

OFFICIAL TRANSCRIPT OF PROCEEDINGS BEFORE THE POSTAL REGULATORY COMMISSION

In the Matter of:)
)
RATE ADJUSTMENT DUE TO) Docket No. R2013-11
EXTRAORDINARY OR EXCEPTIONAL)
CIRCUMSTANCES)

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C O N T E N T S

WITNESSES APPEARING:
ALTAU TAUFIQUE
THOMAS E. THRESS

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P R O C E E D I N G S

(9:30 a.m.)

CHAIRMAN GOLDWAY: Good morning, ladies and gentlemen. This hearing will come to order. For the record, my name is Ruth Goldway. I'm chairman of the Postal Regulatory Commission, and I am also the presiding officer in this proceeding. With me on the dais this morning are Vice Chairman Taub to my right and Commissioners Langley to my right also and Commissioner Acton to my left.

This is an unusual proceeding for us, only the second time we have contemplated a request of this nature from the Postal Service, and it is an important process, one that is going to have a great impact on the mailing community. I simply want to comment that my efforts in the proceedings this morning are to be thorough, careful and perhaps slower than we might be otherwise to make sure that we consider all of the potential questions that arise as we discuss these matters.

I'm always pleased and proud to be with my colleagues and to represent the staff, who have worked very hard on analyzing the presentations and suggesting approaches for the Commissioners to take as we review the matter.

1 At this point I'd like my colleagues, if
2 they'd like to say anything, to say anything.

3 (No response.)

4 CHAIRMAN GOLDWAY: Not at all? Then before
5 proceeding further I want to remind all of you in
6 attendance this morning to please turn off your cell
7 phones, BlackBerrys, iPods or other personal
8 communication devices. When in operation, these
9 devices interfere with the overhead microphones and
10 the hearing room audio system. Muting your
11 communication device is not enough. It must be turned
12 off to avoid electrical interference. Thank you for
13 your cooperation.

14 Today's hearing is being held in Docket No.
15 R2013-11. It involves the Postal Service's request
16 for authority to increase rates for market dominant
17 products in excess of otherwise applicable
18 limitations.

19 The PAEA authorizes such rate adjustments
20 "due to either extraordinary or exceptional
21 circumstances" so long as "such adjustment is
22 reasonable and equitable and necessary to enable the
23 Postal Service under best practices of honest,
24 efficient and economical management to maintain and
25 continue the development of postal service of the kind

1 and quality adapted to the needs of the United
2 States." This language is general and provides for a
3 range of judgment, and we will be exercising our best
4 efforts to find agreed upon values for this language.

5 The background of today's hearing can be
6 briefly summarized as follows: On September 26, 2013,
7 the Postal Service filed its rate request. On
8 September 30, 2013, the Commission issued its Order
9 No. 1847 establishing this docket and the procedures
10 to be followed. On October 17, 2013, a Presiding
11 Officer Ruling was issued that revised the schedule to
12 be followed in this case due to the Commission's
13 suspension of activities associated with the lapse in
14 appropriations.

15 The Commission has now held three technical
16 conferences on October 24, 31 and November 1, 2013, to
17 discuss and clarify technical aspects of the
18 September 26, filing. Hearings are scheduled for
19 today, November 19, and for tomorrow, November 20, in
20 order to permit the Commissioners to question three
21 Postal Service representatives that filed statements
22 supporting the Postal Service's rate request.

23 Today the Postal Service is presenting Altaf
24 Taufique and Thomas E. Thress -- is it Thress or
25 Thress?

1 MALE VOICE: Thress.

2 CHAIRMAN GOLDWAY: Thress. -- for
3 questioning. Tomorrow we will hear from Stephen
4 Nickerson.

5 While these are the only hearings currently
6 anticipated, it is at least possible that we will need
7 to hear from additional Postal Service representatives
8 because of the information developed during these two
9 days of hearings or to explain or supplement Postal
10 Service responses to outstanding followup information
11 requests. If so, we shall deal with any such need
12 when it arises. In that connection, Rule 65 of the
13 Commission's rules applicable to this type of rate
14 proceeding authorize the Commission to require
15 supplementary written responses following the
16 hearings.

17 Now, this type of proceeding is very
18 different from the Commission's N case proceedings or
19 those rate proceedings conducted prior to the
20 enactment of the PAEA. For exigent rate case
21 proceedings such as this one, the Commission is
22 required to conduct a hearing, but not a formal trial
23 type hearing under the formal rulemaking or
24 adjudication provisions of the Administrative
25 Procedures Act, 5 U.S.C. §§ 556 and 557.

1 In the exigent rate cases, interested
2 persons do not have the opportunity to cross-examine
3 Postal Service representatives. They have,
4 nevertheless, been afforded the opportunity to suggest
5 questions to the Commission. A number of groups and
6 entities have filed such suggested questions. I and
7 my fellow Commissioners appreciate the effort that has
8 gone into the preparation of these questions, and we
9 want to thank those who have filed proposed questions.

10 I know that some of those questions will be
11 asked during today's and tomorrow's hearings. Some
12 have already been asked in POIRs. We have determined
13 that some of those questions are more likely to elicit
14 meaningful responses if presented in the form of
15 written information requests. Therefore, additional
16 Presiding Officer Information Requests will include
17 some suggested questions, as well as followup
18 questions from these hearings.

19 In making our decision on the merits of the
20 Postal Service request, all of the information that we
21 learn from the questioning at these hearings will be
22 considered, along with the statements, library
23 references, responses to Presiding Office Information
24 Requests, comments and other pleadings and supporting
25 information filed in this docket.

1 Does any participant have a procedure matter
2 to discuss before we begin?

3 (No response.)

4 CHAIRMAN GOLDWAY: If not, then, Mr.
5 Kettering, Postal Service counsel, will you identify
6 the first Postal Service representative so that I can
7 swear him in?

8 MR. RUBIN: Actually it will be David Rubin
9 for the Postal Service, and I am calling Altaf
10 Taufique as the first Postal Service witness.

11 CHAIRMAN GOLDWAY: Would you please stand?
12 Whereupon,

13 ALTAF TAUFIQUE

14 having been duly sworn, was called as a
15 witness and was examined and testified as follows:

16 CHAIRMAN GOLDWAY: Thank you. You may be
17 seated.

18 As I previously mentioned, there's no need
19 to formally accept statements and responses to the
20 information requests into the record. They're already
21 part of our administrative record in this proceeding.
22 However, I do want to remind counsel that there is a
23 continuing obligation to update and correct these
24 materials.

25 So we are now ready for questions from the

1 Commission based on your library references, your
2 statements and your responses to the Presiding Officer
3 Information Requests. Are there questions for Mr.
4 Taufique from the Commissioners? Commissioner Taub,
5 would you like to begin?

6 EXAMINATION

7 BY VICE CHAIRMAN TAUB:

8 Q Good morning, Mr. Taufique.

9 A Good morning.

10 Q Appreciate your responsiveness to the
11 Presiding Officer Information Requests and the
12 statements provided. I just wanted to explore a few
13 things that you had mentioned and maybe after my
14 fellow colleagues ask some questions may have some
15 followup on another round, shall we say.

16 Is it a correct interpretation of how I
17 interpret what's presented that the assertion is this
18 is a reasonable request in that there's only
19 \$1.78 billion annually being requested; that it could
20 have been higher, but the Postal Service in its
21 judgment is viewing this as reasonable in that regard?
22 Is that a fair characterization? And if so, maybe you
23 could elaborate on it a bit, or am I missing something
24 there?

25 A My understanding is the harm caused by the

1 great recession was significantly larger, the
2 financial harm, than what we've asked for. So
3 especially in terms of asking for the exigent price
4 increase, there were a number of factors that were
5 considered in terms of financial need of the Postal
6 Service, the impact on customers, different classes of
7 mail, how they would be impacted.

8 So given all of those factors, it was deemed
9 reasonable that we would ask for a 4.3 percent, a
10 smaller increase than what would be warranted by the
11 overall damage, the financial damage that was caused
12 by the great recession.

13 Q The other aspect that I had read in your
14 statement was there's a concern of balancing that,
15 recognizing the mailers are facing a slow recovery as
16 well and trying to limit the impact on them. Could
17 you elaborate a little bit on that concern?

18 A As we know, the recovery of the economy is
19 continuing, but it's a slower pace than the fast
20 recession that we've had, so keeping that in mind and
21 keeping the fact and keeping in mind that the
22 customers were also facing a bad economy in their
23 businesses, it was deemed reasonable that we did not
24 ask for the total amount of the damage that was done
25 by the great recession.

1 Q The statement talks of the governors have
2 made a decision that they're only looking for -- I'm
3 going to give you away, Steve; our general counsel
4 described it -- a peanut butter approach of just
5 smearing the 4.3 percent across the board above the
6 CPI and that the governors, the testimony indicates a
7 concern regarding volume losses, which could be
8 triggered by even a larger increase.

9 Do you have a sense of what that magnitude
10 might be? You know, where was the dividing line of
11 saying volume losses triggered at some level would be
12 even larger if we went beyond 4.3 percent or
13 \$1.78 billion on the total?

14 A The experts within the Postal Service who
15 deal with customer classes, deal with customers
16 themselves, their educated estimate was that overall a
17 6 percent increase -- that's what I've talked about in
18 my statement also -- would be the maximum that we
19 could do at this point in time.

20 In fact, the whole process of filing an
21 exigent case was not an easy thing for the Postal
22 Service because we're looking at the customers and the
23 impact of increased prices on our customers. So this
24 was not the most desirable option. We would have
25 options if those are possible. We would have

1 preferred those options.

2 So given the fact the legislative changes
3 were not coming forth, the decision was made that a
4 reasonable increase of 4.3 percent above CPI spread
5 equally among all the mailers would meet the needs of
6 the Postal Service and not the customers
7 significantly.

8 Q I appreciate that. To pick up on that point
9 of spreading the results across all the mailers, the
10 testimony submitted cites in terms of the explanations
11 and the compliance with the law.

12 One of the Commission's rules when it comes
13 to the filing of the exigent rate cases, specifically
14 3010-61(a)(3), and I'm not looking for you to recall
15 that, but it's requiring the justification for the
16 extraordinary and exceptional events and equally
17 requiring that the Postal Service explain both in
18 essence the due to nature, the how what is being
19 sought from an overall, in this case the
20 \$1.78 billion, relates to those events, but also how
21 the specific rate increases proposed relate to dealing
22 with the event itself.

23 As I hear what you're saying and reading the
24 material, the 4.3 percent is intended to say there's
25 this large event of the great recession that occurred,

1 and a reasonable way to do that was to spread it
2 across everyone.

3 Would there be a different approach that
4 could be taken or should be taken, or would it be in
5 conflict with the large event being reasonable to more
6 precisely change certain rates as opposed to the
7 peanut butter approach, trying to more isolate, for
8 example, first class mail may have been affected to X
9 degree from the great recession versus standard mail
10 would be Y and that may mean that first class is
11 getting X percent increase that may be different than
12 standard mail, as an example, as opposed to the peanut
13 butter approach?

14 A So let me understand the question. Your
15 implication is that recession caused volume declines
16 differently in different classes of mail, so the
17 implication of your question I think, if I understand
18 it right, is we should have given a bigger increase to
19 first class mail. Is that the correct understanding?

20 Q I'm not suggesting that the Postal Service
21 should have done that. I'm just trying to explore the
22 idea that the governors have felt this 4.3 percent
23 across the board from everyone is a fair and
24 reasonable way to do that, and on its face I
25 understand that.

1 I'm also just trying to make sure, fully
2 explore the idea that did the Postal Service consider
3 alternative approaches to the 4.3 percent and, if so,
4 what might have they been to link it to the great
5 recession. If not, why not, and would it have been
6 reasonable to do it differently?

7 A First of all, my job in this whole process
8 was to design rates that would meet the requirement of
9 the law and that those were a reasonable and equitable
10 price increase as a reserve of -- so there are other
11 witnesses who will be more capable of talking about
12 the impact of the overall recession.

13 But coming back to the fact how we could
14 have done it differently besides, the other option
15 could have been that we would have increased the
16 prices based on causation, if first class mail caused
17 the bigger impact. That would be sort of like
18 punishing the survivors. I mean, the mail that has
19 been lost is already lost, and now we're looking at
20 the customers and volumes that are there in place.

21 We thought it was reasonable and equitable
22 to basically spread the burden equally among all the
23 classes of mail because at this point in time
24 everybody sort of benefits if the Postal Service
25 continues its operation, so everybody shares the

1 burden equally to keep the Postal Service in
2 operation.

3 Q I appreciate the answer. Thank you. In
4 that regard then, following along the perspective, is
5 that why, for example, worksharing discounts? We have
6 obviously situations where the pass-throughs are not
7 fully at the 100 percent level, and obviously the law
8 allows for justification so in the pending CPI case,
9 as in previous ones, the Postal Service may cite
10 certain statutory exemptions.

11 In terms of achieving what you described as
12 the reasonable market approach, the way I understand
13 the Postal Service's case was the attempt was we're
14 keeping things the same. The idea here is in the
15 exigency case we're not looking to rectify or
16 ameliorate or deal with whether it's workshare
17 discounts that aren't fully within the confines or
18 underwater products.

19 In essence it was saying look, the CPI case
20 was where we try to do those things. We're just
21 trying to keep things all the same. We're not here to
22 undertake efforts. Is that a correct understanding?
23 How would you characterize it? And if it is correct,
24 maybe you could elaborate a bit more on the Postal
25 Service's desire to do that.

