason why some publications would pay sharply higher postage under the Time Warner proposal. Still, their percentage increases would be small compared with the very high increases that the Postal Service is proposing in this docket for non-machinable Standard flats. See Tr. 39/13523. Stralberg points out that in many cases non-machinability can and likely will be avoided if it is recognized as a cost driver in the rate structure. In some cases, it is unlikely that a publication that is non-machinable will change. For example, a publication that is non-machinable because of excess weight will probably not shed weight (which could mean loss of advertising dollars) in order to avoid paying the charge for non-machinability.⁴⁶ Table 5 in Stralberg's response demonstrates that many of the publications in which McGraw-Hill expressed interest because of their high percentage increases could, by adopting a machinable format, incur not a much higher increase than under the Postal Service's rate proposal but a lower one.

⁴⁶ However, Stralberg points out, as an example of things that mailers can and will do in order to reduce their costs, that last year many of Time Inc.'s magazines reduced their trim size and basis weights in response to the R2005-1 rate increase. See Response to Questions Posed at Hearing at 27.

Stralberg also points out that for most of the publications identified as non-machinable in the Postal Service's POIR 19 data, the reasons for non-machinability remain unknown, despite interrogatories to the Postal Service aimed at determining the reasons. He points out reasons to believe that some of these publications may in fact be machinable and that others could easily change by using automation compatible poly-wrap materials.

Stralberg also identified small high density publications that are entered into the mailstream far from their destination as another example of inefficiencies that can be avoided. In one such case, all the pieces were shown in the POIR 19 data as being entered in Zone 6. He pointed out a number of examples where

[p]roducing such volumes closer to where their readers are, or dropshipping them to a destinating facility, could turn very large rate increases into very low increases or no increase at all.

Another reason why some publications showed high percentage increases under the Time Warner rates was the lingering presence of "skin sacks" that are not in compliance with the 24-piece per sack minimum requirement. For example, the largest increase for any POIR 19 publication under Time Warner's rates (58.53% for publication 205) applied to a publication that is both non-machinable and uses sacks with fewer than 24 pieces, even though it is a lightweight publication.⁴⁷

Another reason for the considerable variation in percentage impact under the

⁴⁷ Stralberg concluded that in a few instances, for very small publications, the appearance of skin sacks may be a result of exceptions allowed under the May 2006 regulations but that in most cases publications simply were not yet in full compliance with the new regulation. Such instances should disappear by the test year.

Time Warner proposal is related to the use of firm bundles. Under these cost-based rates, some users of firm bundles would pay less than they pay now, while others would pay much more, including Time Inc.'s two classroom publications. Response to Questions Posed at Hearing, at 27. But even for those that end up paying more, firm bundles in most cases remain a bargain, when compared with the costs of mailing several copies individually to the same address.

Stralberg also pointed out that many publications would see a higher postage increase because Time Warner's proposed rates pass through "only" 100% of the cost savings produced when mailers put a barcode on their flats. The competing proposals pass through over 800%. Aligning the rates more closely with costs is bound to cause some discomfort for those who have become accustomed to automation discounts far in excess of the costs avoided, especially if their publications have been receiving such discounts without even being AFSM-100 machinable.

Generally, the medium-sized publications in the POIR 19 sample fared less well under the Time Warner proposal than those in other size categories. Two reasons for this are the high percentage of publications that are beneficiaries of excessive discounts for pre-barcoding and the high incidence of non-machinability in this stratum. But as Stralberg also points out, publications in this category should be excellent candidates for comailing or at least co-palletization. The same is true for many publications whose circulation is larger than 100,000.

Stralberg shows that among medium-sized publications that are machinable and either comailed or co-palletized, the number that would do better under the

Time Warner proposal and the number that would do better under the Postal Service proposal is about the same. He also notes that it is not possible based on the information provided by the Postal Service to determine which of these publications are comailed and which are only co-palletized, and argues that those that are comailed likely would do better under the Time Warner proposal.

Time Warner does not argue that all publications can be comailed or co-palletized. Clearly, many are too small for these to be viable options. But as Stralberg's analysis shows, most very small publications would do quite well under the Time Warner proposal, and many of those that would not do well with their current mailing characteristics would have opportunities to do much better, as discussed above. Nor does Time Warner dispute the fact that comailing or co-palletization is not a viable option for some small and medium-sized publications that are so time-sensitive that their publishers find it worthwhile to airlift them to destinating facilities. But publications entered in sacks near their destination, assuming the sacks are reasonably full and not "skin sacks," will also do quite well under the Time Warner proposal.

And for other medium-sized publications, comailing and co-palletization are viable options that increasingly are being adopted and will become more available with the stronger rate incentives that Time Warner's rate proposal offers.

As Mitchell observes, in the last five years particularly, printers and consolidators have been investing in systems to comail or to create co-pallets. The costs of such systems are substantial, which is not altogether surprising in this still early stage of their development, but will undoubtedly decline over time, resulting in

gains in overall efficiency. For this to occur, however, comailing and co-palletization must be given every reasonable opportunity to develop. This means recognizing real Postal Service costs that such alternatives will help avoid. As Mitchell's analysis of Tang's rate proposal illustrates, that will not happen under her proposed rates. In fact, it may well happen to a lesser degree than under the current rates. See TW-T-1 at 17-21.

Time Warner's proposed rates will reward small as well as large mailers who are already preparing and entering their mail in an efficient manner. Some very small publications will even pay less than under current rates. At the same time, these rates will provide strong incentives for other mailers to improve their mail characteristics and entry practices so that they too will experience substantially lower postage costs. For medium-sized publications that are not particularly time-sensitive (and most of them are not), this will increasingly mean comailing or co-palletizing as such options become available and affordable. For others it will mean other adjustments, such as entering their mail (even if it is in sacks) closer to its destination, using fuller sacks, and using mail-piece formats that are consistent with the Postal Service's automation equipment.

