

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

COMPLAINT OF TIME WARNER INC. ET AL.
CONCERNING PERIODICALS RATES

Docket No. C2004-1

RESPONSES OF TIME WARNER INC. ET AL.
WITNESS ROBERT W. MITCHELL TO USPS/TW ET AL.-T1-1-11 AND 13-15
(June 28, 2004)

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. (collectively, Time Warner Inc. et al.) hereby provide the responses of witness Mitchell (TW et al.-T-1) to United States Postal Service interrogatories USPS/TW et al.-T1-1-11 and 13-15, filed June 14, 2004.

USPS/TW et al.-T1-12 has been redirected to witness Stralberg.

Each interrogatory is stated verbatim and followed by the response.

Respectfully submitted,

s/ _____
John M. Burzio
Timothy L. Keegan

COUNSEL FOR
TIME WARNER INC.

Burzio & McLaughlin
Canal Square, Suite 540
1054 31st Street, N. W.
Washington, D. C. 20007-4403
Telephone: (202) 965-4555
Fax: (202) 965-4432
E-mail: burziomclaughlin@covad.net

Response of Witness Mitchell to USPS/TW et al.-T1-1

USPS/TW et al.-T1-1. Between the time that you became aware that you would testify in this proceeding and today, did you conduct any field observations of flats mail processing, distribution, and delivery activities at postal facilities? If your response to this question is yes, please list the dates, facility type, facility location, and tasks observed. Please provide any copies of notes that you may have taken during those observations.

RESPONSE

No.

Response of Witness Mitchell to USPS/TW et al.-T1-2

USPS/TW et al.-T1-2. Between the time that you became aware that you would testify in this proceeding and today, did you conduct any field observations of flats printing, binding, mail preparation, and distribution activities at mailer facilities? If your response to this question is yes, please list the dates, mailer names, facility names, facility locations, and tasks observed. Please provide any copies of notes that you may have taken during those observations.

RESPONSE

No.

Response of Witness Mitchell to USPS/TW et al.-T1-3

USPS/TW et al.-T1-3. On page 3, lines 16-18 of your testimony, you state “[i]mprovement in our understanding of costs in recent years has brought the existing deficiencies into clearer focus and has suggested new paths that cost recognition should follow.”

(a) Please list the specific “improvements” to which you are referring.

(b) Please list the “suggested new paths” to which you are referring and explain how they correlate to the “improvements” you have listed in your response to (a).

RESPONSE

The section on page 3 of my testimony, to which you refer, is a summary section that relates in large part to Section III. C., beginning on page 14, which contains additional references and discussion.

(a) The improvements I have in mind relate to a clearer understanding of the importance of cost drivers and their rolls in understanding cost incurrence. Such drivers have been discussed in recent years in Postal Service testimony before the Commission, including that of witness Bozzo, who stated that he employed a multi-stage procedure that “breaks down the connection between cost and volume into a two step procedure. The first (‘attribution’) step requires measurement of the elasticity of an operation’s costs with respect to its outputs (or ‘cost drivers’); the second (‘distribution’) step requires estimates of the elasticities of the cost drivers with respect to subclass (RPW) volumes.” Docket No. R2000-1, USPS-T-15 at 52.

(b) The new paths relate to the recognition of the cost drivers in the design of the rates, such as the recognition of the costs of handling bundles, the costs of handling sacks, and the costs of handling pallets. These are all recognized in the proposed rates. Points of entry are also recognized in an improved way.

Response of Witness Mitchell to USPS/TW et al.-T1-4

USPS/TW et al.-T1-4. On page 3, lines 18-21 of your testimony, you state that “the makeup of bundles, sacks, and pallets, including their entry points and associated interactions, are now understood to be important cost drivers, but these factors are all but neglected in rates.”

(a) Please list the specific cost drivers that you feel affect bundle costs. For each cost driver, please indicate whether you feel it is neglected in the rates.

(b) Please list the specific cost drivers that you feel affect sack costs. For each cost driver, please indicate whether you feel it is neglected in the rates.

(c) Please list the specific cost drivers that you feel affect pallet costs. For each cost driver, please indicate whether you feel it is neglected in the rates.

(d) Please list the specific cost drivers that you feel affect piece distribution costs. For each cost driver, please indicate whether you feel it was neglected in the rates.

