

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

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

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Docket No. C2004-1

RESPONSES OF TIME WARNER INC. ET AL.  
WITNESS ROBERT W. MITCHELL TO MH/TW ET AL.-T1-1-18  
(June 22, 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 McGraw-Hill interrogatories MH/TW et al.-T1-1-18, filed June 8, 2004.

Each interrogatory is stated verbatim and followed by the response.

Respectfully submitted,

s/ \_\_\_\_\_  
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## Response of TW et al. Witness Mitchell to MH/TW et al-T1-1

**MH/TW et al.-T1-1:** Under the reasoning presented in your testimony at page 16 lines 3-8, please explain whether, assuming cost-based rates, it would be efficient, as you use that term, for the Postal Service to handle 500 one-piece sacks in lieu of one 500-piece pallet.

### RESPONSE

The evidence shows that the Postal Service's cost of handling 500 one-piece sacks is higher, on average, than the Postal Service's cost of handling one 500-piece pallet. The question of efficiency, however, is a little different, and it involves more than just issues of Postal Service handling.

Suppose that the mailer views himself as receiving \$50 in value of service from using the sacks instead of the pallet, that the cost to the mailer of preparing the sacks is \$500 lower than the cost of preparing the pallet, that handling the 500 sacks costs the Postal Service \$550 (\$1.10 per sack), that handling the pallet costs the Postal Service \$25, and that the rates are cost-based in the sense that the sack charge (from the Postal Service to the mailer) is \$1.10 and the pallet charge is \$25. If the mailer shifts to the pallet under these conditions, the mailer will lose \$25.00 ( $50+500-550+25$ ), the Postal Service will remain at financial breakeven, and the nation will lose \$25.00 (gain \$25 in resources released by the Postal Service and the mailer ( $550-500-25$ ) and lose \$50 in value of service). Under these conditions, a change to pallets would not be an efficiency improvement and, in view of the alternatives that we know about, there is nothing inefficient about the mailer using sacks.

The numbers in this example were developed for illustrative purposes. Actual numbers could be different. An outcome suggesting an efficiency improvement for shifting to pallets could easily occur. Such an outcome should not be taken as a

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reflection on anything the Postal Service or the mailer had been doing before the rate change, but no shifting will occur unless improved signals are sent in the rates.

## **Response of TW et al. Witness Mitchell to MH/TW et al-T1-2**

**MH/TW et al.-T1-2:** Based on the reasoning presented in your testimony at page 16 lines 3-8, will the Postal Service be efficient under cost-based rates regardless of whether mailers modify their behavior?

### **RESPONSE**

I hope that the Postal Service is productively efficient whether it handles several sacks with one bundle each or one sack with several bundles. But the reasoning you cite relates to economic efficiency, not productive efficiency, which is a broader concept than just what the Postal Service does. On this point, please see my response to MH/TW et al.-T1-1.

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

**MH/TW et al.-T1-3:** Please discuss the extent to which unit costs for Postal Service transportation, and its unit costs of handling sacks, can be expected to increase assuming that mailers engage in increased dropshipping and reduce their use of sacks.

### RESPONSE

A unit cost is usually for some operation or group of operations, and is the cost of that operation or group divided by the volume going through it. The operations about which you ask are those of (a) transporting mail and (b) handling sacks. The cost measure receiving prominent attention in virtually all proceedings before the Commission, and which is most relevant to virtually all economic analyses, is the attributable cost or the volume variable cost.

(a) The unit cost of transporting mail will remain the same when mailers engage in dropshipping, because the percentage decrease in the numerator is the same as the percentage decrease in the denominator. If the volume reduction is large, there is a possibility that the marginal cost will decline, due to scale effects. This would come about from a lower volume variability of the Postal Service's transportation systems, and would result in lower unit transportation costs, not higher ones. Such an effect would be second-order in nature. But there is no magic level for volume and there is no justification for attempting to control volume to obtain a specific unit cost outcome.

(b) The unit cost of handling sacks will remain the same when mailers shift to pallets, because the percentage decrease in the numerator is the same as the percentage decrease in the denominator. In this case, economies of scale are not generally believed to exist, so the size of the volume change should not matter.