V. THE DISCOUNT FROM THE FIRST-CLASS RATE FOR QBRM LETTERS AND CARDS SHOULD BE INCREASED, AND CERTAINLY NOT DECREASED

Business Reply Mail (BRM) allows a recipient of mail (usually a bulk recipient) to supply a reply envelope or card and pay the postage for a responder to return the envelope or card to it. If the BRM is Qualified (QBRM)—that is, approved by the Postal Service as having appropriate characteristics, including a barcode—the recipient receives a discount from the otherwise applicable First-Class rate. Currently, this discount is 3.2 cents for letters and 2.9 cents for flats. The Postal Service has proposed to reduce the discount to a uniform level of 2.5 cents for QBRM letters and cards, based on a cost study showing a savings of 1.52 cents. See Request, Rate Schedules 221 and 222; USPS-T-34 at 24-25; and Response of Witness Taufique to TW/USPS-T32-1 (Tr. 16/4900).

Time Warner witness Mitchell (TW-T-3) reviews the history, use, and characteristics of QBRM and explains why the discounts should not be reduced but increased to 4 cents for letters and 3.5 cents for cards. His argument is based on a range of considerations, including that the Postal Service cost study (see USPS-T-22 at 16) is excessively narrow.

QBRM has a barcode and a FIM mark, does not require a stamp or associated window service, is highly automated and seldom receives manual sorts, usually destinated at high-volume locations, is often held out at the outgoing primary, seldom needs forwarding or other UAA attention, is picked up by the recipient or delivered in bulk, and usually is associated with a high multiplier effect. TW-T-3 at 6-8. QBRM also makes the use of the mail convenient.

A QBRM discount was first recommended by the Commission in Docket No. R97-1, where the Postal Service described it as “a rational extension of de-averaging.” USPS Rp. Br. at V-30. Similarly, the Commission indicated that its recommendation was “based on a finding that there is evidence of some savings in both mail process and delivery.”⁴⁸ It seems clear that the purpose of the discount is to recognize the lower costs of QBRM and to encourage its use as an effective component of the mailstream. Also, QBRM is a way for bulk *recipients* to contribute to cost-reducing preparation in a way not dissimilar to the way bulk *senders* participate in worksharing. Time Warner believes that QBRM, given its characteristics and the role it plays, should not have its discounts reduced.

Under the methodology last approved by the Commission, in Docket No. R2000-1, the cost savings for QBRM is 4.140 cents. Response to TW/USPS-6 (Tr. 18D/6632). This result is higher than the Postal Service’s 1.52 cents primarily because the Postal Service study does not recognize that QBRM pieces receive fewer manual sorts after the initial outgoing sort than do handwritten reply pieces. These additional savings should continue to be recognized.

Mitchell discusses a range of considerations, beyond the issue of fewer manual sorts, that suggest that an appropriate cost basis for QBRM should be wider than 4.140 cents, not narrower. See TW-T-3 at 9-13. One of these is QBRM’s avoidance of window service costs, which would add about 1.6 cents to the cost savings. See PRC Op. R2000-1 (March 22, 2002), pp. 556-57, ¶ 6034. These

⁴⁸ PRC Op. R97-1 (May 11, 1998), p. 318, ¶ 5166.

savings should be included because an essential feature of QBRM is that it be counted and rated before being given to the recipient, and there are separate charges for counting and rating. Unless the savings in window service costs is recognized, QBRM would be paying a portion of window service costs (that associated with stamp sales) plus the counting and rating charges (a substitute for stamp sales), which is double counting.

In view of the savings of 4.140 cents and these other considerations, a discount of 4 cents for letters is reasonable. The discount of 3.5 cents for cards continues the current structure. QBRM should be encouraged, not discouraged. It is among the lowest-cost mail in the system and it helps stimulate the demand for many other components of the mailstream.

CONCLUSION

Stralberg and Mitchell have amply demonstrated (1) that data currently gathered by the Postal Service show that "costs are determined in meaningful and systematic ways by the makeup of bundles, sacks, and pallets, and associated interactions, including entry points" (Complaint at 6); (2) that these cost drivers are substantially within the control of mailers and therefore appropriately should be reflected in rates; and (3) that because they are not currently reflected in rates, there is "no way mailers can make efficient decisions" (*Id.*). Mitchell discusses all of the signals proposed and explains their relationship to costs, their consistency with guidelines followed regularly by the Commission, and their potential importance in influencing mailer behavior.

Time Warner has proposed a rational rate structure, where rates follow costs.

Time Warner has taken into account the Commission's recommendations in Order No. 1446, while the Postal Service has not.

The rates proposed by T/W in this docket represent a significantly lower impact than the rates proposed in Docket No. C2004-1 upon the very small publications with circulation of less than 1000 copies. These publications make up more than half of all Periodicals titles.

Time Warner has provided a simple method for the Commission to further reduce impact upon small and medium-sized mailers if it believes it necessary to do so.

The opportunity exists to improve the Periodicals rate structure. The state of

our understanding identifies what these improvements should be and provides the analysis necessary to make them. The next step should be taken.

Respectfully submitted,

s/

John M. Burzio
Timothy L. Keegan

Burzio & McLaughlin
Canal Square, Suite 540
1054 31st Street, N. W.
Washington, D. C. 20007-4403
Telephone: (202) 965-4555
E-mail: burziomclaughlin@covad.net

COUNSEL FOR
TIME WARNER INC.