1 A In this particular case we had the
2 opportunity --

3 CHAIRMAN GOLDWAY: Mr. Taufique, I've just
4 got a note. Could you bend your microphone a bit more
5 closely to you?

6 THE WITNESS: Sure.

7 CHAIRMAN GOLDWAY: Thanks.

8 THE WITNESS: Please ask me if I don't
9 understand. In this particular case, the Postal
10 Service had the opportunity of filing two separate
11 cases, a CPI case and an exigent case. We tried to
12 address the pass through issues, cost coverage issues
13 -- in fact, there's a couple of pages that I wrote on
14 the subject of how we at least made some progress on
15 the cost coverage issues in the CPI case.

16 So the goal was to address all of those
17 issues in the venue of a CPI case and keep the exigent
18 case clean, make it across the board, because the
19 whole idea is to get enough money for the Postal
20 Service to remain in operation, and other
21 controversial issues -- this is not a panacea for all
22 of the perceived ills in the various relationships, in
23 pass-throughs, in cost coverage issues.

24 But in the exigent case we were careful that
25 pass-throughs that were over 100 percent in the CPI

1 case, we made sure that they did not go further away
2 from 100 percent, but pass-throughs that were below
3 100 percent like in the case of five digit automation
4 letters and first class mail, the pass through was
5 probably 82 percent in the CPI case, in the exigent
6 case around 89 percent, so it actually improved. So
7 we made sure that there was no harm done to pass
8 through issues as a result of the exigent filing.

9 But pass-throughs have been sort of near and
10 dear to my heart because I deal with pass through
11 issues. We have made an effort. If you look at the
12 record from R2008-1 to R2013-1, I believe, we have
13 made significant progress in many pass through areas,
14 but one of the hurdles that we have faced is that cost
15 avoidances for good reasons because of the knowledge
16 just accrued by the Commission, new data being
17 introduced. The cost avoidances have fluctuated.

18 In fact, I could give you some examples if
19 you want to where it has been a challenge for us to
20 follow those cost avoidances and make our discounts
21 equal due to the cost avoidances. But what we have
22 done from my perspective, if you look at the history I
23 think we have made significant progress in the area of
24 pass-throughs.

25 It has never been our goal. I mean, except

1 for one bigger disagreement that we have between
2 single piece and presort mail where we did not agree
3 with the Commission that that should be linked in the
4 workshare relationship, in all other cases below that
5 we have tried to match the discounts to cost
6 avoidances to the best of our ability. Like I said,
7 in some cases there have been some significant
8 fluctuations in cost avoidances. And I'm not
9 criticizing the cost avoidance estimates because there
10 were changes in methodology approved by the
11 Commission, new data.

12 So our goal was essentially to address all
13 those issues in the CPI cases, and we have made
14 significant progress in terms of cost coverage.
15 Single piece parcels. Cost coverage was below 100
16 percent. We gave a significantly higher increase in
17 the CPI case. Standard mail flats. The Commission
18 directed us to do at least 5 percent above the CPI,
19 and we have done that in the CPI case. In fact, the
20 standard mail flats receive a higher increase, higher
21 than the average, in the exigent filing also.

22 So since we had two different cases
23 available we thought it was reasonable to address all
24 those issues in the CPI case and keep the exigent case
25 sort of a clean case where we try to raise money for

1 the operation of the Postal Service.

2 VICE CHAIRMAN TAUB: Appreciate that. So
3 the idea being exigency in the Postal Service's mind
4 was "clean" and those other issues were dealt with in
5 the CPI case. I have one more question following on
6 that and then I'll defer to my colleagues, but I'll
7 probably want to come back to some additional lines of
8 inquiry.

9 BY VICE CHAIRMAN TAUB:

10 Q Keeping it clean then, how would you respond
11 to the concern, for example, that there's certain
12 categories of the underwater products, particularly
13 standard mail, periodicals mail, where periodicals as
14 a class, a \$670 million loss just last year alone,
15 \$3 billion since '07. You look at the \$3 billion
16 since '07. The Postal Service is only asking for the
17 \$1.78 here, so there's a perspective that well geez,
18 if these products weren't so far under water in fact
19 maybe it would be wiping out the exigency request in
20 and of itself.

21 How do you respond to that concern, A, and,
22 B, maybe reiterating again why not deal with that here
23 in the exigency case?

24 A Two issues. First of all, in order for
25 periodicals to cover the cost, and if I'm not mistaken

1 there are people in the audience who can correct me if
2 I'm wrong, but it would require around a 20 percent
3 increase or more than 20 percent increase, and we do
4 not know what the implication of that increase would
5 be on the volume.

6 Our goal, at least since I've done pricing
7 at the Postal Service for the last 17 years, at least
8 in my case I have never priced to drive products out
9 of the mail stream. There have been instances where
10 we have done things to improve the preparation where
11 some volume had been lost, but any price increase the
12 volume is lost.

13 But that is not the primary focus that we
14 have, so a 20, 25 percent increase in periodicals, and
15 this is a class of mail that is actually valued in the
16 mailbox. There are folks who are looking forward to
17 receiving this piece of mail, and periodicals, being
18 all catalogs, do generate other mail. They generate
19 first class mail, standard mail, so all of those
20 things are being done at the same time.

21 And then we are in the case of standard mail
22 flats the Commission has asked us to do and we have
23 diligently followed that requirement of being
24 5 percent over the CPI. In periodicals we have tried
25 to provide better pricing signals for better

1 preparation to cut down the cost, and we think it's
2 sort of a balanced approach between costing and
3 pricing.

4 If we use pricing as a whole sort of
5 mechanism for solving these problems we will lose more
6 volume. Because we need all of the volume to survive
7 also, so we need to keep the volume and try to make it
8 profitable. That is the quote. So we thought that an
9 across the board increase would help in that area, and
10 then the CPI cases that we do, that you have done in
11 the past and in the future, we would gradually and
12 incrementally make those changes that would allow us
13 to make these products profitable for the Postal
14 Service.

15 But if you price mail out of the mail stream
16 we cannot make it profitable, so keeping it in the
17 mail stream is important and especially the mail that
18 is valued by the customers, by the recipients of the
19 mail and mail that generates other classes of mail
20 also. Did I answer the question?

21 Q Yes. Yes. That was helpful. I guess the
22 one followup on that would be again with the theory
23 the approach the Postal Service has taken then in the
24 governors' perspective a reasonable way of spreading
25 it across the board at 4.3 percent, to the extent then

1 that these issues of underwater, workshare are not
2 addressed is there a concern that the 4.3 percent
3 across the board amplifies any of the issues,
4 perceived inequities, problems as opposed to using the
5 case in a way to do that?

6 Not suggesting that again the Postal Service
7 should or should not have done that. I'm just trying
8 to make sure I have a good understanding of why the
9 Postal Service has chosen the path it has.

10 A And I would have to agree with you that
11 across the board increase, and we have done two of
12 those in the past back in R94-1 and then
13 R2005-1, but in most cases you've had the opportunity
14 to correct the relationships in the future CPI
15 filings. In the past there were omnibus cases.

16 So our goal would be that in the future CPI
17 filings you would continue to work with the pass
18 through issues, the cost coverage issues and try to
19 resolve those issues and keep the mail in the mail
20 stream. So yes, there is a problem. There's always a
21 problem with an across the board increase in that
22 sense, but we have other opportunities to fix those
23 problems as we go forward.

24 Q And my last question on this. If the Postal
25 Service had chosen in this case to undertake dealing

1 with workshare issues, underwater products using this
2 as a CPI type case perspective that the Postal Service
3 has here, to what extent would you view the challenge
4 of then linking those changes to our rule that seems
5 to require linking back any price increases to
6 explaining how the specific price increases
7 themselves, as opposed to \$1.78, were linked to the
8 extraordinary and exceptional event, in this case the
9 great recession?

10 So if one were to, for example, deal with
11 the underwater products and try to undertake differing
12 prices to address that how would you explain those
13 differing prices being linked to the cause of the
14 great recession, as opposed to trying to deal with
15 inequities that have existed and that the Postal
16 Service has been trying to deal with through both
17 price and cost cutting? Is that possible? And have I
18 confused you fully?

19 A Yes.

20 Q I have earlier talked about how our rules
21 require the Postal Service to explain how the
22 extraordinary event caused the losses and how the
23 \$1.78, the overall increase, is linked to that. The
24 rules also require that the specific price increases
25 proposed have to then go back and explain how that is.

1 I understand how you've described and the
2 governors' decision that a reasonable and equitable
3 way to deal with what some would consider a
4 catastrophic event to our nation's economy you would
5 spread the peanut butter, as I described it. We've
6 had a discussion here the last 20, 25 minutes about
7 issues regarding workshare and underwater products and
8 how the Postal Service made its decision. Look, we're
9 keeping it clean here. We're not here to deal with
10 that.

11 If the Postal Service had made the decision
12 not to keep it clean, shall we say, how would one link
13 that back to the extraordinary event if the effort is
14 to deal with worksharing issues that have been
15 problematic, if it's to deal with underwater products?
16 Are those linked to the event? How would you do that?
17 Or are these issues for Witness Thress?

18 A I think Witness Thress would be a better one
19 to answer that one, but from my perspective we were
20 asked -- the pricing folks were asked -- to come up
21 with a set of prices to recover this amount of damage.

22 Since in this particular case it's compared
23 to R2010-4 where we had just one case -- we were
24 trying to address all the issues in one case because
25 there was no CPI available at that time. In this

1 particular case the CPI was available and we could
2 file a CPI case and address the cost coverage issues
3 and pass through issues in the CPI case to keep it
4 sort of above board and basically make it a revenue
5 requirement case where we -- not only revenue
6 requirement, but this is the amount of money that the
7 Postal Service needs to continue its operation for the
8 next two years.

9 Q So the idea would be if the exigency case
10 had been filed on its own it may therefore have been
11 dealing with some of these issues as in the initial
12 filing in this case as opposed to the presence of the
13 CPI case?

14 A It would not be my decision, but I would
15 imagine that if there was only one case that was being
16 filed then all of these things would have been
17 combined together, the remedy between need and
18 addressing all the other issues like we had in
19 R2010-4.

20 VICE CHAIRMAN TAUB: Gotcha. Thank you very
21 much. I'll probably have some followup, but thank
22 you, Madam Chair.

23 CHAIRMAN GOLDWAY: Sure. I understand
24 Commissioner Langley would like to ask a question now.

25 COMMISSIONER LANGLEY: Thank you very much,

1 and thank you, Mr. Taufique, for being with us today.

2 CHAIRMAN GOLDWAY: Commissioner Langley,
3 could we wait just a moment? The recording clerk
4 needs a few seconds to change his --

5 COMMISSIONER LANGLEY: Of course.

6 (Pause.)

7 CHAIRMAN GOLDWAY: Thank you. Now you may
8 continue, Commissioner Langley.

9 COMMISSIONER LANGLEY: Thank you very much.

10 BY COMMISSIONER LANGLEY:

11 Q I do know from your testimony and then the
12 discussion that has ensued right now between you and
13 Commissioner Taub discussing the across the board
14 application of the proposed rate increase, and I'm
15 curious whether or not the Postal Service looked at
16 whether the volume and revenue loss associated with
17 the great recession was equal among all the users of
18 market dominant products.

19 A I'm trying to recall what Witness Thress
20 wrote.

21 Q If it would be better to ask it of him, I
22 shall do so.

23 A For that he would be the right person.

24 Q Okay. Then probably looking at how the
25 Postal Service forecasts the impact on the different

1 classes and products in an across the board request.

2 Is that your area, or would that be more Mr. Thress'?

3 A Could you repeat the question one more time,
4 please?

5 Q Sure. The Postal Service forecasts loss for
6 the different classes and products when a rate
7 increase is proposed. You're looking at the future to
8 see what is going to happen if a certain price is
9 imposed on a certain product or class of mail. And
10 was that done with this particular increase?

11 A All the financials that are presented to the
12 Commission --

13 CHAIRMAN GOLDWAY: Speak into the
14 microphone, please.

15 THE WITNESS: Oh, sorry about that.

16 CHAIRMAN GOLDWAY: Thank you.

17 THE WITNESS: All the financials that are
18 reported in this particular filing are based on
19 forecasted volume after the price change, so Mr.
20 Nickerson's testimony I think addresses that issue.

21 COMMISSIONER LANGLEY: Okay. I will ask
22 that of him. That's all I have for right now. Thank
23 you.

24 CHAIRMAN GOLDWAY: Commissioner Acton?

25 COMMISSIONER ACTON: Thank you, Madam

1 Chairman.

2 BY COMMISSIONER ACTON:

3 Q Mr. Taufique, is it your testimony that the
4 board of governors have affirmatively reviewed the
5 issues that you and Vice Chairman Taub were discussing
6 earlier with respect to concerns about workshare
7 discounts and cross subsidies and whatnot and
8 purposefully have applied their pricing authority to
9 file these two cases in a way that separates those
10 responsibilities, but tries to accommodate them?

11 A The question is are the governors aware of
12 the two separate cases?

13 Q You described earlier we've got two dockets
14 pending; that you are approaching or at least the
15 Postal Service is approaching this as a challenge that
16 they are trying to meet in separate initiatives.

17 A Right.

18 Q One, the price gap case. The other, the
19 exigency case. Have the governors purposefully
20 reviewed these different priorities and decided to
21 file these cases in this manner to accommodate those
22 concerns?

23 A I would not know. Basically what I know is
24 that the governors approved the filing of the CPI case
25 as a separate docket and the exigent case a separate

1 docket and they approved it, but I would not know if
2 there was a purposeful sort of intention of addressing
3 those issues in one case.

4 Q But that is the intent of the Postal
5 Service, according to your testimony here this
6 morning?

7 A What we tried to do, and it came from the
8 mechanics of the case. What we tried to do was
9 essentially that in the CPI case the structural
10 changes. Like I said, the cost coverage issues. We
11 tried to address those in the CPI case. Whether the
12 governors purposefully decided that or not I would not
13 know.