RESPONSE

(a) The issue is not that some unidentified cost drivers affect bundle costs. It is rather that the number of bundles is the driver that affects bundle handling costs. Another link in the analysis is between volume and the number of bundles.

(b) The issue is not that some unidentified cost drivers affect sack costs. It is rather that the number of sacks is the driver that affects sack handling costs. Another link in the analysis is between volume and the number of sacks.

(c) The issue is not that some unidentified cost drivers affect pallet costs. It is rather that the number of pallets is the driver that affects pallet handling costs. Another link in the analysis is between volume and the number of pallets.

(d) The issue is not that some unidentified cost driver affects piece handling costs. It is rather that the number of pieces is the driver that affects piece handling costs. Another link in the analysis is between volume and the number of pieces.

Response of Witness Mitchell to USPS/TW et al.-T1-5

USPS/TW et al.-T1-5. On page 4, lines 1-2 of your testimony, you state, “[i]f the factors that drive costs were reflected in rates, mailers would respond accordingly.”

(a) Please confirm that the mail preparation activities that are performed at a given mailer plant are not only affected by postal operations and equipment, but are also affected by the operations and equipment at the mailer plant. If not confirmed, please explain.

(b) Please confirm that there may be instances where mailers would not necessarily respond to a revised rate structure (e.g., the ability to respond was deemed to require a cost prohibitive investment, etc.). If not confirmed, please explain.

RESPONSE

(a) Confirmed. It might be more complete to say that mailers make decisions on mail preparation in view of current and anticipated postal rates, postal regulations, postal operations, and the equipment in their plants. Also, plans for equipment are made in view of current and anticipated postal rates and regulations, which emphasizes the importance of rates such as those being proposed.

(b) I agree that “there may be instances where mailers would not necessarily respond to a revised rate structure” in a way that would lead to immediate increases in efficiency. We need to keep in mind, however, that the framework within which this question is faced involves more than just investment, that changes can be small or large, and that the likelihood of zero change is low. I believe most or all mailers go through some kind of reasoning process to decide what is best for them. This could also be referred to as an optimization process, although it is not necessary to allude to advanced calculus to acknowledge that reasoning takes place. When most of the inputs to this optimization process are changed, it is difficult to argue that the decisions will be unaffected.

Response of Witness Mitchell to USPS/TW et al.-T1-6

USPS/TW et al.-T1-6. Please see Graph 1 on page 10 of your testimony. Please provide the underlying data points and indicate the source(s) for those data points.

RESPONSE

The development of the graph is detailed in the spreadsheet Indexes-T1.xls, being filed as Library Reference, TW et al.-LR-4. The variables in it should be self-explanatory. The CPIU is from the Bureau of Labor Statistics. The percentage rate increases, markups, and markup indexes for Periodicals are directly from the Commission's Opinions.

Response of Witness Mitchell to USPS/TW et al.-T1-7

USPS/TW et al.-T1-7. On page 12 lines 14-17 of your testimony you state, “There is little question, for example, that some of the recent growth in the volume of parcel post has been due to cost-based rate innovations, and Standard Mail rates have been moving in the direction of closer alignment with costs.”

(a) Please describe the Parcel Post “cost-based rate innovations” to which you refer.

(b) Please describe the basis for your claim that “Standard Mail rates have been moving in the direction of closer alignment with costs.”

RESPONSE

(a) The cost-based rate innovations in parcel post, to which I refer, are primarily those of Docket No. R97-1, where the Commission recommended a DSCF rate, a DDU rate, an OBMC rate, a balloon rate, a change in the recognition of oversize pieces, and a prebarcoded rate, much as proposed by the Postal Service.

(b) My basis is the development of the irregular shape surcharge, the extension of barcode discounts to machinable parcels, the recognition of non-machinability for letters, and the deaveraging of basic presort into mixed AADC and AADC. Earlier, a number of changes were made in and soon after Docket No. R90-1, including dropship discounts (based on both transportation and non-transportation costs), letter/flat rate differentials, extensive barcode discounts, and high-density and saturation rates.

Response of Witness Mitchell to USPS/TW et al.-T1-8

USPS/TW et al.-T1-8. On page 12-13 of your testimony, you describe how mailers have become increasingly sophisticated in their ability to respond to rate signals and specifically mention how this circumstance is related to computers.