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

**MH/TW et al.-T1-4:** Does your testimony at page 21 line 19 through page 22 line 1 that the “expectation would certainly be for [local and regional publications] to print near their areas of delivery” assume that postage costs are or should be the primary factor in choosing a printing site? Please explain your answer, including the basis for any such assumption.

### RESPONSE

No. Although publishers often negotiate with printers over the requirements (or specifications) of the job, with the end result thereby influenced by the capabilities of the printers and what they are able to offer, the common situation often boils down to printers submitting bids and publishers deciding what is best for them. The publisher would be expected to consider any postage differences as well as any differences in printing prices. Note, however, that the postage is often influenced by the way the printer prepares the mail, which in turn influences the printer’s costs. Under these conditions, the printing costs cannot really be separated from the postage costs. Also, it would not generally be wise for a publisher to take the lowest-cost printing bid and then say: “Just pass on to me any postage costs that you incur.” See also my response to ABM/TW et al.-T1-61 (corrected).

## **Response of TW et al. Witness Mitchell to MH/TW et al-T1-5**

**MH/TW et al.-T1-5:** Does your testimony at pages 23 and 24 regarding “Camp 2” mailers assume that a local or regional publication that is printed at some distance from its delivery area would not have the same incentives as a national publication, with comparable circulation in that area, to dropship into that area? Please explain your answer, including the basis for any such assumption.

### **RESPONSE**

No. However, local and regional publications that print at a distant location and then dropship could be viewed as Camp-3 mailers. The point of this passage in my testimony does not concern these mailers, because both the printing prices and the transportation prices they pay are market prices that would be expected to reflect all associated costs. They are, in effect, Camp-1 mailers with a market-based adjustment.

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

**MH/TW et al.-T1-6:** With reference to your testimony at page 35 lines 14-15 that the current one-cent-per-piece discount for dropshipped pallets “presents an unnatural incentive to remove potentially attractive pallets from the Service’s transportation system,” (a) please explain what you mean by a “potentially attractive pallet” and (b) please explain whether you are suggesting that it would be more beneficial for the Postal Service to transport that pallet than if it were dropshipped, and explain the basis for any such assumption.

### RESPONSE

(a) I mean that if the Postal Service is going to receive the same postage for transporting a pallet as it would receive for transporting an equivalent number of sacks (adjusted for the one-half-cent pallet discount), it should prefer to handle the pallet and should not arrange a discriminatory and unbalanced incentive to get the pallet to dropship. Certainly with the handling costs included (which are not in the dropship discounts), the unit transportation cost for an all-pallet system would be lower than that for an all-sack system, an outcome providing lower rates to mailers for transporting their mail. This would allow a more effective and more competitive postal system, in line with what should be its goals.

(b) Under the current rate, it would not be beneficial for the Postal Service to transport the pallet instead of it being dropshipped, because the extra postage it receives for transporting the pallet is less than its additional costs. This relationship does not hold under the proposed rates, under which the Postal Service should be indifferent.

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

**MH/TW et al.-T1-7:** Based on the rate structure proposed at page 43 of your testimony, please confirm that in lieu of a 3-digit origin entered pallet consisting solely of 5-digit bundles totaling 500 copies and weighing 250 pounds, it would be less costly to (a) the mailer and (b) the Postal Service if the same bundles were mailed in ten 50-copy, 3-digit origin sacks. If you do not confirm, please explain and provide your calculations. If you do confirm, please explain whether mailing the sacks in lieu of the pallet would be more efficient, as you use that term.

### **RESPONSE**

Not confirmed, unless the mailer's cost of preparing the pallet is the same as his cost of preparing the sacks and the value of the service received is the same. Until this additional information is known, a conclusion on efficiency cannot be reached. See also my response to MH/TW et al. -T1-1. Your example illustrates an aspect of reality that is rarely acknowledged and seems little understood, that the use of sacks can in some circumstances be a low-cost, efficient way of preparing and handling the mail. There is no reason to be against them *per se*.