14 Q Well, you'll have to forgive me. I'm not
15 familiar with the internal workings and how the
16 governors make these decisions. But does the
17 executive leadership team and the staff responsible
18 for crafting these proposals brief the governors about
19 these options?

20 A Yes, they do as far as I know.

21 Q And they make a decision about how to
22 proceed, the board?

23 A The board --

24 BY CHAIRMAN GOLDWAY:

25 Q Are you aware? The executive management

1 would go to the governors and say we have an option to
2 do 4.3 percent across the board or we have an option
3 to further address the inefficiencies and inequalities
4 in the rates and we recommend that we do the across
5 the board and the governors have chosen, or did the
6 governors simply get the two different proposals, one
7 for CPI and one for rates, and then approve them
8 without having --

9 A Yes.

10 Q -- considered the options?

11 COMMISSIONER ACTON: Thank you, Madam
12 Chairman, for that clarity.

13 CHAIRMAN GOLDWAY: I think that's the
14 question we're asking.

15 COMMISSIONER ACTON: And before the witness
16 responds, an important point that the Commission is
17 trying to discern in our discussions and briefings is
18 exactly how the Postal Service has applied its
19 considerable statutory pricing authority in crafting
20 these two proposals to meet the regulatory concerns
21 that we typically review when these sorts of cases are
22 brought.

23 THE WITNESS: What I know, the governors --
24 I was not a part of the group that presented to the
25 governors, but the governors were presented these two

1 options and the governors made the decision of filing
2 two separate cases. Beyond that is beyond the scope
3 of my knowledge.

4 COMMISSIONER ACTON: I appreciate that, Mr.
5 Taufique, and you can only answer what you know. I
6 understand that.

7 BY CHAIRMAN GOLDWAY:

8 Q Would there be anyone else in the executive
9 management other than you who would have briefed the
10 governors on the various options they have for
11 structuring the prices that are in these two cases?

12 A The ELT is responsible for presenting.

13 Q Yes. You had a team responsible for
14 presenting the CPI case and a team responsible for
15 presenting the exigency case, or were they the same
16 management?

17 A Same management.

18 Q So who would that have been who would have
19 made that presentation?

20 A A number of people were involved. I am not
21 sure if there was one person.

22 CHAIRMAN GOLDWAY: Perhaps we could get that
23 information from the Postal Service. Who were the
24 staff people who directly briefed the board of
25 governors on this?

1 COMMISSIONER ACTON: Well, we can pursue
2 this, but for me at least it's a central question, Mr.
3 Taufique, simply because I'm trying to appreciate how
4 it is that my brethren on the board may have
5 contemplated their options and made decisions about
6 how to accommodate typical regulatory concerns.

7 I mean, they have in my view. I'm not
8 prejudging anything because I don't know yet what
9 we're going to do in these instances, but I'm trying
10 to get a gauge for how individuals who are chosen by
11 the President and confirmed by the Senate and made
12 decisions that are important in these cases.

13 So we may look down the road to try to
14 discern, at least get a clearer picture of exactly
15 what the contemplation was at the board level about
16 how it is they're going to craft these separate but
17 related apparently proposals to address concerns
18 because when we make our decisions we have to decide
19 where the business is ours and where the business is
20 the operators', and I think that's an important line
21 that I'm trying to distinguish. So I appreciate the
22 insight this morning.

23 THE WITNESS: I understand that.

24 COMMISSIONER ACTON: Thank you.

25 CHAIRMAN GOLDWAY: Postal Service counsel,

1 do you have information you can provide for us, or do
2 we need to ask another POIR to get the names of those
3 people and then pursue questions of them? If you give
4 us the names, we can just do a POIR more directly.

5 MR. RUBIN: Yes. I'm not prepared to
6 respond right now. We could take it as homework or I
7 guess as a POIR.

8 CHAIRMAN GOLDWAY: Well, why don't you
9 respond to my inquiry as to whether you can identify
10 the specific people who actually briefed the board of
11 governors on their various options here, and if you
12 can do that for us then we can craft the POIR that we
13 would like to for those executives.

14 COMMISSIONER ACTON: And just to be clear,
15 counsel, the reason I'm trying to flesh this out is
16 simply because when we had these debates here at the
17 Commission about how to proceed and we hear from
18 witnesses that certain considerations were involved in
19 crafting these proposals it's important that we have
20 as clear a picture as possible of how that came about.

21 What the witness is outlining makes sense to
22 me strategically and all. If I were a governor, I'd
23 want to know all these options and develop a plan that
24 tries to address typical concerns, but this witness is
25 unable to confirm for us definitively if that was part

1 of the Postal Service's plan or if this is all just a
2 happy or unhappy accident.

3 MR. RUBIN: Well, I mean, the witness stated
4 that the options were presented to the governors and
5 they chose one.

6 CHAIRMAN GOLDWAY: Well, he couldn't tell us
7 who has done that or in what fashion so we need more
8 information about that.

9 MR. RUBIN: I mean, why do we need -- I
10 mean, it's sort of hard. There is a decisional
11 process and it's hard to know, but we'll --

12 CHAIRMAN GOLDWAY: I think the Commissioners
13 are struggling with the fact that the law requires
14 that any adjustments that you request be necessary,
15 equitable and necessary for the Postal Service under
16 best practices of economical and efficient management
17 to maintain the Postal Service.

18 And there are real questions about pricing
19 issues that we have discussed over many years now
20 about products that are under water, efficient
21 component pricing when you have workshare discounts
22 and pass-throughs that don't correspond to
23 efficiencies, and this was an opportunity for the
24 Postal Service to assure a certain level of
25 efficiencies.

1 And they decided to address it in one way
2 rather than another, and I think we need more
3 information about how the postal governors, the board
4 of governors, chose the option they chose in order for
5 us to be confident that that's the reasonable,
6 equitable, necessary best option or a reasonable
7 option rather than rates that are efficient and
8 economical that we are more familiar with.

9 We're certainly respectful of the process,
10 but we'd like to know more about it, so these are
11 questions that are pursuing that. And if you can
12 identify the actual process of who actually briefs the
13 board of governors and what options the board of
14 governors were presented with it would help us a great
15 deal in making our decisions. I think that's what
16 we're trying to get at here.

17 COMMISSIONER ACTON: And this is the last
18 comment I'll have on it. Thank you, Madam Chairman,
19 for clarifying that.

20 I don't make this inquiry because I'm
21 critical of the proposal. I simply am trying to learn
22 more about the background of how it came to be. So if
23 you feel that the responses that we have here and in
24 writing are sufficient for that purpose then so be it,
25 but if there's greater enlightenment that can be

1 shared I think it would be helpful.

2 MR. RUBIN: All right. We'll work to
3 provide a response to concerns.

4 CHAIRMAN GOLDWAY: Do you have any other
5 questions? I'd like to ask just a few more questions.

6 BY CHAIRMAN GOLDWAY:

7 Q You had stated that in this proposal, in the
8 exigency rate proposal, that standard flats are
9 receiving a higher increase in this case. I was under
10 the impression that it was the opposite, so could you
11 identify for me --

12 A Let's go back to the table that I presented.
13 I want to be sure that I'm --

14 Q Could you show me where it is?
15 (Pause.)

16 A Okay. On page 9 of my statement.

17 Q Okay.

18 A The average increase for CPI plus exigent
19 for standard mail. This is Table 2.

20 Q Yes.

21 A The average increase for standard mail is
22 5.942, and the increase for flats is 6.169.

23 MR. RUBIN: And that's as revised
24 October 29, 2013.

25 THE WITNESS: Right. That is as revised on

1 October 29, 2013.

2 CHAIRMAN GOLDWAY: Tell me the page again.

3 THE WITNESS: Page 9. It's revised page 9
4 actually.

5 BY CHAIRMAN GOLDWAY:

6 Q So I don't know if I have that 9. And the
7 number is again?

8 A The average increase for standard mail is
9 5.942, and the increase for standard mail flats is
10 6.169.

11 Q Now, that's the combined of the CPI and --

12 A Right.

13 Q I want to know what is just in the --

14 A Just in the exigent?

15 Q In the exigence case.

16 A The number for standard mail is 4.264.

17 Q 4.264.

18 A And standard mail flats are 4.283.

19 Q 4.283. So it's higher.

20 A Yes.

21 Q The increase for standard flats is higher by
22 .02 percent. Yes?

23 A Yes. In this case the goal was not to
24 achieve the 5 percent above average because this was
25 an across the board change. The CPI case, the goal

1 was to do 1.05 percent of the CPI for standard mail
2 flats.

3 Q Okay. But at least the trend isn't being
4 reversed --

5 A Yes.

6 Q -- in this case. The next comment you had
7 was that your general approach is to adjust the
8 inefficiencies in the pricing systems that we have in
9 the CPI cases. That's been your effort, and you made
10 a --

11 A Yes. Yes, we have.

12 Q -- considerable effort to do that in this
13 most recent case.

14 A Yes.

15 Q But the frustrations that we have are that
16 with inflation continuing to be so low it gives us
17 very little room to make those adjustments in the CPI
18 case. Isn't that the case? Even if you wanted to
19 make changes in underwater costs for periodicals you
20 couldn't do it under the CPI regime. Isn't that the
21 case?

22 I mean, you can make some minor adjustments.
23 Whether we've done enough or not we've talked about
24 them for years, minor adjustments in pricing signals
25 for periodicals, but you can't really change a rate

1 that's 75 percent of cost coverage, 80 percent,
2 whatever it is, with a 1.2 percent price increase, a
3 1.5 percent increase.

4 A I agree with the statement, but essentially
5 the --

6 Q So is it a good long-term strategy to rely
7 on the CPI cases to address those real inefficiencies?

8 A I don't think it's a good long-term strategy
9 to give periodicals a 25 percent increase either.

10 Q Yes. That's a good point. That's a good
11 point.

12 A We've sort of struck it between, you know.
13 So all that we can do is to work with the pricing
14 signals. And I've worked with periodicals for a long
15 time. We've got 80 percent of the volume that is
16 being produced by 20 percent of the mailers, and 20
17 percent of the volume is being produced by 80 percent
18 of the mailers. I think that was the picture when I
19 used to work in periodicals.

20 So the changes that you make to give the
21 right signals, and again we have tried to do the whole
22 structure change as we did in Article 6-1 and we
23 continue to do those right signals. There are
24 significant impacts. You talk about 30, 40 percent
25 increases for small periodicals, and I'm not

1 exaggerating at all in this case I don't think. When
2 the first time a complaint was filed we did an
3 analysis of the impact of the change on small
4 periodicals.

5 So I think there's an endless perspective we
6 take baby steps in terms of moving towards, and we are
7 hoping that not just on the pricing side, but
8 introducing FSS. That would hopefully -- because FSS
9 scheme pallets would reduce the cost significantly
10 because there's no bundle sorting. So we are hoping
11 that -- I'm not a costing expert, but I think combined
12 with the things that we're doing on the cost side and
13 things we're doing on the pricing side would help us
14 gain some momentum in terms of getting close to
15 covering the cost.

16 But, like I said, a 25 percent increase
17 would be totally -- it would cause a big chaos in the
18 industry, which there is still volume loss every year
19 that we see and would cause a lot of small
20 publications, those publications that provide the ECSI
21 value, the educational, cultural, scientific,
22 informational value, to these particular types of mail
23 would be significant I think.

24 Q I know we've been struggling.

25 A Yes. I think we --

1 Q Your office and our staff have been
2 struggling --

3 A I know.

4 Q -- with the periodicals issues, but it does
5 strike me that when you're considering a price
6 increase of this nature and you recognize that
7 significant losses to the Postal Service have come
8 from that class of mail or standard flats that you
9 have an opportunity to make some adjustments that may
10 not be in a CPI case. And I just wondered whether
11 you're confident that continuing with the CPI
12 adjustments we'll be able in the long run to
13 ameliorate the losses that the Postal Service is
14 having in those products.

15 A Yes. If my recollection is accurate, I
16 think there were some indications from the Commission
17 after the R2010-4 decision was announced that this
18 would not relate to any need to address anything on
19 the product side. I may be mistaken, but I thought
20 that was.

21 Q Uh-huh. Well, I think one can interpret the
22 various things that we said in different ways. I'll
23 agree to that.

24 And then my other question based on your
25 comments with Commissioner Taub was that you said

1 there's mail that generates other mail and so you want
2 to make sure that you're not raising rates to the
3 point where you eliminate mail that generates other
4 mail, even if that mail doesn't cover its costs. Do
5 you have a way of measuring that?

6 A Okay. Difficult to quantify, but I think in
7 one case it's easier to quantify as standard mail
8 flats. If you look at standard mail flats, they're
9 basically -- my understanding is they're residuals
10 from carried out mailing because carried out and
11 standard mail and the standard mail flats serve the
12 same market. Folks who have the density to produce
13 carried out bundles pay the carried out prices.

14 Q Yes.

15 A And that particular part of it is
16 profitable. Carried out has been profitable for quite
17 some time actually. So standard mail flats is a
18 residual from carried out.

19 But a significantly higher increase in this
20 particular area would affect those people who are also
21 providing profitable mail, which is carried out. But
22 it is difficult to quantify what other mail is being
23 generated, but we know for sure that the periodicals
24 do send out bills. Catalog mailers mail out products.
25 So there is the relationship between this class of

1 mail and other mail that is generated.

2 Q In previous years the Postal Service has
3 argued that increasing the price of flats would use
4 valuable cap room on a product with declining volume,
5 and that's not the case in an exigency.

6 So could the Postal Service have raised
7 flats somewhat more than what you've proposed? You've
8 proposed a 0.2 differential. Could you have done a .1
9 differential or something else?

