

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 McGRAW-HILL WITNESS SCHAEFER
TO TW et al./MH-T1-1-10)
(September 29, 2004)

Intervenor The McGraw-Hill Companies, Inc. ("McGraw-Hill") hereby provides the responses of witness Schaefer (MH-T-1) to Complainants' interrogatories TW et al./MH-T1- 1 – 9, filed September 15, 2004, and TW et al./MH-T1-10, filed September 17, 2004. Each interrogatory is stated verbatim and followed by the response.

Respectfully submitted,

/s/

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Response of Witness Schaefer to TW et al./MH – T1 - 1

TW et al./MH-T1-1. For each McGraw-Hill publication, please provide all memos, analyses, and spreadsheets that have been created to illustrate how the publication could modify its mailing practices if the complainants proposed rates were implemented.

RESPONSE:

No such documents have been created to the best of my knowledge.

Response of Witness Schaefer to TW et al./MH – T1 – 2

TW et al./MH-T1-2. On page 5, lines 18-20, of your testimony, you refer to now-defunct Platt's Energy Business and Technology (herein PEBT), and say that it would have received a 28.2 percent rate increase under the proposed rates. For that publication, please address the following questions.

- (a) What was the most recent circulation of PEBT, and what proportion of that circulation was delivered through the Postal Service?
- (b) What was the proportion of advertising of PEBT?
- (c) What proportion of mailed PEBT pieces were in firm bundles?
- (d) What proportion of PEBT pieces were sent to firm addresses?
- (e) What was the estimated average annual income of persons receiving PEBT?
- (f) Since the rates proposed by Time Warner Inc. et al. are designed to move postage toward costs, do you agree that the ECSI-adjusted postage paid by PEBT was approximately 22 percent ($0.282/1.282$) below the Postal Service's costs of handling and delivering PEBT, and therefore that PEBT went out of business despite receiving a 22 percent subsidy of its delivery costs? (ECSI-adjusted postage means the postage that would exist if the pieces had a subclass-average proportion of editorial content and therefore that any extent to which the postage is below costs is not due to deference for editorial content.) Please explain any disagreement and provide your own perspective on what the postal costs for handling PEBT might be.
- (g) Assuming PEBT was receiving a 22-percent subsidy of its delivery costs, please explain whether it would be your contention that a larger subsidy would have kept it in business, and if so, how much larger that subsidy should be.
- (h) Thinking in terms of a business plan for prospective publications or for publications like PEBT, is it your contention that the Postal Service should systematically offer such publications subsidized rates, beyond any benefit they receive for their editorial content, in order to make it more likely that the plan will show a net profit for the prospective publisher or publisher? If so, please outline the factors that the Postal Service should consider in judging the worth of the publication or in deciding how much subsidy to provide.

- (i) If a subsidy is to be provided, please explain who it is that should pay the subsidy.
- (j) On page 6, line 21, you state that McGraw-Hill publications “must stand on their own financially.” Does this mean that McGraw-Hill demands strict profit-and-loss accountability for each publication in its portfolio but that the Postal Service should contribute subsidized rates to the financial equation? Explain any non-yes answer.
- (k) Suppose that McGraw-Hill has a small publication with below-cost postage that is very profitable. Do you agree that the subsidy provided by the Postal Service goes directly to the McGraw-Hill bottom line, serving to increase the profits of the publication beyond what they would otherwise be? Explain any non-yes answer.

RESPONSE:

- (a) 41,034 copies , 74% of which was delivered by the Postal Service.
- (b) 27%
- (c) 12.31%
- (d) 9.8%
- (e) McGraw-Hill never compiled the requested information and is unable to answer this question.
- (f) I am neither a postal cost expert nor a rate design expert, and I am therefore unable to confirm or comment substantively.
- (g) I make no such contention.
- (h) I make no such contention. I have simply stated my view that providing appropriate discounts from rates that are based on averaged costs of

outside-county Periodicals is a better approach than a radical de-averaging of those costs. See part VI.A.1 of my direct testimony.

(i) See my answer to subpart (h) above.

(j) The quoted statement does not have the meaning you suggest. See my answer to subpart (h) above.

(k) See my answer to subpart (h) above. While below-cost postage may improve the profitability (or mitigate the unprofitability) of a publication, this would not apparently depend on the size of the publication or the degree to which it is otherwise profitable.

Response of Witness Schaefer to TW et al./MH – T1 – 3

TW et al./MH-T1-3. Please refer to Charts A, B, and C on pages 7-13 of your testimony.