## **Response of TW et al. Witness Mitchell to MH/TW et al-T1-8**

**MH/TW et al.-T1-8:** Referring to your statement on page 45 note 39 that “Periodicals mailings are to a considerable extent repetitive,” please confirm that weights of publications can vary widely from issue to issue and that under the current and proposed rate structures, such variation can substantially change the way that the mail is prepared and entered. Please explain your answer fully.

### **RESPONSE**

Confirmed, due in part to the acknowledgment of regulations and in part to decisions made by the printer/publisher. Note, however, that postage variations and the costs of making preparation changes are presumably considered when such changes are made. Also, the rates being proposed will send improved signals to guide decisions on preparation changes.

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

**MH/TW et al.-T1-9:** With reference to your testimony at page 47 lines 12-14, consider two Periodicals mailings by different mailers, one mailing consisting of 20,000 pieces and the other consisting of 2,000,000 pieces, with each mailer using the same presort software parameters and identical piece characteristics. Under the current rate structure the larger mailer pays considerably lower rates due to its higher volume, although an identical effort was undertaken to achieve the presort. Please explain whether and how it would be fair and equitable to widen this gap under the proposed rate structure, given that the mailers are taking identical steps to prepare and ship their mail efficiently, and assuming that the smaller mailer is unable to comail or co-palletize.

### RESPONSE

Your question seems to presume that the status quo just happens to be fair, even though it too was created by following (an earlier set of) cost-based arguments, but that any improvement in the recognition of costs that might widen any rate differences would be less fair, based on a subjective impression about the amount of effort by the mailers involved. By implication, it would seem, any back-steps in the recognition of costs that might narrow any rate differences would be more fair. Fairness arguments, however, are always in the eye of the beholder and often warrant further review.

The rates being proposed are a step from the present situation to recognize costs in more appropriate ways. A number of reasons for doing this have been explained, including sending appropriate signals, improving efficiency, and making the Periodicals subclass more effective. But the steps are also justified on fairness grounds, because the current recognition of costs is now understood to be misaligned with how costs are actually incurred. It is difficult to argue the fairness of presenting a given rate to all mailers when some of the mailers incur lower costs and some of them incur higher costs.

## **Response of TW et al. Witness Mitchell to MH/TW et al-T1-10**

**MH/TW et al.-T1-10:** Referring to your testimony at page 49 note 40, please explain the basis for your confidence that but for the mailbox rule, private operators would be delivering a substantial portion of periodicals.

### **RESPONSE**

Over some period of years, a number of private delivery operations have existed, and many still exist. I have talked with the operators of some of them, and the common theme has almost always been: "If only we could use the mailbox." But my confidence at this point is due almost entirely to my understanding of the experience of Publishers Express.

Publishers Express was a delivery operation for magazines begun in Atlanta. It grew from serving 2 ZIP Codes in one city to serving 1,000 ZIP Codes in 32 cities. Its CEO was Jim O'Brien, with whom I now work and with whom I have discussed this issue many times. He has explained that only one difficulty limited the operation's success. It was not the level of its rates relative to those of the Postal Service, or its costs, or a lack of interest and support from publishers. Rather, it was the persistent preference of recipients for receiving their magazines in their mailboxes. I have taken the position many times that I would be happy to put two boxes in front of my house, one postal and one non, but it has not been found possible to bring about such an outcome on a broad basis. It is also suggestive to note that Publishers Express had just scratched the surface on the opportunities of automation. Given time, advances would have been made, costs would have declined, and the effectiveness of operations would have increased.

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

**MH/TW et al.-T1-11:** With reference to your testimony on page 40 lines 3-7 that “[t]o build these non-transportation costs into the pound rates, as well as to recover the revenue loss associated with the unzoned editorial pound rate, the usual procedure has been to develop first-cut pound rates based on transportation costs alone, and then to add an additional amount (23.8 cents per pound in PRC LR-8, R2001-1) onto each zoned rate.”