10 A In designing the prices --

11 Q Why not decrease carrier route and increase
12 the residuals?

13 A In designing the exigent prices, sort of the
14 criteria that we had established for ourselves, after
15 given all the proper needs from the upper management
16 and the board of governors, was to do in the cost we
17 did not use any price elasticities relationship to
18 figure out the volume impact as a result of
19 differential price changes.

20 The goal over here was to -- you know, the
21 idea was that everybody benefits by the Postal Service
22 remaining in operation, so everybody should bear the
23 burden of this. It's a painful burden, but everybody
24 should equally share the burden of the price increase.

25 Q And the average price increase is

1 4.3 percent across the board?

2 A The average price increase is 4.3 percent.

3 Q And for standard flats it's 4.283. Couldn't
4 you have done at least the average?

5 A You can see the deviations were not by
6 design. The whole process becomes quite complicated
7 when you try to fix the -- make sure the pass-throughs
8 don't go beyond what they were before. The drop ship
9 discounts for standard mail are sort of uniform across
10 all presort levels. The discounts for nonprofit and
11 commercial mail remain the same.

12 Q Are the drop ship discounts as important for
13 efficiency as the workshare pass-throughs or the
14 covering of costs?

15 A Drop ship discounts are workshare discounts
16 for that matter. Drop ship also is classified as one
17 of the workshare. Presorting, bar coding, handling
18 and transportation, they're all workshare.

19 Q And you want them consistent between the
20 classes?

21 A Right. And standard mail drop shipping is
22 quite important because a lot of mail is drop shipped
23 at a closer destination I think, so in overall
24 standard mail; not just standard mail flats, but the
25 letters, high density. Drop shipment is important.

1 In fact, even in R2005-1 across the board we
2 maintained the same drop ship discounts, and the
3 Commission agreed with us in that instance. Like I
4 said, the goal over here was to distribute the burden
5 as equitably as possible -- that was the goal -- and
6 address the other issues that the Commission has asked
7 us to do to give them a bigger increase in the CPI
8 case, which we have been doing in the last two cases.

9 CHAIRMAN GOLDWAY: Okay. Well, we've had an
10 interesting discussion. I appreciate it.
11 Commissioner Taub, did you have some more followup
12 questions?

13 VICE CHAIRMAN TAUB: Yes. Thank you.

14 BY VICE CHAIRMAN TAUB:

15 Q Mr. Taufique, thank you for your time with
16 us this morning. Obviously we only have these two
17 days of hearings, so if you are willing to indulge me
18 a little bit --

19 A Sure.

20 Q -- before we lose you to the nice, cold
21 winter day out there? A couple things I wanted to
22 look at.

23 In your statement on page 3 there's the
24 section that starts: The Postal Service has chosen an
25 across the board price change for the exigent

1 increase. And I respect the governors' decision on
2 that. I'm for one not looking to get into the board
3 room.

4 A What line number are you on?

5 Q Page 3.

6 A Page 3. What line number?

7 Q Middle page. Subsection A it starts.

8 A Okay.

9 Q Given the decision that they made and as we
10 talked about in my earlier round with you, the idea
11 was this spread the peanut butter approach because it
12 was viewed as that was the most fair and equitable way
13 that they viewed everyone would feel the pain and not
14 get into the impact and keep it clean, shall we say.

15 On this page in that first paragraph after
16 subsection A it does say: This approach is similar to
17 the approach adopted by the Postal Service and
18 approved by the Commission in Docket No. R2005-1. And
19 there's a footnote: In that docket only one factor, a
20 statutory escrow funding requirement, drove the price
21 increase, and that factor did not affect mail classes
22 or customers differently.

23 Just trying to tease out that comparison to
24 the case before us, and we had talked about this in
25 one of the earlier questions, is the suggestion that

1 the impact of the great recession didn't affect
2 classes of mail differently, that it was all across
3 the board.

4 A My understanding is that the impact of the
5 great recession affected different classes of mail
6 differently.

7 Q So to the degree that there's a comparison
8 being made with the '05 docket, does it necessarily
9 hold from that perspective?

10 A From our perspective, like I said before,
11 given the largest increase to the mail classes that
12 had the most volume declines would be unfair to those
13 people who are left in the industry at this point in
14 time.

15 So it's essentially what is lost is lost and
16 right now we're pricing for the mail that is in our
17 system at this point in time. So punishing the
18 survivors is sort of -- that is the option that we
19 would have chosen if we had given a larger increase to
20 those classes of mail that had the significant volume
21 reduction.

22 And number two, the comparison I think is
23 valid because at this point in time the Postal Service
24 needs this money to remain in operation, and everybody
25 benefits from the Postal Service remaining in

1 operation so everybody pays an equal share of the
2 burden. That is sort of the logic that compares to
3 the two cases.

4 Q I appreciate that. And certainly on the
5 wind up to your statement on page 36 I think that
6 point is emphasized. This approach results in an
7 equitable sharing of the burden of the exigent price
8 increase. I was just trying to tease out that
9 comparison to the '05. There certainly seemed to be
10 some differences there as well. It wasn't such a
11 clean comparison. So thanks for amplifying that.

12 I'd like to look at your answer to the
13 Presiding Officer's Information Request No. 6.

14 A No. 6.

15 Q And it was Question No. 26, which was the
16 only one of two that you had the joy to answer.
17 Twenty-six speaks of the issue here of the workshare
18 discounts and benchmarks for media mail, library mail.

19 A Right.

20 Q What I'd like to go to is your answer on
21 subsection B.

22 A Okay.

23 Q And you do point out here, and I'm looking
24 at the bottom of the second page of your answer. We
25 don't have page numbers in the answers.

1 A Yes.

2 Q But you say although the transposition of
3 the cost avoidances does not impact the justifications
4 for the pass through, it does have an impact on the
5 methodology used for the exigent pricing described in
6 your statement. You talk about the intent of the
7 methodology was to avoid increasing above 100 percent
8 pass-throughs.

9 As a result of the transposition error that
10 was identified, the pass through for basic presort for
11 media mail increased 156 to 163, the pass through for
12 library 150 to 156 contrary to stated intentions, also
13 as a result of the error, and then it continues on.
14 The Postal Service did not increase five digit presort
15 so as to bring the five digit pass-throughs closer; at
16 the end if the numbers had not been transposed and
17 methodology had been executed flawlessly what the net
18 impact would be.

19 And what I wanted to ask about was you say
20 here given that the exigent increases for package
21 services products which received price increases
22 ranged from 4.2 to 4.6, correcting this error and
23 changing all of the package services prices to follow
24 the stated methodology precisely would not result in
25 any meaningful price changes.

1 I wanted to have you on the oral part of
2 this amplify that a little bit more to explain. Is
3 this really an error, but relatively speaking a minor
4 error, and if you were to go back and start changing
5 everything what the second and third order effects of
6 that would be and your suggestion that most price
7 cells are going to remain unchanged so we'd prefer to
8 just leave it as is.

9 A Like I've said over here, we would have
10 preferred if the error was not made, but the error was
11 made and justification for pass-throughs over 100
12 percent remained the same, but since the exigent
13 filing we were trying to maintain the same pass
14 through if they were over 100 percent.

15 We would have done things differently to
16 maintain those pass-throughs because our goal was to
17 -- our benchmark for pass-throughs was the CPI filing.
18 We did not want to go above that or make the pass-
19 throughs worse than what they were in the CPI filing.

20 So by the time the error was recognized it
21 was a little bit too late to make the change. And we
22 looked at the impact of the change. It would have
23 been slightly higher, which would have been preferable
24 for media mail and library mail because those are
25 underwater also, and the overall increase for package

1 services would have been slightly lower.

2 We did not think it was significant enough
3 for us to go back because all the prices that we
4 proposed are approved by the governors, so at this
5 point in time since the change was not significant
6 that the Commission would accept it.

7 Q Leave it as is. Okay. And thank you for
8 amplifying that. In that regard I had another related
9 question on packaging services with the idea of okay,
10 there was an error. Just leave it as is. We
11 acknowledge it.

12 But on packaging services, if we look at
13 your statement now, page 7, and there was a correction
14 I believe to your statement on page 7. Page 7,
15 footnote 5. You refer to the prices in Docket No.
16 R2013-10, and your footnote says: BPM flats prices
17 within package services have been proposed to increase
18 less than .314 percent than average so more of the cap
19 space can be allocated to the underwater products. So
20 let's keep that in mind.

21 A Okay.

22 Q But then go to page 33 of your statement, at
23 the very top of page 33, the second full sentence on
24 that page. It says: By continuing to restrain the
25 increase for BPM flats, the Postal Service hopes to

1 spur additional volume growth for this profitable
2 product.

3 So in this docket the Postal Service is
4 proposing increases for BPM flats of 4.626 percent,
5 which if you want to consult those numbers, but it's
6 4.626 percent. If you look, that's the highest
7 increase of any product in package services.

8 So I was just trying to probe the possible
9 apparent inconsistency with these two rationales from
10 the footnote, from what's on 33, and yet BPM flats is
11 apparently getting the highest increase of any product
12 in package services in this docket.

13 A This is my weakest class, so let me --

14 Q Yes, please. It's your revised page 9,
15 Table 2.

16 A Revised page 9. I'm looking at it right
17 now.

18 (Pause.)

19 A There's no time for a break. I would like
20 to get more information on this subject.

21 VICE CHAIRMAN TAUB: Oh, sure. Sure. No.
22 You know, from my perspective I'm happy to get that in
23 writing, but if it's something --

24 THE WITNESS: Okay.

25 VICE CHAIRMAN TAUB: -- you can easily knock

1 out and we verbally can handle orally, I'd be okay
2 with that too.

3 CHAIRMAN GOLDWAY: I think actually that's a
4 very good suggestion. I know that Commissioner Acton
5 has one more question and we might want to take a
6 break after that question, and if you could prepare
7 your response to Commissioner Taub's question then
8 you'll come back on the stand and if we have a couple
9 more items for you to clear up before we excuse you?

10 THE WITNESS: Sure. If I cannot prepare a
11 response at this point in time I'll do it in writing
12 later on.

13 VICE CHAIRMAN TAUB: Sure.

14 CHAIRMAN GOLDWAY: So, Commissioner Acton,
15 why don't you begin and then --

16 COMMISSIONER ACTON: Thanks.

17 CHAIRMAN GOLDWAY: -- we'll take a little
18 break.

19 COMMISSIONER ACTON: Thanks, Madam Chairman.

20 BY COMMISSIONER ACTON:

21 Q You know, one of the provisions in the law
22 calls for a full discussion of why the requested rate
23 adjustments are reasonable and equitable as among
24 types of users of market dominant products. So what's
25 reasonable and equitable may be a bit ephemeral and

1 depend upon your relative point of view.

2 I just want to give you a chance here to
3 feel like if there's anything you want to add in terms
4 of a summary of why it is the Postal Service's
5 proposal is both reasoned and equitable I would invite
6 you to do it here.

7 I think you've touched on those points in
8 your written testimony and you've spoken about it here
9 today, but since it's a consideration that the
10 Commission will be focused on in this sort of review,
11 if there's anything, any core aspect of the
12 consideration that the operator endeavored to look at
13 when it made this decision about how to parse out
14 these rates in a reasonable and equitable fashion,
15 then now is the time to share it.

16 Witness Taufique, if you feel like you've
17 touched all these bases and you've made your case as
18 best you can then that's a perfectly suitable
19 response.

20 A I would like to rely on what I have said on
21 pages 10 and 11 of my statement.

22 Q Okay. And then finally, my last question.
23 There's another provision of the statute that calls
24 for when the Postal Service may be able to rescind
25 exigent rate adjustments in whole or in part. Are

1 those questions for you, or is that for a different
2 witness?

3 A Probably a different witness on this one.

4 Q Do you have a clue for us on which witness
5 we may direct those?

6 A I would think Mr. Nickerson would be the
7 right person on those.

8 COMMISSIONER ACTON: Thank you. Thanks for
9 your testimony today. It's very helpful to have you
10 here and talk with us.

11 THE WITNESS: Thank you.

12 CHAIRMAN GOLDWAY: Thank you. So we will
13 break until 11:00, exactly at 11:00, and we'll come
14 back then and if Witness Taufique is able to answer
15 Commissioner Taub's question, fine. If we need to
16 clarify that, we'll work on it at that time.

17 THE WITNESS: Sure.

18 CHAIRMAN GOLDWAY: Thank you.

19 THE WITNESS: Thank you.

20 (Whereupon, a short recess was taken.)

21 CHAIRMAN GOLDWAY: Good morning. We're back
22 in session after a break. Checking, make sure our
23 various computer networking is up and running and the
24 witness was checking on his potential answer to a
25 question from Commissioner Taub.

1 Can I ask you, Witness Taufique, if you've
2 been able to respond?

3 THE WITNESS: Yes. The reason for the
4 larger increase for BPM flats --

5 CHAIRMAN GOLDWAY: Could you speak more
6 directly --

7 THE WITNESS: I'm sorry. Okay. The reason
8 for the larger increase for BPM flats in the exigent
9 filing, per se, was because of the fact that there
10 were a couple of pass-throughs that we're trying to
11 keep in line so those cells received higher increases
12 and that is why the overall piece is higher for BPM
13 flats.

14 It was not done intentionally to -- you
15 know, basically it was across the board, but because
16 those pass-throughs were getting worse, beyond 100
17 percent, so keeping them on line gave slightly higher
18 increases, and that is why the BPM flats received the
19 higher increase among package services for exigent
20 filing.

21 BY VICE CHAIRMAN TAUB:

22 Q I appreciate it. So if I understand what
23 you're saying, it was, again, this idea of keeping the
24 exigency case a clean case and just trying to make
25 sure the work share pass-throughs weren't getting

1 worse.