- (a) You indicate on page 7, line 25, that you focused on “postage increases.” Please explain whether you have in fact focused on unit postage increases, so that your curves are not affected by changes in volume levels.
- (b) You indicate on page 8, line 7, that you have made adjustments “for changes in the rate structure over the period.” Please describe in detail the nature of the adjustments that you made and how you recognized changes in the rate structure.
- (c) Please explain whether your curves have the character of a per-piece postage index or of a price index. If they are a price index, please outline what quantity weights you used and whether the indexes are based on an unchanged set of quantity weights or whether they are link relative in character.
- (d) If your indexes are per-piece postage in character, please discuss the meaning that should be attached to a comparison between a per-piece postage index and a price index such as the CPIU.
- (e) Do you agree that there are factors that affect per-piece postage indexes that do not affect price indexes? Explain any non-yes answer.
- (f) Please explain whether any of your postage curves recognize additional costs to the mailer (sometimes called user costs) of preparing the mail to take advantage of worksharing discounts and other changes in rate structure.

RESPONSE:

(a) Volumes for the publications in question were held constant for each year analyzed, using the current parameters as a base and making adjustments for prior year rate structures as explained in response to subpart (b) below.

(b) The current mailing characteristics for each publication were used as a base, in conjunction with an average weight and advertising percentage. The parameters were then used to determine total postage in prior years using the rates that were in effect at the time. The following assumptions were made:

- Delivery unit and SCF rates started on February 3, 1991. For prior period analysis, any copies currently under those rates are accounted for in zone 1 & 2.
- ADC rate started on June 30, 2002. For prior period analysis, any copies currently under that rate are accounted for in zone 1 & 2.
- Automation discounts started on September 20, 1992. For prior period analysis, any copies currently in the automation category are put into the non-automation category.
- Presort level 3/5 was split into separate sorts for 3-digit and 5-digit on January 10, 1999. For prior period analysis, copies in 5-digit are all moved to 3/5 digit, and copies in 3-digit are moved one-half to 3/5 digit and one-half to Basic.

(c) I am not an economist and thus am unable to address these questions meaningfully.

(d) I am not an economist and thus am unable to address this question meaningfully.

(e) I am not an economist and thus am unable to address this question meaningfully.

(f) User costs are not reflected.

Response of Witness Schaefer to TW et al./MH – T1 – 4

TW et al./MH-T1-4. Please refer to Chart A on page 8 of your testimony. Do you agree that the index for Engineering News Record (ENR), which you characterize on line 3 as “a small-circulation magazine,” tracks closely the index for all Periodicals? Explain any non-yes answer.

RESPONSE:

The index for *ENR* (which I characterize at page 8, line 3 of my testimony as a “smaller-circulation magazine”) appears generally to track or exceed the index for all Periodicals

Response of Witness Schaefer to TW et al./MH – T1 – 5

TW et al./MH-T1-5. Please refer to your statement on page 9, line 7: “It is hard to believe in this light that, as stated by witness Mitchell, the current rates provide signals that are ‘hidden by excessive tempering.’”

- (a) Please explain what it is about the index for Engineering News Record approximating the average for Periodicals and the index for Business Week being between the CPIU and the average for Periodicals that makes it difficult for you to believe that the current rates might hide (or not provide) signals relating to postal costs.
- (b) Suppose under the current rates a mailer made a decision that it would be somewhat easier for the production people to put six bundles in two sacks instead of one sack, and the postage did not change. Please explain the sense in which any of the curves you show make it “hard to believe” that the increase in postal costs associated with the shift to two sacks is “hidden” from the mailer making the decision to change.

RESPONSE:

(a) As explained in the remainder of the referenced paragraph, larger-circulation Periodicals tend to respond to existing price signals in order to lower their postal costs.

(b) The quoted statement refers to existing price signals under current postal rates, including pallet and drop-ship discounts that discourage use of sacks. Periodicals mailers also receive price signals from printers and transporters that discourage use of sacks, as I discuss on pages 14-15 of my testimony. I have not suggested that current postal rates do or should reflect all postal cost differences, whether associated with sack usage or otherwise.

Response of Witness Schaefer to TW et al./MH – T1 – 6

TW et al./MH-T1-6. Please refer to page 11, lines 15-16, where you argue that the “smaller-circulation publications” have “borne the brunt” of the excessive increase in the costs of Periodicals.