(a) Please specify what portion of the additional amount of 23 cents is attributable to the revenue leakage associated with the unzoned editorial pound rate, what portion is attributable to pound-oriented non-transportation costs, what portion is attributable to non-distance-related transportation costs, what portion is attributable mark-up for institutional costs, and what portions are attributable to any other factors (please specify any and all such other factors and the portion attributable to each). If necessary, please provide your best estimate. Please specify the precise source for your answers, and for the 23.8 cents per pound figure, and explain any necessary calculations.

(b) Please specify which of such portions, if any, of the referenced additional amount of 23.8 cents is incorporated in the pound charges for DDU, DSCF and DADC, respectively, and the extent to which each is so incorporated. If necessary, please provide your best estimate. Please specify the precise source for you answers and explain any necessary calculations.

### RESPONSE

I have discovered that the reference in my testimony on line 7 of page 40 should be to the Outside County Excel workbook in PRC Library Reference 9, instead of 8. Unless otherwise noted, cells in that workbook referenced in this answer are on sheet ‘Pound Data\_Adv’, the 23.8-cent figure being in cell F73.

(a) The calculations below are based on the scheme used to develop the settlement rates as contained in the library reference. Since the editorial pound rate in the settlement is 77.8 percent of the zones 1&2 pound rate for advertising, instead of the traditional 75 percent, the proportion developed for it is somewhat lower than normal, but not much. The advertising pound rates are shown in cells D78-D92, and the corresponding volumes are in cells E78-E92. The editorial pound rate in the settlement is \$0.19. The pounds of editorial are in cells D28-D37 on sheet ‘Pound

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

Data\_Ed'. If the editorial pounds are distributed to the zones on the advertising pounds, and then multiplied by the difference between the advertising rate and the editorial rate, and summed, the result is a leakage of \$214.3 million, which is 47.2 percent of the \$453.6 million shortage (cell F72) behind the 23.8-cent figure.

It is not entirely clear to me how to go about tracing the non-distance-related transportation costs, shown in cell C43 to be 2.4 cents per pound. They are in the first-cut advertising pound rates, and since the editorial pound rate is 77.8 percent of the zones 1&2 rate, one could argue that 22.2 percent of 2.4 cents (=0.53 cents) times the editorial pounds is a revenue leakage of \$13.0 million that is due to the non-distance-related transportation costs and is already part of the \$214.3 million.

The markup on Outside County Periodicals is \$33.3 million (Appendix G, Opinion, Docket No. R2001-1). If 40 percent of this comes from the pound rates, the markup on the pound rates is \$13.3 million, which is 0.31 cents per pound. This is 2.9 percent of the \$453.6 million. Applying the 22.2-percent figure suggests a leakage of 0.07 cents per editorial pound due to markup, which is \$1.68 million. This too is already part of the \$214.3 million.

The per-pound portion of the DADC, DSCF, and DDU discounts for advertising resulted in a leakage of \$15.2 million (the discounts in C47-C49 times the volumes in cells C4-C6). This is 3.5 percent of the \$453.6 million.

Based on this reasoning, the remaining 46.4 percent ( $100 - 47.2 - 2.9 - 3.5$ ) of the \$453.5 million, and therefore of the 23.8-cent figure, is for non-transportation costs recovered in the pound rates, by virtue of the decision to obtain 40 percent of the revenue from the pound rates.

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

(b) All of the 23.8 cents is included in all of the pound rates in all of the zones, including DADC, DSCF, and DDU.

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

**MH/TW et al.-T1-12:** With reference to your testimony at page 40 lines 3-7 that an additional amount (some undefined portion of 23.8 cents per pound) is incorporated in each of the current zoned advertising pound charges to recover the revenue leakage associated with the unzoned editorial pound charge:

(a) Please confirm that a Periodical comprised of 100% editorial content would not pay any portion of such additional amount, regardless if it were mailed a relatively short distance or a relatively long distance. If you are unable to confirm, please explain fully.

(b) Please confirm that only a Periodical comprised of 100% advertising content would pay such additional amount in full, and would do so regardless of the distance it was mailed. If you are unable to confirm, please explain fully.