(a) Based on that statement and the extensive Periodicals experience you describe in your response to ABM/TW et al.-T1-1, please describe the current level of sophistication for the customers of Periodicals mailers. Specifically address how increased internet usage may have resulted in the adoption of on-line Periodicals subscriptions, rather than Periodical subscriptions that have been obtained through the mail.

(b) Based on your experience working with the various members of the Periodicals industry, as described in your response to interrogatory ABM/TW et al.-T1-1, how has the increased usage of the internet affected Periodicals mail volume?

RESPONSE

(a) I have only a layman's knowledge of the practices of the "customers of Periodicals mailers." Since I see ads on the Internet regularly, I am aware that subscriptions are promoted there. For example, the website of *PC World* magazine shows such promotions.

(b) I do not know and I do not believe that anyone else knows.

Response of Witness Mitchell to USPS/TW et al.-T1-9

USPS/TW et al.-T1-9. On page 13, lines 11-13 of your testimony, you state that “many of the costs depend on the quantities and sizes of the bundles, sacks, and pallets in a mailing, but this fact goes largely unrecognized in rates.” Please state which costs depend on those factors and indicate how they are unrecognized in the rates.

RESPONSE

The costs of handling bundles depend on the number of bundles, yet there is no per-bundle rate element. The same could be said for sacks and, to a slightly limited extent, for pallets.

Response of Witness Mitchell to USPS/TW et al.-T1-10

USPS/TW et al.-T1-10. On page 13, lines 13-15 of your testimony, you state that “the costs of handling bundles depend on the makeup (e.g., ADC, SCF, 3-digit, or 5-digit) of their containers and where they are entered, but neither are these factors recognized in rates.”

(a) Based on this statement and the statement referenced in USPS/TW et al.-T1-13, please confirm that the occurrence of broken bundles also affects Periodicals costs. If not confirmed, please explain.

(b) Please confirm that the materials which mailers use to secure bundles is one element that affects bundle breakage. If not confirmed, please explain.

(c) Please describe the different materials and methods that Periodicals mailers use to secure bundles.

(d) In general, are there differences as to the materials and methods that large Periodicals mailers use to secure bundles, when compared to small Periodicals mailers? If so, please describe these differences.

(e) Have you conducted any studies that evaluate the appropriateness of various mailer bundling materials, given their impact on bundle breakage in postal facilities? If so, please provide the results of those studies.

(f) Do you believe that the materials used to secure bundles by mailers (in terms of the likelihood those materials would result in broken bundles) should also be incorporated into the rates a given mailing should be assessed? If not, please explain why not.

RESPONSE

(a) Confirmed. The costs of bundle breakage are recognized in the costing systems and in the costing models used to develop the current rates and the rates proposed in this Complaint. Also, I am generally aware that there have been, and may be ongoing, joint Postal Service/mailer efforts to deal with the bundle breakage question.

(b) Confirmed.

(c) I do not have an understanding that would allow me to provide such a description.

Response of Witness Mitchell to USPS/TW et al.-T1-10

(d) I do not know.

(e) No.

(f) Mailers who prepare bundles that do not break would certainly seem justified in being opposed to having their rates elevated by practices of mailers whose bundles do break, even though one of the elements in the breakage question is the way the bundles are handled by the Postal Service. I am not prepared to provide advice on whether this issue is best pursued through Postal Service development, joint Postal Service/mailler efforts, regulations, rates, or a process of recognizing the costs as done now.

Response of Witness Mitchell to USPS/TW et al.-T1-11

USPS/TW-et al.-T1-11. On page 14, lines 11-12 of your testimony, you state that, “[t]he current rates send underdeveloped signals to mailers, thus failing to provide them with a reasonable and valuable avenue for responding to the high costs.” Please confirm that it is possible that, even if the Postal Service, the Commission, and the Periodicals mailing industry expended the resources required to develop alternative price signals and/or respond to those price signals, the result might have little to no effect on Periodicals costs and cost coverage. If not confirmed, please explain.

RESPONSE

Not confirmed. Mailers historically have responded to price signals and will continue to do so. When mailers perform functions previously undertaken by the Postal Service, and those functions incur volume variable costs, postal costs will decline unless the Postal Service fails to adapt.

