

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

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POSTAL RATE AND FEE CHANGES, 2006

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: Docket No. R2006-1  
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RESPONSES OF TIME WARNER INC.  
WITNESS MITCHELL (TW-T-1) TO INTERROGATORIES  
OF UNITED STATES POSTAL SERVICE (USPS/TW-T1-1-2)  
(October 18, 2006)

Time Warner Inc. (Time Warner) hereby provides the responses of witness Robert W. Mitchell (TW-T-1) to Postal Service interrogatories USPS/TW-T1-1-2 (filed October 4, 2006).

Each interrogatory is stated verbatim and followed by the response.

Respectfully submitted,

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**RESPONSES OF WITNESS MITCHELL (TW-T-1) TO  
INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE**

**USPS/TW-T1-1.**

Please refer to your testimony at pages 2-3, where you update a Docket No. C2004-1 comparison of the CPI-U to an index of Periodicals rates (at constant markup index).

- a. Please confirm that, in response to TW et al./USPS-RT2-7 in Docket No. C2004-1 (Tr. 6/2185-90), witness Tang presented the drawbacks of comparing the CPI-U index to your “index of Periodicals rates, at a constant markup index.”
- b. Please refer to Postal Service witness Tang's response to TW et al./USPS-RT2-7. Do you agree that since 1985 significant structural changes have occurred in rate design and mail mixes? If not, please explain fully.
- c. Do you agree that since 1985, there have been large changes in worksharing opportunities and productivity investments? If not, please explain fully.
- d. Please refer to Postal Service witness Tang's response to TW et al./USPS-RT2-7, especially Tables 1, 2 and 3. How does a constant markup index recognize the significant structural changes that have occurred in Periodicals rate design and mail mixes, and the large changes in worksharing opportunities and productivity investments?
- e. When there have been large changes in relative costs within Periodicals rate categories, is it useful to examine other measures, such as unit contribution, as well as markup or cost coverage? If not, please explain fully.

**RESPONSE:**

- a. I agree that witness Tang responded to interrogatory TW et al./USPS-RT2-7 in Docket No. C2004-1, but, for the following reasons, I do *not* agree that what her response presented is properly characterized as “drawbacks” to my analysis.

(1) Tang's response states that her testimony on my CPIU comparison "point[ed] out that one way to look at the changes in Periodicals rates over the past two decades is to look at the price of an average Periodicals piece," by which she means the *postage* of an average Periodicals piece, which is commonly referred to as the average per-piece revenue (herein shortened to per-piece revenue). Her suggestion is fundamentally misguided. The ratio of revenue to an output measure like the number of pieces is not a rate and cannot be used to construct a rate index.<sup>1</sup> It is true that an increase (decrease) in rates would increase (decrease) the per-piece revenue, *ceteris paribus*. But there are other factors as well that affect the per-piece revenue, factors that have nothing to do with the average level of rates. That such factors might explain much of the behavior of the per-piece revenue is more than just a theoretical possibility; some of these other factors have changed substantially. In particular, there have been increases in activities like presorting, prebarcoding, walk sequencing, co-mailing, palletizing, co-palletizing, and dropshipping, all of which would decrease the per-piece revenue but none of which implies a change in any rate or in the average level of rates. In addition, the per-piece revenue is affected by changes in piece weight, the proportion of letters to flats, and the sending of Ride-Along pieces.

Tang's reliance on an inappropriate measure pervades her response. In every table and every explanation, she focuses on per-piece revenue and jumps to

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<sup>1</sup> The construction of price indexes is closely related to the development of output and productivity measures, on which a considerable literature exists. Specifically, a revenue index divided by a *quantity weighted* output index is a price index, and a revenue index divided by a price index is an output index of the kind needed as the numerator of productivity measures. The Postal Service deals with these issues properly in its *total factor productivity* (TFP) indexes. See Dianne C. Christensen, Laurits R. Christensen, Charles E. Guy, and Donald J. O'Hara, "U,S, Postal Service Productivity: Measurement and Performance," pp. 237-259, in *Regulation and the Nature of Postal and Delivery Services*, edited by Michael A. Crew and Paul R. Kleindorfer, 1993, Kluwer. See also John W. Kendrick, *Productivity Trends in the United States*, A Study by the National Bureau of Economic Research, 1961, Princeton Press. In his volume testimony, Postal Service witness Thress develops appropriate price indexes. See USPS-T-7, p. 17, beginning on line 16. See also Thress's price indexes, USPS-LR-L-63, file Prices.xls, which shows in considerable detail the development of his indexes.

conclusions about rates. Such a transgression of logic is particularly affronting in this situation because most or all of the mailer activities influential in determining the per-piece revenues are performed at considerable cost to the mailers involved. Mailers incur the costs of both the worksharing activities and the higher postal rates, and the Postal Service tells them not to be concerned, because the total amount they are paying in postage has not increased all that much.