(c) Please confirm that under the Domestic Mail Classification Schedule (e.g., sections 412.4 and 413.3), Periodicals are generally required to have no more than 75% advertising content. If you are unable to confirm, please explain fully.

(d) Please confirm that a Periodical mailed from zone 8, and containing 60% advertising content, would pay more – 50% more – of the referenced additional amount than a Periodical mailed from zone 1&2 and containing 60% editorial content, assuming that each Periodical mailed the same number of pounds. If you are unable to confirm, please explain fully.

(e) Please confirm that a Periodical mailed from zone 8 will always pay more of such additional amount for each pound mailed than will a Periodical mailed from zone 1&2 so long as the Periodical mailed from zone 8 contains a higher percentage of advertising content than the Periodical mailed from zone 1&2. If you are unable to confirm, please explain fully.

(f) Please confirm that Periodicals with identical percentages of advertising content will always pay an identical portion of such additional amount for each pound mailed, regardless of whether such a Periodical is mailed from zone 8 or zone 1&2. If you are unable to confirm, please explain fully.

(g) Please confirm that the extent to which a Periodicals mailer pays an additional amount to recover the revenue leakage associated with the unzoned editorial pound charge is determined solely by the number of advertising pounds mailed by the Periodical, and not by the distance mailed (with the possible exception that the advertising pound charge for short hauls such as DDU entry may not contain any such additional amount at all). If you are unable to confirm, please explain fully.

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

### RESPONSE

(a) Not confirmed. The 23.8-cent figure is added to all pound rates before the editorial pound rate is calculated.

(b) Confirmed, but only because you specified “in full.” A periodical with 70 percent advertising, for example, would pay it *in full* on 70 percent of its weight and *in part* on 30 percent of its weight.

(c) Not Confirmed. General publications, but not requester publications, may not have advertising in excess of 75 percent in more than one-half of their issues during any 12-month period.

(d) Not Confirmed. Since the editorial rate is 77.8 percent of the zones 1&2 advertising rate, one could argue that the zone-8 piece pays the full 23.8 on 60 percent of its weight and 77.8 percent of 23.8 on 40 percent of its weight, for a total of 21.69 cents per pound. The zones 1&2-piece would pay the full 23.8 on 40 percent of its weight and 77.8 percent of 23.8 on 60 percent of its weight, for a total of 20.63 cents per pound.

(e) Based on the allocation scheme outlined in my answer to part “d” of your question, confirmed, but only because the zone-8 publication is specified to have more advertising than the zones 1&2 publication, not because it goes further.

(f) Confirmed.

(g) Not confirmed. See my response to part “d” of your question. But, however viewed, the exception you suggest for short hauls is not needed.

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

**MH/TW et al.-T1-13:** With regard to your testimony at page 37 lines 19-21 that the proposed rate structure “does not favor some (longer-distance) editorial matter over other (shorter distance) editorial matter”, please confirm that under the current rate structure, (a) all editorial matter pays the same flat pound charge (or, for DDU entry, a lower charge), (b) no editorial matter pays any additional amount to recover for revenue leakage associated with the flat editorial pound charge, (c) only advertising matter pays such an additional amount, and (d) it does so without regard to the distance that it is mailed (with the possible exception that the advertising pound charge for short hauls such as DDU entry may not contain any such additional amount at all). If you are unable to confirm, please explain fully.

### RESPONSE

(a) Not confirmed. I see no pound rate difference for DDU entry.

(b) Not confirmed. See my response to MH/TW et al.-T1-12.

(c) Not confirmed. See my response to MH/TW et al.-T1-12.

(d) Not confirmed, with or without the possible exception you note, specifically because part “d” is introduced with an “and” that follows from part “c.”

## **Response of TW et al. Witness Mitchell to MH/TW et al-T1-14**

**MH/TW et al.-T1-14:** Referring to your testimony at page 23 lines 17-22 that so-called “Camp 1” local and regional publications “have short hauls and relatively high cost coverages” while so-called “Camp 2” local and regional publications “have a substantial haul and relatively low cost coverages,” please confirm that a “Camp 1” publication with a high editorial percentage may have a cost coverage that is below 100%, and lower than the cost coverage of a “Camp 2” publication with a high advertising percentage. If you are unable to confirm, please explain fully.