- (a) Suppose the inflation in all Periodicals costs over the period shown in your charts had been 20 percentage points lower than it actually was. Do you accept that under these conditions the level of each Periodicals rate cell would likely be 20 percentage points lower at the end of the period than it actually was and that, *ceteris paribus*, the postage paid by each and every Periodicals title would likely be 20 percentage points lower at the end of the period than it actually was. If you do not accept this outcome of the supposition, please explain in detail every rate design and costing reason for your non-acceptance and describe the outcome that you feel would be more likely.
- (b) If all Periodical titles would share in a general cost *reduction*, as suggested in the previous part of this question, please explain the rationale and the basis for arguing that the smaller publications have “borne the brunt” of the general cost *increase* that actually occurred.
- (c) Please explain the basis for your statement at page 11, lines 16-18, that the Complainants have “seize[d] upon” the excessive cost increases “as a reason to further increase the cost burden borne by smaller-circulation publications.”
- (d) When witness Mitchell said on page 3 of his testimony, line 3, that “[t]he fact that [these excessive cost increases have] been occurring makes it all the more important to search for other avenues of progress, on which this Complaint focuses,” did you take this to mean that he had searched for ways to place burdens on small-circulation publications?
- (e) In the Rate Design section that begins on p. 26 of Mitchell’s testimony, do you find any decision that:
 - (1) is not based on well established, balanced, and explained rate design principles?
 - (2) is biased with the intent to affect in a negative way a particular mailer group? or
 - (3) is justified on the basis of the size of recent cost increases?

Please explain “yes” answers to any of these questions.

RESPONSE:

(a) I am not a rate design expert and thus am unable to confirm or elaborate.

(b) Larger publications are better able to mitigate rate increases through worksharing.

(c) See my direct testimony at page 7, lines 10-15.

(d) I did not rely on the quoted sentence for the conclusion that you suggest, nor do I otherwise know what was in the mind of witness Mitchell.

(e) (1) My comments on the proposed rate design appear at pages 24 through 37 of my direct testimony. My silence regarding any particular aspect of the proposed rate design should not be construed as any endorsement. I do not purport to be a rate design expert. (2) I do not purport to know the intent of witness Mitchell. (3) See my answer to subpart (c) above.

Response of Witness Schaefer to TW et al./MH – T1 – 7

TW et al./MH-T1-7. Engineering News Record appears to be an excellent candidate for co-mailing. Why is this title not co-mailed?

RESPONSE:

Engineering News Record is a weekly publication. Weeklies do not generally make good candidates for co-mailing, as witness Schick acknowledged (Tr. 2/388, 414, 425, 543-44).

The printer of *Engineering News Record*, Perry Judd, does not currently offer co-mailing of publications. *ENR* is under contract with Perry-Judd and does not have the liberty of changing printing locations.

McGraw-Hill has explored co-mailing with some of our printers that do have such capability, but as noted in my direct testimony, these printers have been unwilling to accept into their co-mailing pools publications printed elsewhere.

McGraw-Hill would certainly be willing to co-mail its publications to the extent that equipment is available making it feasible to do so, provided that savings can be realized and that delivery of the publication is not adversely affected.

Response of Witness Schaefer to TW et al./MH – T1 – 8

TW et al./MH-T1-8. On page 21 you discuss the difficulties of palletizing airfreight copies. Does your airfreight forwarder offer the service of re-palletizing copies at the destination city, so that they can be entered into the Postal Service as palletized copies? If your response is no, please explain fully.

RESPONSE:

While our forwarder does offer a re-palletization service, the service is not available at all destinations. McGraw-Hill has evaluated this service in the past and made some limited use of it approximately four years ago. In general, adding process steps to the supply chain, as would occur by palletizing mail, breaking it down into a number of boxes for air shipment, and then re-palletizing it at the destination city, introduces a number of potential failure points. Forwarders' expertise lies in moving freight, not mail preparation. We do not feel that it is generally prudent to move this task to the forwarder given that it is not a core competency of the forwarder.

Response of Witness Schaefer to TW et al./MH – T1 – 9

TW et al./MH-T1-9. How does Business Week prepare and enter its backdate copies and any supplemental mailings? Could these copies be co-mailed? If your response is no, please explain fully.

RESPONSE:

Business Week does not issue backdated copies or supplemental mailings.

Response of Witness Schaefer to TW et al./MH – T1 – 10

TW et al./MH-T1-10. On page 4 of your testimony, you refer to “the three loyal subscribers to Dodge Daily Bulletin Western Missouri.”

- a. What is the annual subscription rate for this publication to these three subscribers? Are the subscription rates equal for all editions of this publication?
- b. Have you ever considered faxing Dodge Daily Bulletin Western Missouri to its three loyal subscribers? If your response is no, please explain fully.
- c. Have you ever considered e-mailing Dodge Daily Bulletin Western Missouri to its three loyal subscribers? If your response is no, please explain fully.

RESPONSE:

- a. \$3,612. There is only one edition.
- b. While faxing has been considered, the publication has found it to be impractical from an operational standpoint.
- c. While electronic access is available, these subscribers elect hard-copy delivery.