Thus, as publishers make changes, the Postal Service’s costs would be expected to change. This is suggested by the cost analysis supporting the rates and is a consequence of the control of the Postal Service of its operations. The cost coverage is a result of the changes in postage and in the Postal Service’s costs.

Response of Witness Mitchell to USPS/TW et al.-T1-12

USPS/TW et al.-T1-12. On page 15, lines 3-5 of your testimony, you state, “[f]or 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.”

(a) Have you conducted any studies, or are you aware of any studies, that support your conclusion that the cost of sorting bundles is virtually independent of the weight of the bundles and the number of pieces in them? If so, please provide the results of those studies. If not, please provide the basis for your claim.

(b) Please confirm that a bundle for a given issue of a periodical would weigh more than a second bundle, if the number of pieces in the first bundle were greater than the number of pieces in the second bundle of the same periodical. If not confirmed, please explain.

(c) When less secure bundling materials are used, isn't it possible that the first bundle described above in (b) might be more likely to break when it is processed? If your response is no, please explain.

(d) When a heavier bundle that contains more pieces is processed through postal dumping mechanisms and equipment, please confirm that it is possible that the weight could not only result in that bundle being broken, but could also result in other nearby bundles being broken? If not confirmed, please explain.

(e) Please confirm that when a heavy bundle containing many pieces breaks, the piece distribution costs would be greater than they would have been had the same number of pieces been secured in multiple bundles prepared at the same presort level, assuming that the multiple bundles did not break. If not confirmed, please explain.

RESPONSE

This interrogatory has been redirected to witness Stralberg.

Response of Witness Mitchell to USPS/TW et al.-T1-13

USPS/TW et al.-T1-13. On page 30 of your testimony, you describe the per-sack and per-pallet rates associated with your proposal. Are smaller mailers more likely to enter their mail in sacks when compared to large mailers? Please explain your answer.

RESPONSE

Yes, assuming they both distribute nationally. But the importance of recognizing the costs of sacks in rates goes to more than the question of whether a mailer will switch from sacks to pallets. For example, there is the question of how many sacks are used and how full they are, and there is the question of how supplemental mailings and special or separate editions are mailed. These questions are not faced by large mailers only.

Response of Witness Mitchell to USPS/TW et al.-T1-14

USPS/TW et al.-T1-14. Your proposed rate schedule, on page 43 of your testimony, proposes rates that are expressed in terms of dollars per bundle, dollars per sack, and dollars per pallet. Do you believe that these rates would cause some mailers to submit larger bundles, fuller sacks, and larger pallets? If not, please explain why not. If so, would there be instances where that might not necessarily be a good thing? Please elaborate.

RESPONSE

I agree that the rates would cause some mailers to submit larger bundles, fuller sacks, and/or larger pallets. To the extent that the rates reflect the costs involved, it is not clear to me that there are instances where this might not be viewed as a “good thing.”

Response of Witness Mitchell to USPS/TW et al.-T1-15

USPS/TW et al.-T1-15. On page 54, line 9 of your testimony, you discuss how your proposed rates (page 43) meet the criterion specified in U.S.C. 39 § 3622(b)(4), concerning the effect of rate increases on mailers.

(a) Please confirm that some mailers would experience large rate increases were your proposed rates to be adopted and implemented. If not confirmed, please explain.

(b) Did you consider a phased approach to implementing the proposed rate schedule in order to mitigate the impact of rate shock on some mailers? If not, why not?

(c) When compared to the rates you propose on page 43, do you feel that a phased implementation (incrementally increasing rates for those impacted mailers) would better meet the requirements of U.S.C. 39 § 3622(b)(4)? If not, why not?

RESPONSE

(a) If one assumes that they change nothing in response to the new rates, confirmed.

(b) Yes.

(c) Not necessarily. The Commission has already indicated that it will not recommend specific rates in this docket, implying that any effects from the proposed changes are in the neighborhood of two years off. This provides considerable notice to mailers. When the Postal Service does propose rate changes, it will have the option of proposing a phasing scheme. When this is done, it should be noted that the structural deficiencies identified in the Complaint have been accumulating for some time. The changes that need to be made are, in my opinion, overdue. Please see also my response to ABM/TW et al.-T1-30.