### **RESPONSE**

Not confirmed, based on my assumption in the paragraph beginning on line 4 of the same page of my testimony that all local and regional publications have an average proportion of advertising. I understand that average cost coverages vary with the proportion of advertising, which is a different effect from the one discussed in the section to which you refer. It is important to keep effects separate.

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

**MH/TW et al.-T1-15:** Referring to your testimony at page 24 lines 12-14 that “[t]hose who decide to print locally should not be required to pay elevated postal rates to help support publishers who make different decisions or who mail more broadly,” (a) please explain whether your reference to publications printed locally was intended to include only so-called “Camp 1” local and regional publications, and not national publications that have the ability to print in multiple locations, and if so please explain the distinction; (b) please confirm publications printed locally pay no more per pound, if they pay anything at all, to support publishers who mail more broadly than do any other publications that have the same percentage of advertising content. If you are unable to confirm, please explain fully.

### RESPONSE

(a) My Camp 1 does not include “national publications that have the ability to print in multiple locations.” Subject discussion is intended to focus the characteristics and the fairness of a particular situation that really does exist. This does not mean that it does not have spillover implications for other situations. I agree that a national publication printing in more than one location does have some Camp-1 characteristics, partly in the sense that its cost coverage would be high and partly in the sense that it could decide to print some distance from one of its destination areas if the costs were lower. In doing this, however, it might in effect be relinquishing one of its multiple locations.

(b) On a per-pound basis, confirmed, but they see none of this payment returned to themselves by virtue of their having some higher-zone mail.

## Response of TW et al. Witness Mitchell to MH/TW et al-T1-16

**MH/TW et al.-T1-16:** With reference to your testimony at page 25 lines 6-9 that “[p]ublications whose subscribers are concentrated in limited geographic areas .... are not part of some kind of continuum that warrants averaging for rate purposes:”

- (a) Please state whether you believe that separate subclass status may be warranted for such publications, and explain your answer;
- (b) Please confirm that under established law and practice, the rate design for a single subclass may properly include a range of varying cost coverages, including cost coverages below 100% so long as the subclass as a whole recovers its costs. If you do not confirm, please explain fully.
- (c) Please confirm that the current pound-oriented editorial benefit for outside county Periodicals depends upon where a mailer falls on the continuum of editorial percentages and on the continuum of distance mailed. If you do not confirm, please explain fully.
- (d) Please confirm that local and regional publications do not constitute a distinct group in this regard inasmuch as “Camp 2” local and regional publications may be printed at some distance from their delivery area, while national publications may have shorter hauls to many delivery areas due to their ability to print in multiple locations and to engage in dropshipping. If you do not confirm, please explain fully.
- (e) Please confirm that the extent, if any, to which a mailer helps pay for the revenue leakage associated with the current flat editorial pound charge depends only (or at least primarily) on where the mailer falls on the continuum of advertising percentages. If you do not confirm, please explain fully.
- (f) Please confirm that the revenue leakage associated with the current flat editorial pound charge is recovered in a manner that reflects cost averaging for rate purposes, i.e., solely from a uniform component of each of the zoned advertising rates (with the possible exception that the advertising rates for short hauls such as DDU entry may not contain any such component). If you do not confirm, please explain fully.

## RESPONSE

(a) In general, no, because important cost differences can be properly recognized within a single subclass, in line with the instant Complaint. It is interesting to think, however, as discussed on page 53 of my testimony, beginning on line 10, about the effect a separate subclass has had on In-County mailers.