(2) According to Tang, “[i]mplicit in Mitchell’s comparison ... is the idea that Periodicals subclasses either would or should have maintained the same markup index over approximately a two-decade period.” To the contrary, I have made no such assumption at any time, implicit or otherwise. In order to separate rate changes due to cost changes (the subject that I was addressing) from rate changes due to markup changes (a subject that I was not addressing), and for this reason only, my analysis develops rates *as if* the markup index had been unchanged.

(3) Tang then provides a gratuitous assessment of the merits of maintaining a constant markup index, and in so doing fails to respect or even acknowledge the logic underlying the index and the Commission’s introduction of it. For example, she observes that a product that has large increases in worksharing relative to other subclasses, so that the Postal Service’s costs for it decline substantially, would see rates with a smaller per-piece contribution the next time rates are set, and that some other product might accordingly receive a larger price increase than it otherwise would. She says that such outcomes are “neither reasonable nor sound” and “show convincingly that it is neither reasonable nor appropriate to *assume* that constant markup indexes would or

should be used as an element in developing product prices.”<sup>2</sup> She does not acknowledge that the outcome she condemns is a natural consequence of setting economically efficient rates, a normal and expected result of competitive forces, that it can easily be caused by other factors as well (such as a volume decline of another product), and that it is consistent with broadly accepted notions of equity. The reason the Commission adopted the practice of using markup indexes is that they provide a valuable reference point, particularly for comparing contribution burdens over time. The indexes should not be written off in such a peremptory way.

b. Yes. Note that I discuss certain of the “significant structural changes ... in rate design” on page 3 of my testimony and that the effect of these changes is to make the relationship between Periodicals rates and the CPIU all the more troubling, not less.

c. Yes as to worksharing opportunities. I am not certain what you mean by “productivity investments,” but if you mean capital investments by the Postal Service in mail-processing technologies, the answer is also yes.

d. Please see item number 3 in my response to part a of this interrogatory.

e. Changes in “relative costs” would involve such developments as transportation costs having declined (increased) relative to sorting costs, sorting costs having declined (increased) relative to mail handling costs, and delivery costs having declined (increased) relative to sorting costs, and so on. I do not know how

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<sup>2</sup> Compare PRC Op. R90-1 (January 4, 1991), at IV-4:

We measure relative burdens with a markup index, which compares the markup for each subclass with the systemwide average markup. . . . We find this measure particularly valuable because it allows us to compare relative burdens from case to case, while case to case comparisons of cost coverages or unit contributions are made misleading by variations in the amount of total and attributable dollars involved.

relative costs have changed. Whatever has happened to them, no adjustments in ratesetting principles should be needed.

**RESPONSES OF TIME WARNER WITNESS MITCHELL (TW-T-1) TO  
INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE**

**USPS/TW-T1-2.**

Please refer to your testimony at page 17, lines 17 – 20, where you express concern about the container rate causing “mailers of 5-digit pallets to merge them into larger 3-digit pallets in order to reduce the container charges. . . .”

- a. Please confirm that the container rate proposed by the Postal service is \$0.85. If you do not confirm, please explain.
- b. Please confirm that the proposed 3-digit automation flat per-piece rate is \$0.327. If you do not confirm, please explain.
- c. Please confirm that the proposed 5-digit automation flat per-piece rate is \$0.255. If you do not confirm, please explain.
- d. Would the differential between the 3-digit and 5-digit piece rates tend to discourage the conversion of 5-digit pallets to 3-digit pallets? If not, please explain.
- e. Do you believe that mailers deciding whether to merge 5-digit pallets into larger 3-digit pallets should consider the impact on the piece rates that result, as well as the container rate? If not, please explain fully.

**RESPONSE:**

- a. Confirmed.
- b. Confirmed.
- c. Confirmed.
- d. No. When 5-digit pallets are merged to create 3-digit pallets, neither the bundles nor the presort levels of the pieces in the bundles are affected. Therefore, the piece rates cited in parts b and c of this question are irrelevant.

e. I believe that all such factors, including the handling costs of the bundles and the containers, which vary by entry point and container makeup, should be considered by mailers when they make mailing decisions. A primary reason supporting the rates I propose is that virtually none of these comparisons can be made under the current rates or the rates proposed by the Postal Service. However, the particular comparisons you suggest are irrelevant to the mailing decision to which your question has reference.