2 A Right.

3 Q To what extent -- looking at the citations I
4 gave you on page 33 and then that footnote, that
5 explains the larger increase. Do you still see, if at
6 all, that there's a discrepancy between what was
7 stated, though, on your testimony, if we can look at
8 that again.

9 CHAIRMAN GOLDWAY: Could you give me the
10 citation again for this one.

11 BY VICE CHAIRMAN TAUB:

12 Q So on page 33 you had said by continuing to
13 restrain the increase for BPM flats the Postal Service
14 hopes to spur additional volume growth for this
15 profitable product. And then on page 7, footnote 5.

16 A On page 7, footnote 5, we're discussing the
17 CPI filing and in the CPI filing the BPM flats were
18 given a lower increase so that most of the cap can be
19 used to give the higher increases to those products
20 that were under water.

21 And on page 33 the above average increase
22 for BPM flats was not by design. Like I said, you
23 know, and as Commissioner Goldway asked me earlier,
24 our goal was to keep it 4.3 percent across the board.

25 We were restricted by some of these other

1 factors, like keeping the pass-throughs at the same
2 level if they were over 100 percent and other factors
3 that for -- so that is the reason BPM flats have a
4 slightly higher increase, but that was not by design,
5 that was the mechanical application and making sure
6 that all the other, you know, restrictions were met.

7 Q So I understand that. And on page 33 then
8 is it accurate to say by continuing to restrain the
9 increase for BPM flats, hope to spur additional
10 volume?

11 A If you look at the combined increase for
12 exigent and -- let's go back to --

13 Q Yes. Your Table 2.

14 A Yes. I'm trying to find --

15 Q And it's page 9.

16 A Thank you.

17 Q I see. The 4.955?

18 A Yes. 4.955 is the, probably the lowest.
19 Except for the negative number for inbound surface
20 parcel post, 4.955 is the lowest increase of all of
21 the products within packaged services.

22 Q Thank you for walking me through that. Last
23 question somewhat in regard talk of packaged services.
24 Obviously this is market dominant side. A lot of that
25 stuff is competitive.

1 To what extent, if at all, and this is --
2 there have been questions by the presiding officer to
3 Witness Nickerson. I'll explore this with him
4 tomorrow, but again, since you're here, I'll take the
5 opportunity to ask your perspective, if any, on it.

6 To what extent, if at all, should we be
7 concerned about the competitive product price increase
8 as it relates to the exigency? How should it be
9 factored in, if at all? The idea being the Postal
10 Service has suffered from the Great Recession.
11 There's a loss of volume, and hence, revenue.

12 The competitive product side is not
13 restrained by a pricing cap, but it's restrained, one
14 could argue, by competition. There have been some
15 questions asking the Postal Service to update the
16 competitive product filing that was just recently done
17 vis-a-vis this case.

18 From someone who is setting the mechanics of
19 the prices, how do you see, if at all, the competitive
20 product rates should be taken into account when we
21 examine the exigency case?

22 A First of all, the competitive products make
23 a very small portion of the overall revenue so the
24 impact is not significant in terms of the overall
25 revenues. I have not been involved in competitive

1 pricing but my understanding is that competitive
2 pricing is being done to retain volume and so there
3 are strategies behind the numbers that you see. That
4 is my understanding. So these strategies are quite
5 different than what we look at on the market dominant
6 side. I won't be the right person to speak about
7 those strategies.

8 VICE CHAIRMAN TAUB: Appreciate that. Thank
9 you.

10 Those are all the questions I have, Madam
11 Chair.

12 CHAIRMAN GOLDWAY: Thank you.

13 BY CHAIRMAN GOLDWAY:

14 Q I just want to go over one more time in
15 general the concept that the Postal Service has done a
16 detailed analysis of the impact of the recession, the
17 Great Recession, on mail volumes class by class,
18 product by product. We can disagree about the
19 analysis but it was done in great specificity and
20 detail.

21 The Postal Service is saying we're going to
22 take some portion of the losses that we've identified
23 and basically say, well, this is the general needs of
24 the system to keep operating and so we're going to
25 allocate the costs of this to every user equally.

1 The proposal is something like the 2005 case
2 where there was a payment for escrow that everybody
3 had to pay, but is that what you're saying? You're
4 saying even though we've identified very specific
5 numbers, our approach to solving the problem is to
6 come up with some kind of operations fee for everyone
7 in the system and everyone's going to pay 4.3. Is
8 that a fair understanding of how you chose this way to
9 spread the price increase among all users equally?

10 A From our perspective, the successful example
11 of this kind of an increase was an across the board
12 increase. I go back to R2005-1. So that may have
13 played a role in deciding to go across the board. As
14 I said earlier, that in this vertical case, from the
15 analyst's perspective, which is what I am, we were
16 trying to address the other issues in the CPI filing.
17 Like I said, if you look at the history of pass-
18 throughs, we have constantly made progress.

19 In terms of cost-covered issues, the
20 Commission directed us to do something different on
21 standard mail flats and we have tried to do that.
22 We've done something on periodicals in terms of
23 pricing signals.

24 So since we had two venues available, the
25 reasonable fashion in which we could raise the money

1 for the operation at the Postal Service was to do an
2 across the board increase. I don't know if I answered
3 the question or not.

4 Q No. Well, you've basically said that the
5 concept of the 2005 rate increase, which was a kind of
6 response to what was then a request for an overall
7 escrow account over the whole system, is the model you
8 used. I'm wondering if there's any other way to
9 explain that model that would correlate more directly
10 to the specific analysis of the losses that are part
11 of this case. I see a bit of a disconnect between the
12 two and I'm trying to get a better understanding of
13 how you went from one analysis to the solution of the
14 across the board.

15 A The first analysis, again, my best
16 understanding, was to quantify the impact of the Great
17 Recession. The second part basically dealt with do
18 you want to recover all of this? Would that be
19 harmful to our customers? Would that be bad for our
20 business ultimately?

21 So the direction that we were given was that
22 4.3 percent was deemed to be reasonable, and an
23 equitable fashion would be to distribute this burden
24 across all the mailers.

25 Q So you were basically told work on the

1 numbers with a 4.3 percent across the board. You
2 really weren't in the discussions about whether it
3 should be 4.3 or some other way in which you could
4 allocate rates.

5 A I may have heard some discussions.
6 Essentially my understanding from being in different
7 meetings is that it was deemed that six percent was
8 the maximum increase that we could give at this point
9 in time. Folks who deal with the customers and know
10 more about the marketplace than I do -- if that was
11 the maximum increase, and CPI was around 1.6, 1.7
12 percent, so 4.3 percent was the remainder that we were
13 supposed to recover in the exigent filing.

14 So the concern was to balance all the
15 factors, you know? You need the money. At the same
16 time, you don't want to cause irreversible harm to the
17 customers. So the balance was maintained by coming up
18 with the six percent overall increase and keep the --

19 Q Okay. So I understand rather than ask for
20 the full amount of loss that your analysis identified,
21 you determined that, on average, a six percent
22 increase would be fair to, the market would have,
23 would get you revenue but not damage volume so much in
24 the future that you could do that.

25 But within that 4.3, why did you make the

1 decision to go across the board with that rather than
2 use that 4.3 to make other adjustments that might be,
3 create more efficient prices?

4 You're saying you did it because there was
5 this concept that there's a general operations of the
6 Postal Service that needs to be maintained. Everybody
7 benefits from the operations of the Postal Service so
8 everybody's going to pay this four percent to keep the
9 Postal Service operating.

10 A We have the opportunity to make the
11 adjustments that you talked about in the CPI filings,
12 and in this case, like I said, we had the opportunity
13 to do two separate dockets: A CPI filing that would
14 continue to address the issues that you have raised,
15 and keeping the exigent sort of a vehicle to raise the
16 money for the postal operation.

17 Q But when you make this decision to grow
18 across the board, some mailers are going to respond
19 differently from others. That question was somewhat
20 asked earlier, I think by Commissioner Langley. You
21 know, have you figured out that some mailers are going
22 to respond with lower volumes and some mailers aren't?

23 Some mailers will respond with opportunities
24 to do more presorting or entering into the mail at
25 other access points to get more discounts, others

1 don't have the opportunity to do that. So when you
2 did this across the board increase did you think about
3 the fact that the increase doesn't necessarily fall
4 equally on everybody?

5 A Under the old omnibus led cases there was
6 some discussion of what is called Ramsey pricing, or
7 pricing based on elasticities. I think the governors
8 in this particular case chose that the equitable
9 fashion -- again, the impact of any increase -- you
10 could have chosen a different model -- it would have
11 impacted folks differently. So this was thought to be
12 the most, the least deceptive model. The most
13 appropriate --

14 Q So even though there would be differences
15 the different mailing groups would experience with a
16 4.3, some having more difficulty with it than others,
17 that this was more equitable than making adjustments
18 so that each mailer could have a more equal response
19 to the rate increase.

20 A That is sort of the world that we live in.
21 The CPI increase is a given percent change that
22 applies to all classes of mail. I mean we don't have
23 an overall CPI to meet for all the classes of mail
24 where we could raise some classes of mail by above
25 CPI. The world that we're living in is that CPI

1 applies equally to all classes of mail.

2 So we know that the elasticities may be
3 different, the reaction may be different, so this 4.3
4 percent model was deemed to be the most appropriate
5 and the least deceptive model for the Postal Service
6 to approach this exigent price increase.

7 CHAIRMAN GOLDWAY: Okay. Thank you. I
8 think -- does anyone else?

9 COMMISSIONER ACTON: One thing on it.

10 CHAIRMAN GOLDWAY: Okay. Mr. Acton?

11 BY COMMISSIONER ACTON:

12 Q Mr. Taufique, I just want to add, you know,
13 the Chairman mentioned at the outset that we will have
14 a lot of presiding officer information requests. I'm
15 sure it's evident to you from the exchange this
16 morning that your testimony and analysis is going to
17 be central to what we're able to accomplish here,
18 particularly in a thorough and timely fashion.

19 So I only raise that because I sense we're
20 drawing to a, your time here today is probably drawing
21 to a close. So I just want to encourage you when you
22 get those POIRs, and there are a dozen pages of them
23 here that our staff has prepared for us that can get
24 rather technical which is why I didn't opt to ask them
25 verbally, but I look forward to reading your responses

1 soon.

2 So I just want you to know that's in the
3 works, and I encourage you to get back with us with
4 your answers as soon as possible because it helps us
5 do what we have to do.

6 A We'll do our best.

7 COMMISSIONER ACTON: Thank you.

8 CHAIRMAN GOLDWAY: Commissioner Langley?

9 COMMISSIONER LANGLEY: Thank you.

10 BY COMMISSIONER LANGLEY:

11 Q I have one follow-up. Do you know how much
12 volume loss for each class will be associated with the
13 exigent price increase if it were granted? Was a
14 calculation done on that?

15 A My understanding is that the calculation is
16 done. We did not take into account the calculation.
17 The revenue analysis that was presented includes the
18 impact of volume losses.

19 So essentially, to think about it, in the
20 past when we did the omnibus cases we would actually
21 go through different iterations. We would produce the
22 prices, forecasting folks would run the volume
23 forecast, financial folks would look at, you know, and
24 then would revise the prices again.

25 That did not happen in this set up. In the

1 CPI case we don't do that, but the financial analysis
2 that is presented includes the volume impact of price
3 changes, yes.

4 Q And who did that analysis then of the volume
5 impact?

6 A There is a forecasting group within Postal
7 Service that does that. Our next witness, Mr. Thress,
8 is part of this, work for that group.

9 Q So Mr. Thress would have that information?

10 A I'm not sure if he has that information
11 readily available, but he could probably get it.

12 COMMISSIONER LANGLEY: Okay. We'll follow
13 up there. Thank you.

14 CHAIRMAN GOLDWAY: Thank you.

15 Commissioner Taub? Vice Chairman Taub?

16 VICE CHAIRMAN TAUB: Yes. Thank you.

17 BY VICE CHAIRMAN TAUB:

18 Q Just to reconfirm my understanding of a
19 couple of points along this line of questioning. And
20 we don't need to pull it out. I'll read it. You just
21 confirm if I'm reading it correctly.

22 In your response to the presiding officer's
23 Information Request No. 5, Question 7, the question
24 was did the Postal Service use estimates of price
25 elasticity of demand directly for selecting the rates

1 proposed in this docket?

2 Your answer was Postal Service did not use
3 estimates of price elasticity of demand directly for
4 developing the rates in this docket. In the judgment
5 of the governors, an across the board approach was
6 preferable for addressing the circumstances presented
7 in this case.

8 So to the extent -- if we were exploring
9 differences dealing under water, correcting pass-
10 throughs, looking at impacts on, would we, would the
11 Postal Service need to be instead cranking in price
12 elasticity of demand into these rates, whereas by
13 taking the 4.3 percent approach the idea is, look,
14 those are for the CPI case, we're just going to spread
15 it across the board, shall we say, and not do harm or
16 worsen inequities that are there? Is that a correct
17 understanding? If it's off, correct it, or --

18 A That would be accurate.

19 Q And your testimony, the witness statement
20 speaks to the 4.3 percent meet in one of the, the
21 second objective in the law, which is predictability
22 and stability of rates 4.3 percent.

23 Could you describe for us how that would
24 contrast with shall we say a CPI case type changes
25 where things are going up, other things are going

1 down, there isn't -- would the latter create less
2 predictability and stability for this purpose? Is a
3 4.3 percent better for that or is it kind of a wash?