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(b) Confirmed in the sense that such is sometimes done and has not, to my knowledge, been held to be illegal, but not in the sense that it generally qualifies as good rate setting. Usually, it does not. My testimony discussing why the proposed rates are more appropriate than the current ones is in agreement with the Commission's statement that: "The Commission begins the rate design process assuming equal implicit markups. This is a neutral starting position which seems to be implied by § 3622(b)(1), a fair and equitable schedule." PRC, Opinion, R2000-1, p. 390, ¶5533. However, note that, in line with the recognition of ECSI value and consistent with the rates now in effect and current Commission practice, the proposed rates involve a coverage on editorial matter that is below 100 percent and a coverage on advertising matter that is above 100 percent. See also my response to ABM/TW et al.-T1-15.

(c) Confirmed. The way distance is recognized is one of the deficiencies in the current rates, as explained in my testimony.

(d) Not confirmed. Your question hinges on the words "in this regard," and I do understand the regard to which you refer. The existence of the nationals has nothing to do with the constitution of Camp-2 publishers.

(e) Not confirmed. First, it would appear to depend also on the weight of the publication. Second, it is not clear that your statement allows for the fact that editorial also helps pay for its own editorial benefit, as explained further in my response to MH/TW et al.-T1-12, section d.

(f) Not confirmed. I do not understand cost averaging to have anything to do with placing uniform burdens from non-cost sources on rate payers. It is true that the leakage is recovered with a per-pound charge on advertising, as well as on editorial, though at a lower level, that is uniform across zones, even without the exception you

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note. This is also true of the rates being proposed. The instant Complaint does not focus on the way the leakage (which level is not changed) is recovered, but on the skewed way in which the leakage amount is given to mailers, with attendant degrees of unfairness, poor signals, and little encouragement for economic efficiency.

## Response of TW et al. Witness Mitchell to MH/TW et al-T1-17

**MH/TW et al.-T1-17:** Referring to your testimony at page 53 lines 15-20 that “the rate for DSCF-entered In-County publications is an at cost-rate,” and that “if Outside County rates were cost based, the rate for DSCF entered Outside County pieces would be near the corresponding In-County rate,” but that “the Outside County rate is in the neighborhood of twice the In-County rate:”

(a) Please confirm that the current rate structure for Within County Periodicals contains only two pound charges: a “Delivery Unit” charge of 11.2 cents per pound and an “All Other Zones” charge of 14.6 cents per pound. If you do not confirm, please explain fully.

(b) Please explain what you are referring to when you refer to “the rate for DSCF entered In-County publications.”

(c) Please explain what you are referring to when you refer to an In-County rate corresponding to the rate for DSCF entered Outside County pieces (20.3 cents per pound) that is “in the neighborhood of twice the In-County rate.”

(d) Please specify and quantify each of the cost components that make up each of the two pound charges for Within County Periodicals, e.g., distance-related transportation costs, non-distance-related transportation costs, distance-related non-transportation costs, non-distance-related non-transportation costs, mark-up for institutional costs, etc. If necessary, please provide your best estimate. Please specify the precise source for you answers, and explain any necessary calculations.

(e) Please address whether the assumed fact that the DSCF pound charge for Outside County Periodicals is substantially higher than the “corresponding In-County rate” could be explained by a combination of such factors as those referred to you at page 13 lines 9-11 and 15-17 of your testimony (various pound-oriented savings or portions thereof reflected in piece discounts for Outside County Periodicals), by the lower mark-up for Within County Periodicals, by the effect of changes in mail volume on the unit costs of transportation, and/or any other potentially relevant factors.

## RESPONSE

(a) Confirmed.

(b) If an In-County publication enters qualifying mail in a DSCF, it pays the pound charge for “All Other Zones.” It is true, of course, that an SCF could be the delivery unit for some of the mail in its area.

## **Response of TW et al. Witness Mitchell to MH/TW et al-T1-17**

(c) A number of comparisons can be made. I did not develop a weighted average. Suppose one considers a barcoded flat in a 5-digit bundle entered at a facility qualifying as a DSCF. If the piece qualifies only for the Outside County rates, it pays 20.3 cents per advertising pound plus 19.3 cents per editorial pound plus 22.6 cents per piece minus the per-piece DSCF discount of 0.8 cents minus the per-piece editorial discount minus any pallet discount. If the same piece qualifies for the In-County rates, it pays 14.6 cents per pound plus 6.7 cents per piece. The primary pound rates, 20.3 and 19.3 cents for the Outside County piece are clearly much higher than the 14.6 cents paid by the In-County piece. The piece rate before any adjustments for the Outside County piece, 22.6 cents, is substantially higher than the 6.7 cents paid by the In-County piece. My statement merely means that once total per-piece postages are calculated, the charge for Outside County is often in the neighborhood of twice the corresponding In-County charge. The exact proportions are unimportant. The question is: since the Outside County rate schedule has numerous rate elements designed to recognize the costs of the mailing, both schedules have markups approximating zero, and the In-County schedule is even more clearly at cost (having a much greater degree of uniformity), why does the Outside County piece pay so much more? It must be because something is wrong with the Outside County rate schedule.

(d) PRC Library Reference 9, Docket No. R2001-1, contains a workbook that develops the In-County rates. Based more on continuity with the past than on a cost study, it gets 40 percent of the revenue requirement (the CRA cost times the contingency times the cost coverage), adjusted for fees and Ride-Along revenue, from the pound rates. No transportation costs are used, whether distance-related or not. No non-transportation costs are specified to be pound-related. The pound rate is set to obtain the desired revenue, with a difference between the DDU rate and the

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all-other of 3.4 cents per pound. Letting  $R$  = the all-other pound rate, it simply solves an equation in which  $R * \text{all-other pounds} + (R - 3.4) * \text{DDU pounds} =$  desired revenue. The 3.4-cent figure is the sum of two components. The first is a 35 percent passthrough applied to the per-pound non-transportation savings between the DSCF and the DDU for Outside County Periodicals. The second is an 82 percent passthrough applied to the 2.4 cent per-pound non-distance-related transportation cost of Outside County Periodicals.

(e) The problems that I discuss on page 13 are too small to explain the large differences in question, and they go primarily to relationships between somewhat similar publications instead of to averages. The markups are both so low that they cause almost no effect. The transportation costs that receive so much attention in Outside County Periodicals are long-haul, segment 14 transportation costs that are unimportant in In-County. Also, to the extent that the variability of transportation costs has been measured correctly, the unit costs would not change much with volume.

A well-researched and defensible explanation for the difference referred to in your question does not exist. My guess would be that at least three factors are important.

(1) The offices through which In-County periodicals are handled may tend to be smaller offices than for Outside County and these offices may perform simple and quick operations to get the periodicals on their way. (2) Outside County periodicals may be picking up excess costs in the costing systems, different from those that should be associated with tight, streamlined operations. (3) The Outside County rates are still far from cost-based and the markup on destination-entered periodicals is extremely high. The complainants believe that their proposal will take a first step in dealing with factor number three.

**MH/TW et al.-T1-18:** Referring to your testimony at page 53 lines 22-23 that “higher zone periodicals have rates that are substantially below costs:”

(a) Please confirm that this assertion depends on the percentages of advertising and editorial content of higher zone Periodicals. If you do not confirm, please explain fully.

(b) Please confirm that under your proposed rate structure, as under the current rate structure, a 100% editorial publication could have a cost coverage of approximately 85% -- substantially below costs. If you do not confirm, please explain fully.

## **RESPONSE**

(a) Paraphrased and stylized, the lines you cite say: If In-County is lower-zone and at cost, and if the lower-zone portion of Outside County has rates that are much higher than the corresponding In-County rates, and further if the Outside County rates as a whole are at cost, then the higher-zone portion of Outside County must be well above costs. My statement is more of an implication than an assertion, although I don't see how it cannot be true. Usually, unless the issue being discussed concerns the level and structure of the editorial benefit, I discuss tendencies for pieces with an average degree of advertising content. This allows cost coverages and per-piece markups within the subclass to be compared with those of the subclass itself. You are correct, of course, that the implicit cost coverages of pieces in the higher zones are affected by the advertising content, as is true for all pieces.

(b) Confirmed. The proposed rates do not change the level of the benefit given to editorial content and do not change the average cost coverages of editorial and advertising matter.