4 A I think 4.3 percent would be better in terms
5 of predictability and stability of the rates. Even if
6 you look at R2010-4, which was not across the board,
7 but if you look at the increases by classes of mail
8 they were almost across the board, except for
9 periodicals.

10 Even in the CPI cases we're constrained by
11 the CPI being applicable to each class of mail across
12 the board. We have options within a class of mail to
13 give some products a higher increase or some a lower
14 increase, but classes of mail get the same increase.

15 So first-class mail, generally speaking, if
16 they know what the CPI forecast is or where CPI comes
17 out to be, they would know that this is the increase
18 that they're going to be receiving.

19 VICE CHAIRMAN TAUB: Okay. Thank you.

20 CHAIRMAN GOLDWAY: Any other questions?

21 (No response.)

22 CHAIRMAN GOLDWAY: Thank you, Mr. Taufique.
23 That concludes your oral testimony in front of us
24 today. As we've indicated, there may be additional
25 questions that we will ask of you based on our

1 conversations here, based on suggestions we get from
2 other participants who considered your testimony and
3 their comments.

4 I want to offer my personal thanks to you
5 for participating and for the clarity and
6 forthrightness with which you answered our questions.
7 I really appreciate it. I appreciate your long
8 service with the Postal Service and the many times
9 you've come before the Commission to share your
10 expertise.

11 THE WITNESS: Thank you very much.

12 CHAIRMAN GOLDWAY: So, with that, I'll
13 excuse you and we'll get to our next witness.

14 (Witness excused.)

15 CHAIRMAN GOLDWAY: Mr. Thress, will you
16 please stand.

17 Whereupon,

18 THOMAS E. THRESS

19 having been duly sworn, was called as a
20 witness and was examined and testified as follows:

21 CHAIRMAN GOLDWAY: We're now ready for
22 questions from the Commission based on the Library
23 references, statement, and responses to presiding
24 officer information requests that you submitted, and
25 we'll begin.

1 One of my colleagues ready to start? I see
2 Commissioner Langley. Great. Thank you.

3 EXAMINATION

4 BY COMMISSIONER LANGLEY:

5 Q Good morning. How are you?

6 A Great.

7 Q We had some questions for Mr. Taufique
8 regarding volume loss which he indicated you would be
9 a far better witness, so let me ask just a first
10 overall question. How much volume loss for each class
11 will be associated with the exigent increase?

12 A My statement estimated the volume loss that
13 was attributable to the Great Recession and that was
14 done on a class by class, category by category basis,
15 and that's presented in my statement. Is that what
16 you're asking?

17 Q No. Apologize for not being clear. What
18 I'm asking is should the request, the 4.3 percent
19 overall across the board request be granted, did the
20 Postal Service do forecasting?

21 A Yes. We did two -- we presented two
22 forecasts in this case. They were attached to USPS-
23 R2010-4R-9, I believe. There's a folder in that
24 called public forecasts and in that there is a before
25 rates forecast, and there is an after rates forecast

1 assuming rates go into effect in January, and there's
2 an after rates forecast assuming rates go into effect
3 in October.

4 So the difference between the before rates
5 forecast and the after rates forecast in terms of the
6 volume, that would be the volume impact of the rates.

7 I believe, just to clarify, the after rates
8 forecast, the rates, that assumes that both the CPI
9 and the exigent rates take effect, and the before
10 rates assumes neither.

11 I know I did an intermediate of what if we
12 just have the CPI. I'm not familiar with what gets
13 filed in the CPI case R2013-10. If there was a
14 forecast filed with that, that would have just the
15 impact of CPI and then you could isolate the exigent
16 by comparing the after rates --

17 Q Your forecast includes the six --

18 A It's essentially six, the average six
19 percent, but it's specific to each class of mail in
20 terms of, you know, it uses specific rates. But yes,
21 it has both CPI and exigent both in the forecast for
22 this case.

23 Q But you didn't separate it out. You didn't
24 assume there's a rate increase and then just do the
25 4.3.

1 A Again, in terms of the process of developing
2 the case, I did, I have made such a forecast and the
3 Postal Service has seen and gotten such forecast. And
4 I have to admit I don't know what they did with it in
5 terms of whether they've showed it to you.

6 CHAIRMAN GOLDWAY: Okay. So we may want to
7 ask for that information.

8 COMMISSIONER LANGLEY: I think that would be
9 helpful.

10 BY COMMISSIONER LANGLEY:

11 Q Do you recall which class will be hit the
12 hardest?

13 A Well, in terms of since it's essentially an
14 across the board rate increase, the extent to which
15 different classes are hit differently will boil down
16 to which mail is most sensitive to price, and that
17 boils down to what we call own-price elasticities,
18 which I do calculate and again were also presented in
19 that same Library reference.

20 Generally speaking, package services are the
21 class of mail which is most price elastic, followed by
22 standard mail, followed by first-class mail, and
23 periodicals mail is the least price elastic according
24 to our estimates.

25 Q I assume you would agree that different

1 classes of mail and different products were hit harder
2 by the recession. Those mailers who use different
3 classes might have more adverse impact from the
4 recession than other mailers.

5 A Yes. Again, my statement breaks out the
6 impact of the Great Recession by product, and yes, and
7 those impacts were very different across the different
8 products. Yes.

9 Q So in like, for example, standard flats,
10 there was a rather large increase in rates in 2007 for
11 flats which could have depressed the flat industry,
12 the catalog industry. Does the recession, does this
13 previous hard impact on catalog mailers come into play
14 at all when you're doing an across the board type of
15 increase? I mean, they already had depressed volumes
16 because of the R2006-1 rate increase.

17 A Two things on that. First, our models in
18 standard mail are estimated at the subclass level, so
19 we estimate an own-price elasticity for standard
20 regular mail as a whole. We don't estimate separate
21 price elasticities for standard regular letters versus
22 flats.

23 The models we estimate, we attempt to model
24 the demand for mail as a function of all the various
25 factors that can affect it, which include price, which

1 include the macroeconomy, which include various other
2 things.

3 One of the things we look at is the
4 functional form, essentially, of the price elasticity.
5 Our best estimate of that functional form is what we
6 call constant price elasticities, which is to say a 10
7 percent rate increase has an X percent impact on mail
8 volume, and that is true regardless of the level of
9 volume, regardless of the level of prices. That's
10 something we've studied.

11 In the past we've looked at the question of
12 are price elasticities a function of the level of the
13 price, and we've found they haven't. We've also
14 looked very carefully at the extent to which have
15 price elasticities changed? Is that one of the things
16 that has changed as a result of the Great Recession?

17 It seems to be the case, our best estimate
18 is that no mail or price elasticities are about the
19 same now as they were prior to the Great Recession and
20 are best modeled in this constant price elasticity
21 way.

22 Q Could you repeat that one more time, please,
23 just so I can make sure that I get it.

24 A Sure. We create a set of demand equations
25 and one of the aspects of building an equation is you

1 have to consider the functional form of we know that
2 price affects mail volume. How does price affect mail
3 volume, and has the extent to which price affects mail
4 volume, does it change over time for various reasons?
5 We've considered those.

6 We've studied the issue does the price
7 elasticity depend on the level of the price, and the
8 answer to that question appears to be no. Have price
9 elasticities changed now relative to where they were
10 in say 2006 and 2007, before the Great Recession? The
11 answer to that appears to be no.

12 So what we're left with is we have a model
13 that's -- the best model of how mailers will react to
14 prices is a constant elasticity model that says the
15 elasticity of standard regular mail with respect to
16 price I believe is minus .4, which basically means if
17 you raise price 10 percent, volume will fall four
18 percent.

19 Q So because of the Great Recession, the
20 pricing, the elasticities have not changed in your
21 mind.

22 A The best empirical evidence suggests that to
23 be the case.

24 Q Even though we may be operating now under a
25 new normal.

1 A We're in a new normal. The Great Recession
2 changed a lot of things. It changed the relationship
3 between mail volume and the macroeconomy, in general,
4 it changed some of the underlying trends, but from all
5 the evidence that we can find, the one thing that
6 didn't change is price elasticities.

7 Q So even though -- and I think this is
8 something we'll probably explore some more, but I did
9 notice in your testimony you were talking about
10 trends, employment and using the private sector,
11 trends there, but I'm just curious because I know
12 companies, in general, were faced with downsizing
13 their personnel and companies, at least from what I
14 saw, was reading, some companies took the opportunity
15 to reorganize their businesses --

16 A Yes.

17 Q -- and letting what they may consider excess
18 people go through attrition, through, you know, firing
19 individuals, and a number of these companies have not
20 rehired. They reorganized, used new technologies, you
21 know, essentially contracted their businesses.

22 Is it still valid to use those economic
23 trends when there may be a wholesale change within how
24 business is doing, how business is operating; and
25 therefore you're using some of these trends for the

1 basis of putting together the testimony and putting
2 together the case for an exigent rate increase.

3 A Well, when we build these models we're
4 trying to isolate individual factors, so our estimate
5 of price elasticities is this is our best estimate of
6 the price elasticity, controlling for everything else.

7 So we have attempted to control for general
8 macroeconomic conditions, and also in this particular
9 case attempted to control for the changes to general
10 and macroeconomic conditions.

11 That said, the Postal Service has changed
12 the price of standard mail since the Great Recession,
13 and controlling for these other factors, the impact
14 that has had on mail volumes is what we would have
15 expected given the levels of these rate increases is
16 consistent with what we saw before the Great
17 Recession.

18 So, yes, there is less mail volume and
19 businesses have changed in ways that affected the
20 level of mail volume, that have affected the trends
21 that are ongoing in mail volume, and controlling for
22 those things, the impact of a change in price is still
23 relatively similar to what it was before --

24 Q So you see it as being unstable even though
25 other things have changed.

1 A Price elasticity is the one thing, it's the
2 one thing in the postal world that stayed stable.
3 Yes.

4 Q So that's the old normal versus the new
5 normal.

6 A It surprised me a little bit, too.

7 Q In your opinion, it has stayed the same,
8 though.

9 A Yes.

10 COMMISSIONER LANGLEY: Okay. Thank you.
11 That's all my questions for right now.

12 CHAIRMAN GOLDWAY: Vice Chairman Taub?

13 VICE CHAIRMAN TAUB: Sure.

14 BY VICE CHAIRMAN TAUB:

15 Q Good morning, Mr. Thress.

16 A Thress. Yes.

17 Q Very good.

18 A Thank you.

19 Q I've been on the Commission two plus years.
20 This is my first opportunity to speak with you in this
21 arrangement, though I understand you're no stranger to
22 both the Regulatory Commission and its predecessor,
23 the Postal Rate Commission.

24 A Yes.

25 Q Twenty-one years I believe.

1 A Twenty-one years I've been working.

2 Q In most places, that's legal drinking age.
3 Hopefully we after today won't cause you to do that,
4 or I may need one after we get done. I have a whole
5 stack of documents here laying on the floor from the
6 2005, 2006 rate cases in which you submitted quite a
7 bit of modeling and forecasting, and the general
8 conclusions of the Commission.

9 At that time, the Rate Commission were to
10 accept that and find that a lot of that was valid, and
11 so certainly I appreciate your long service and the
12 expertise you bring to bear.

13 This is a key part of the Postal Service's
14 case. In essence, what you are putting together is
15 the affect of the recession on mail volumes, and so
16 all else flows from that. So if you could indulge me.
17 Walk me through some of what you've laid out for us to
18 consider, that would be helpful today.

19 Going into this, if I understand, in a
20 broad-based letter you have the source of change
21 analysis which decomposes volume losses of the last
22 five years and you're trying to tease out what is
23 attributable to the recession and what to other
24 factors.

25 Hence, those to the recession are the volume

1 losses that ultimately would be presented here to say,
2 look, this is where the Postal Service, this is what's
3 due to the extraordinary event. Am I --

4 A Yes. Correct.

5 Q Okay. The context of that exigent event has
6 had an ongoing, persistent net adverse and financial
7 impact. The impact remains necessary to address.
8 This is -- I'm just kind of paraphrasing from your
9 testimony restating the Postal Service's case. Idea
10 was Postal Service took other actions first.

11 It can't hold out anymore. They waited in
12 December 2011 when they, this case became mature again
13 after remand, and now, two years later, it can't wait
14 on Congress. We need to come to you.

15 In terms of your modeling, to pull out the
16 recession, if I understand it, we've got four general
17 macroeconomic factors. We've got employment.

18 A Yes.

19 Q Retail sales.

20 A Yes.

21 Q Investment, with gross private, domestic
22 investment.

23 A Yes.

24 Q And foreign trade.

25 A Yes.

1 Q When I had read your testimony, the
2 employment investment retail sales I think, as opposed
3 to foreign trade, it spoke of other factors. Are
4 those the four? Are there others that I'm missing as
5 the ones that are the macroeconomic factors?

6 A Those would be the explicit macroeconomic
7 variables that are included in my equations.

8 Q Okay. And that, we're deriving -- could you
9 talk a little bit, and maybe -- well, let me first
10 make sure I get this straight in my mind. Got the
11 macroeconomic factors, and then we have another
12 section of the analysis of intervention decomposition,
13 the long run mail trends attributable to the Great
14 Recession broken out between the recession and
15 recession diversion.

16 Maybe to put this in some context, if you
17 look at your response to the presiding officer's
18 Information Request No. 3, and it would be your
19 response to Question No. 5 --

20 A Okay.

21 Q -- the second page of that response has a
22 table.

23 A Yes.

24 Q The first column is the total, which is the
25 total of the 53 and a half billion volume loss.

1 A Yes.

2 Q And then that's broken out in two separate
3 columns. There's almost 38 billion and then almost 16
4 billion. Is the 38 billion, those columns are the
5 ones that are, attributable is probably a bad word to
6 use in this joint, but go to the intervention
7 decomposition?

8 A Yes.

9 Q And the 16 billion goes to the macroeconomic
10 factors.

11 A Yes. Yes, that is correct.

12 Q Okay. So let's go for a moment then to the
13 macroeconomic factors which comprise the 16 billion.

14 As I read your testimony, you're saying that
15 through the investigation you did and testing of
16 various alternatives in putting together this
17 approach, these are the macroeconomic factors unlike
18 others that, to you, were related to what one can
19 tease out as due to the Great Recession, is that
20 correct? Or, you know, walk me through how did we end
21 up with these four.

22 A Okay. Let me try to walk you through. You
23 mentioned R2005, R2006. So that's kind of the
24 starting point. We had a model in R2006. It worked
25 pretty well. You guys accepted it, you know. We were

1 all happy with that. Then the Great Recession hit.

2 The equations in R2006 included
3 macroeconomic variables. First-class mail was modeled
4 as a function of employment, standard mail was modeled
5 as a function of investment, various things were
6 modeled as functions of foreign trade and retail
7 sales. So these variables already existed in there.

8 Employment went down, investment went down,
9 foreign trade went down, and those had predictable
10 effects based on our models. My recollection, for
11 example, in standard regular investment went down
12 about, I think it went down about 30 percent during
13 the Great Recession, and the elasticity on investment
14 in our model is around .3, I believe, which would
15 imply that a 30 percent decline in investment should
16 have dropped standard regular mail volume by 10
17 percent. That's how elasticities work. I mean that's
18 based on the historical relationship.

19 But standard regular volume didn't drop 10
20 percent, it dropped 20 percent -- I think it dropped
21 30 percent over three years -- and so we had to
22 introduce, we had to reexamine the specific impact of
23 the Great Recession.

24 The Great Recession had specific impacts on
25 specific classes of mail that were not adequately

1 modeled based on the history that came before. For
2 this purpose, we introduced this intervention
3 analysis.

4 An intervention analysis says, okay, at this
5 particular point in time something happened and that
6 caused mail volume, and it caused mail volume to
7 change. It's a fairly flexible approach so it can
8 either allow mail volume -- one way it could allow
9 mail volume to change is mail volume shifted down to a
10 new level gradually, over time, or immediately, as the
11 case may be.

12 Another possibility is that it also changed
13 the trends in mail volume. So like in, for example,
14 to go back to standard mail, for example, advertising
15 expenditures overall, which I cited in several of my
16 POIR responses -- I think POIR 1, No. 4, is the first
17 place I cite it -- advertising expenditures before the
18 Great Recession grew about five percent a year, on
19 average.

20 Since the Great Recession -- now in the
21 Great Recession advertising expenditures then fell 20
22 percent and that's kind of this level shift which is
23 completely consistent with what we saw in standard
24 mail and kind of tells us the story in standard mail
25 was the story of advertising.

1 Since then, advertising expenditures have
2 not gone back to growing five percent per year. Now
3 they're growing more like one percent. One or two
4 percent per year. In fact, real advertising
5 expenditures, controlling for inflation, in 2012 are
6 the same level they were in 1995. So we've had this
7 big change.

8 So, in addition to the level shift, we've
9 also seen a change in the trend. That intervention
10 analysis also allows us to introduce changes to trends
11 that were triggered by the Great Recession over this
12 time period, and those are what's being captured in,
13 what, in POIR 3, No. 5, what's the column titled
14 columns V and W.

15 Column V is these level shifts that are
16 modeled by intervention variables. Column W is trends
17 that are modeled by this intervention analysis.

18 Q There was some discussion in one of the
19 POIRs asking to clarify this idea of trends versus
20 diversion, that sometimes it was used interchangeably.
21 If I understood and read it correctly, you were trying
22 to clarify and look for the purpose to see trends
23 generally were positive, diversion would be negative,
24 but the idea was -- I think you described it -- to
25 capture the net effect of all trends versus

1 distinguishing positive from negative.

2 A Well, I wouldn't say that's the purpose.
3 The way we do it, that's the result. In the past, and
4 I think even as recently as R2006, we attempted to
5 model diversion by looking specifically at internet
6 variables. The idea of the number of households with
7 broadband, for example. Plug that in to the equation
8 and we can attribute that to that's internet
9 diversion.

10 What's happened is and what typically
11 happens with technological adoption -- and I discuss
12 this in my response to POIR 6, Question 25 -- is that
13 people adopt technology and eventually everybody's
14 adopted and the rate of adoption slows down. In
15 POIR 6, 25, I have, I show a graph of broadband
16 penetration.

17 Q The S curve.

18 A Right, and it's the S curve. So what you
19 had was the percentage of households with broadband
20 in, at the end of 2002, 16 and a half percent of
21 households had it. The end of 2007, 56 percent of
22 households had it.

23 So that's a big growth, and that explains a
24 lot of diversion over that time period, but then from
25 2007 to 2012 we had 56 percent, now we've got 71

1 percent. That's less of an increase and yet we
2 haven't seen less of a decrease in mail volume, so
3 clearly two things are going on.

4 One, there are other factors involved in the
5 trends that we've seen in mail volumes, and the other
6 thing is that it's not a perfect one for one
7 correspondence. It's the not the case of I got
8 broadband installed yesterday so today I'm going to
9 divert all my mail. People gradually use the internet
10 for more and different things and the rate of, the
11 rate at which people begin to pay their bills on line
12 sort of lags the rate at which they get broadband.

13 So because of all that the broadband
14 variable itself no longer works as an explanatory
15 variable to explain continuing downward trends because
16 the variable's not trending anymore. So we changed
17 our methodology and we went with this same
18 intervention analysis approach.

19 The idea is we introduce trends into our
20 equation when basically the model suggests trends have
21 emerged, and if these trends change over time we
22 introduce new trends to allow them to change over
23 time.

24 CHAIRMAN GOLDWAY: And you're asserting that
25 these trends are caused by the Great Recession?

1 THE WITNESS: I'm asserting that some of
2 these trends, the ones that accelerated more recently,
3 have been caused by the Great Recession, yes. There
4 were preexisting trends in first-class mail that tied
5 with this broadband, that tied with the rate of, you
6 know, people, the share of bills paid by mail went
7 from I believe 80 percent in 2002 to 60 percent in
8 2007, so these things existed all along.

9 Social security checks stopped getting paid
10 out and were direct deposit, but again, by 2007 87
11 percent of social security was direct deposit, so
12 these were longstanding preexisting trends. That, in
13 some cases, one might have expected, if anything,
14 should have slowed down. I mean once 87 percent of
15 your checks are direct deposited there's only so many
16 more checks that can be diverted, you know? So, yes.

17 So one of the, clearly -- in 2008 and 2009,
18 in this time period, clearly the trends in first-class
19 mail in particular became much more negative, so those
20 trends are attributed to the Great Recession.

21 But to get back to Commissioner Taub's
22 question, I think, a trend variable is going to pick
23 up anything that trends. It's going to pick up
24 macroeconomic trends, demographic trends, diversion
25 trends. And so it becomes difficult to pull out and

1 say this trend was because of this one specific factor
2 because what it is, it's a combination of all factors,
3 some of which preexisted, and we have the preexisting
4 trends, which we have now taken out.

5 Even in the absence of the Great Recession
6 mail volume was, first-class mail volume was declining
7 by one or two billion pieces a year.

8 But in addition to those preexisting trends
9 toward diversion we've also seen trends that are more
10 clearly related to the Great Recession that have
11 triggered these more recent trends that we are
12 attributing to the Great Recession.

13 BY VICE CHAIRMAN TAUB:

14 Q So when we look at the internet, your point
15 is it's difficult to get a good variable on -- I'm
16 jumping ahead a little bit, but let me step back.
17 Household penetration of broadband kind of is at the
18 top of the *S* curve, shall we say.

19 A Right.

20 Q So the idea that that was going to be useful
21 and all of a sudden you see yet a greater decline in
22 first-class mail, the recession occurs, this must be
23 related to the recession, not the continued
24 penetration of broadband.

25 How do you, one, deal with issues of -- put

1 aside broadband for a moment -- the concern that
2 around the same time, '08-'09, you've got now Apple,
3 Samsung taking off with these tablets, iPhones, so it
4 isn't so much getting broadband connection into one's
5 home.

6 Maybe that reached a top of the S curve, but
7 you had all of a sudden, almost concurrent with the
8 recession, a new form of electronic communication or a
9 tool to do so that if we had just expected it to go
10 from broadband, you know, hey, wow, it shouldn't go --
11 how much more could it be diverted there?

12 In the analysis you present, would we not
13 lose or are we missing this concept of smart phones,
14 and tablets, and, as a diversionary explanation
15 outside of the recession?

16 A Well remember, but with broadband, it's not
17 -- with broadband we would have expected the rate of
18 diversion to slow down. In fact, the rate of
19 diversion did not slow down and our preexisting
20 diversion trends are not slowing down.

21 Instead of modeling, instead of plugging in
22 broadband, which has an S shape, we're plugging in a
23 straight line and so the model already allows for the
24 fact that as some types of diversion are ramping down,
25 some new forms of diversion may be ramping up.

1 CHAIRMAN GOLDWAY: How do you measure -- why
2 did you choose a straight line?

3 THE WITNESS: Because it fits the data best.

4 BY VICE CHAIRMAN TAUB:

5 Q Would the straight line --

6 CHAIRMAN GOLDWAY: But it doesn't.

7 BY VICE CHAIRMAN TAUB:

8 Q -- to the extent there's this, you know, the
9 smart phone issue, for lack of a better term, would
10 that be missing? Would one expect possibly more of a
11 diversion unrelated to the recession but due to
12 outside of broadband, so hence, to use the straight
13 line for broadband may be missing a --

14 A Well, I think it's important to understand
15 what it is that we're hypothesizing smart phones have
16 enabled us to do: To divert mail. Because at the end
17 of 2007 70 percent of households had broadband access.

18 To the extent that -- what a smart phone
19 does is it enables us to access the internet in a
20 slightly different way. For 70 percent of mail, of
21 people, they already had that access to the internet.

22 It allows you to pay your bills on the train
23 going to work instead of at home on your desktop and
24 that may be of value to some people, but it's, to a
25 large extent it's a difference in kind more so than a

1 difference in the nature of it.

2 I mean fax -- we no longer talk about
3 diversion of mail to fax machines because nobody uses
4 fax machines anymore because they got replaced by
5 email. To the extent that faxes got replaced by
6 email, that wasn't a diversion of mail, that was a
7 diversion of a diversion.

8 BY CHAIRMAN GOLDWAY:

9 Q I think it's fair to say that iPads,
10 Androids, social networking are really very different
11 from broadband. It's a whole different way of
12 communicating.

13 I think, at least from my experience and my
14 understanding, you need to have a whole new variable
15 in there that is trending that is separate from the
16 recession that deals with the kind of communications
17 that comes in -- people now carry their lives on an
18 Android. There's cloud computing up there. So you
19 don't need a laptop, you don't need a connection to
20 home. You can talk to a gazillion people. You can
21 use your You Tube.

22 We used to have Netflix as something that
23 was, you had to distribute in the mail and now people
24 on their iPhone or wherever they are can choose 30
25 films from the cloud to watch at the same time.

1 People don't even use their printers anymore
2 because they feel, I think, somewhat concerned about
3 it, but they feel that their lives are all set.
4 They're all stored in the cloud and they've got it
5 here and they can walk around, and they don't need any
6 form of paper communications anymore.

7 I think there's a significant qualitative,
8 quantitative difference between what happened as we
9 were going into email, and laptops, and broadband
10 versus what we got when we got to Androids and the
11 cloud, so I'm concerned that you haven't come up with
12 a factor for that kind of diversion that can't be
13 blamed on the recession.

14 There's no question that the recession
15 pushed more people to look for more ways to save money
16 and to perhaps cut their advertising spending, or send
17 out fewer Christmas cards, or all that kind of stuff,
18 but this new form of communication strikes me as
19 something that is fundamentally different and needs a
20 new trend line.

21 A Well, okay. Let me make three points in
22 response to that. First, from our perspective, it's
23 important that we need to bring this all back to mail
24 volume.

25 Q Right.

1 A I mean on Facebook, yes, I communicate with
2 a couple hundred people from high school, and college,
3 and what not. I wasn't sending them mail before, so
4 my communication with them is not diverting mail in
5 that respect.

6 People had the ability to pay bills on line
7 10 or 15 years ago. It is true that people are more
8 comfortable paying bills on line today than they were
9 10 or 15 years ago and that is part of a general trend
10 of a increased comfort level with technology, but
11 that's a long --

12 Q But you can do it by just, by a scan now,
13 you know? The level of ease with which you can do
14 these transactions has been increased by hundredfold,
15 and the speed with which you can do them has been
16 increased by a thousandfold, and the weight with which
17 you carry these things has been decreased by tenfold,
18 if not more. So you come up with something -- at some
19 point it's different from what it was before. It's
20 not just the same, a gradual change.

21 A Okay. The second point then becomes one of
22 simple mathematics and the question is, okay, can
23 smart phones explain what we've seen in first-class
24 mail volume?

25 What we've seen in first-class mail volume

1 -- and there are volume graphs in my response to
2 POIR 3, No. 1, that I think is probably the best way
3 to visualize it. What we saw in first-class single-
4 piece mail volume is a slight downward trend became a
5 sharp downward trend, and it happened instantaneously
6 with the recession, and it's continued to this day.

7 If you look at the history of smart phones,
8 yes, they coincide, but they coincide in such a way of
9 smart phones were first introduced in this 2007, 2008.
10 They grew very tentatively. Now they've exploded in
11 2011 and 2012.

12 But if you want to explain the trend in
13 first-class single-piece in 2011 and 2012 by the
14 explosion of smart phones in 2011 and 2012, you're
15 left to explain a comparable trend in first-class
16 single-piece volume in 2008 and 2009.

17 There isn't a comparable growth in smart
18 phones. Smart phones are Sing. First-class mail
19 volume is a line. To get from Point A to Point B,
20 yes, you can explain they both get you to the same
21 place, but they get you there over very different
22 paths.

23 Q Or is it that '07 and '08 or '08 and '09 is
24 a result of the recession, but '09 and '10 or '10 to
25 '12 is not a result of the recession, it's a result of

1 this new technology.

2 A Let me put up one more piece of data that I
3 personally think is illuminating. The household diary
4 study looks at first-class mail received by
5 households. You can divide it roughly in half between
6 bills, statements, and advertising, and other.

7 So bills, statements, and advertising, to my
8 mind, these are factors that have a clear
9 macroeconomic component to them. Other is this
10 general communication that we're talking about.

11 From 2003 to 2006, bills, statements, and
12 advertising grew at an average annual rate of 1.4
13 percent. From 2010 to 2012, they've declined by 8.4
14 percent per year. That, to me, clearly macroeconomic.
15 Big change between before the recession, since the
16 recession.

17 The other from 2003 to 2006 were declining
18 at an average annual rate of 1.3 percent. People were
19 sending fewer Christmas cards, people were writing
20 fewer letters, people were sending emails with
21 attachments instead of mail.

22 But from 2010 to 2012, other mail declined
23 at an average annual rate of only 0.8 percent per
24 year. It's the same trend. This is a longstanding
25 trend away from using the mail for personal

1 communication. That trend is separate and distinct
2 from what happened in the Great Recession.

3 CHAIRMAN GOLDWAY: But advertising has been
4 transformed with these new technologies. You have
5 Facebook and Twitter and all these places that people
6 are advertising that weren't available to them, and
7 the cost is virtually nothing to do that.

8 You know, when we used to say you could
9 really fashion and target people through the mail, you
10 can do it now in these other ways so much more
11 quickly. So I think -- and as I said, business
12 correspondence, photographs, various kinds of
13 materials are all now much more available or more
14 transferred.

15 It's not just the -- it's the cloud as much
16 as it is the smart phone. It's the sense that you
17 have all that information stored somewhere that you
18 can get at that I think focuses on the shift and the
19 downturn in, at least some significant portion of that
20 downturn from 2010 to '12 that your analysis is
21 missing.

22 BY VICE CHAIRMAN TAUB:

23 Q To the extent, if at all, there is this
24 missing piece of the analysis -- not suggesting you're
25 acknowledging there is or even there is -- is there

1 any way to measure that? How would your model be
2 changed, if at all, to account for that, and what
3 would the affect be on the results?

4 A Well, it would be very difficult to model it
5 separately if it takes the form of a trend. I mean
6 econometric equations aren't as smart sometimes as I
7 like to talk about them being, you know? The model
8 doesn't know why volume is changing, it merely knows
9 that volume is changing, and it knows that the
10 variables you've included in the equation are
11 changing.

12 So if there are three things that are moving
13 in the exact same direction of the exact same
14 magnitude over the exact same period of time, there's
15 nothing you can do with that econometrically. You can
16 get an overall estimate. The negative trends in
17 first-class mail that have emerged since 2008 and
18 declining employment, those things have combined to
19 reduce first-class mail volume by 22 billion pieces
20 through 2012. That, I can state with a very high
21 degree of certainty.

22 I can point you to data on credit card
23 accounts, which I've done in presiding officer's
24 information requests. I can point you to
25 macroeconomic factors in general. I can point you to

1 the fact that real advertising expenditures in 2012
2 are at the same level they were at in 1995.

3 I can point you to the fact that real median
4 household income declined five straight years from
5 2008 to 2012 by a total of eight percent. I can point
6 out to you that the level of home ownership peaked in
7 2004 at 69 percent and has declined every year since
8 and is now at 65 percent.

9 I can point out to you that the rate of
10 household formation slowed down dramatically in the
11 wake of the Great Recession so that the number of
12 adults per household is now at its all time high.

13 I can point out to you that even in 2012 and
14 2013, according to fed data, the number of new credit
15 card accounts was less than the number of closed
16 credit card accounts so that we are still seeing
17 movement away from credit cards, which have a various
18 obvious translation into mail volume.

19 I can point out to you that the number of
20 mortgage loan accounts has declined for 20 of the last
21 21 quarters and that home equity loan accounts have
22 declined for 19 of the last 21 quarters.

23 So, again, I can point out to you the
24 household diary study data I said before that
25 excluding bills, statements, and advertising, first-

1 class mail volume was declining 1.3 percent per year
2 among mail received by households. In 2010 through
3 2012 that same type of mail is declining by less than
4 one percent per year. That's a continuing trend that
5 we have already accounted for.

6 Q The argument therefore is the Great
7 Recession had such a structural change to our economy,
8 and particularly as it relates to our Postal Service
9 and the postal sector, that these trends you've
10 identified are the new normal, and the volume loss
11 experienced from that new normal will continue on
12 until -- is there an end point?

13 A Until --

14 Q How do we know when there's an end?

15 A I mean until the trends change. I mean, you
16 know, home ownership has a clear and obvious
17 relationship with mail volume. Homeowners receive
18 more mail than non-homeowners. You can look at the
19 household diary study, but I think intuitively you get
20 that. If home ownership rebounds, would that
21 translate into more mail volume? I would hope so.
22 But home ownership hasn't rebounded yet by the, from
23 the data I've seen.

24 Q Yes. In POIR 6, No. 5, I think -- and
25 you've stated here -- from your perspective, the Great

1 Recession, we have not seen the return to what would
2 have been the historical levels one would have
3 expected after a downturn.

4 A Right.

5 Q Therefore, when the Commission is charged
6 with, in the early iteration of this case, first
7 saying was the Great Recession extraordinary, an
8 exceptional event, and the Commission in that case
9 found it was, then obviously what in large measure
10 resulted in the denial and yet a remand to this
11 Commission to explain was looking for the Postal
12 Service to better link what was due to that. As the
13 Commission has said, it's looking for the results of
14 that event and its impact on volumes.

15 So if I understand fully the numerous POIRs
16 that you've responded to -- and I spent Saturday and
17 Sunday reading them yet again after they first came in
18 and trying to sort through this -- but it's, you know,
19 the critical question, at least from my mind, are we
20 to therefore view this as these losses will continue.
21 They may start to, in terms of the impact on the
22 numbers, taper off each year, but it's still we're
23 talking billions.

24 Is there not a different way? And how would
25 one do that? To say, wait a minute, there was the

1 major impact, but at some point there's the new normal
2 and the Postal Service shouldn't be looking for a due
3 to beyond this point in time even though that trend
4 may have resulted from there, but that's the new world
5 we live in and -- is that more judgment or is that a
6 judgment that could be reflected in any of the
7 modeling you're doing?

8 A I think that's a fair question. I think
9 it's also a question that's beyond the scope of my
10 testimony. To the extent that trends have changed and
11 those trends can be tied to the Great Recession, those
12 trends are likely to continue until we see evidence
13 that they aren't.

14 I mean I appreciate the question that
15 there's an application that 20 years from now we're
16 still talking about the impact of the Great Recession.
17 That said, realistically, 20 years from now we might
18 still be talking about the impact of the Great
19 Recession.

20 BY CHAIRMAN GOLDWAY:

21 Q But how much responsibility does the Postal
22 Service have to respond to a new normal and not expect
23 additional payments for something that happened 20
24 years ago?

25 A Well, it --

1 Q I think the other question is what was the
2 old normal? Was the old normal the bubble where
3 everyone got six and seven credit cards without having
4 established any credit and people were begging you to
5 take mortgages and second mortgages? Should that be
6 the standard that we have to go back up to?

7 You know, did we push home ownership way
8 beyond what was financially capable in our country
9 with the various fraudulent or over ambitious
10 activities of the various banks which are now being
11 forced to pay billions of dollars to account for those
12 excesses? I mean where do we put what was a
13 reasonable expectation for performance with what's a
14 reasonable expectation for performance now in the new
15 normal?

16 So I think we have some judgment that has to
17 be made even on the beginning of your measurement of
18 what the Postal Service should be expecting. They
19 were benefitting from this huge housing bubble which
20 was one of the major reasons to cause the recession.

21 So should we ask the Postal Service for, you
22 know, to give back some of the profits that it gained
23 then, or should we anticipate that they're going to go
24 back to that level of activity and provide them these
25 rates because they, you know, expect that's their

1 normal level and we should provide them these rates to
2 justify what may have been artificially exaggerated
3 growth at the time? Do you have an answer?

4 A I was going to say is that a question for me
5 or is that a statement? I'm sorry.

6 Q Well, I think is there a way to measure what
7 was happening in the two or three years before the
8 recession that caused the recession so that you have a
9 more realistic benchmark from which to measure what
10 the expected drop was. Does that make sense to you?

11 BY VICE CHAIRMAN TAUB:

12 Q In fact, and as you think about answering
13 that, you know, as I read your testimony, largely what
14 we're talking about here is not the historical highs
15 that you're looking at necessarily getting back to.
16 There's the level of diversions -- let's take
17 diversion, for example -- and the rate.

18 A Correct. Yes.

19 Q What has changed here is the rate.

20 A Yes.

21 Q So if one is going back, taking certain of
22 your variables to the recession of the early '90s,
23 there was a drop off, a change, and certain other
24 factors, '02. So as you answer that I also would like
25 some clarification.

1 As I understand what you've presented to us,
2 it isn't things were going gang busters in '06 and
3 therefore everything went off the cliff, and
4 everything that went off the cliff in '06 is due to
5 the recession because it's not going back to the '06
6 level. Or is it? Or is it that one would expect it
7 to be at certain levels of recovery given the
8 historical trends.

9 A Well, again, I think if you look at the
10 volume graphs in my response to POIR 3, No. 1, I sort
11 of do address that and look at that, and yes, you
12 know, what would we have expected volume to be had
13 there not been a recession? The answer is we would
14 have expected volume to be in the same general level,
15 I think, overall today as we would have expected to
16 see in 2006, 2007.

17 I think to somewhat to go back to Chairman
18 Goldway's question, mail volume in 2004, 2005, 2006
19 was reasonably well-explained by our models by the
20 levels of investment, by the level of employment, by
21 what was going on with prices. The fact that the
22 Postal Service didn't change prices between 2002 and
23 2006, that helped mail volume.

24 There was not any evidence that mail volume
25 was growing exorbitantly relative to history. I mean

1 standard mail volume in 2004 and '05 grew five percent
2 per year which seems high in this new world, but the
3 fact is standard mail volume grew about three percent
4 per year, on average. It grew five or six percent in
5 the good years, and it maybe fell a little bit during
6 a recessions. You go back to the 1980s and standard
7 mail volume was growing 10 percent per year. I mean,
8 so that's clearly unsustainable.

9 The history of the last 20 years suggests
10 standard mail volume growing five percent in years
11 where you're not raising rates and where the economy's
12 doing well. That's normal.

13 I mean if you want to go, take a step back
14 and say, okay, but those investment levels that you're
15 using to explain it, those are unsustainably high,
16 well that's, I think that question is beyond me. I
17 can just say, you know, I don't think the postal world
18 of 2004, 2005, 2006 was a ridiculously unsustainable
19 world.

20 CHAIRMAN GOLDWAY: Does anyone else have
21 some questions before we take a break? Going to do it
22 afterwards?

23 (No response.)

24 CHAIRMAN GOLDWAY: I think this is a really
25 interesting discussion and I believe that we're going

1 to have more questions for you, but I think it's a
2 good time to break for lunch.

3 THE WITNESS: Okay.

4 CHAIRMAN GOLDWAY: Then we'll come back
5 1:30. Is that reasonable for everyone? We'll come
6 back at 1:30 to continue this discussion.

7 Thank you, Mr. Thress. Did you have a --
8 counsel?

9 MR. RUBIN: Yes. Just to address a question
10 by Commissioner Langley about the volume forecasts and
11 the effects of the exigent increase, those materials
12 are presented in the attachments to the Nickerson
13 testimony. If you'd like, I can point you right now
14 to which attachments you look at.

15 COMMISSIONER LANGLEY: I appreciate that.

16 CHAIRMAN GOLDWAY: That's a good thing to do
17 during the break. Yes.

18 MR. RUBIN: Okay.

19 COMMISSIONER LANGLEY: I was asking Mr.
20 Thress whether he had an explanation.

21 MR. RUBIN: Right. It's in the Nickerson
22 materials.

23 COMMISSIONER LANGLEY: Thank you.

24 //

25 //

1 (Whereupon, at 12:22 p.m., the hearing in
2 the above-entitled matter was recessed, to reconvene
3 at 1:30 p.m. this same day, Tuesday, November 19,
4 2013.)
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1 with me.

2 A Okay.

3 Q How do you differentiate losses that are
4 attributed to the Great Recession from those that are
5 attributed to previous recessions?

6 A We isolate macroeconomic variables from
7 trend variables, from Great Recession-specific
8 intervention variables. So previous recessions were
9 generally well modeled by the macroeconomic variables
10 we included in our equations. The impact of the 2001
11 recession on standard mail is well modeled by looking
12 at what happened to gross private domestic investment
13 in the 2001 recession and applying our estimated
14 elasticity of that to standard mail volume.

15 Our starting point from this is the impact
16 of the Great Recession is anything that was in effect
17 by 2007 is not attributed to the Great Recession for
18 the purposes of this case; anything that happened in
19 2008 and subsequent, either as measured by the
20 macroeconomic variables or by these intervention
21 variables.

22 So to the extent that the -- to the extent
23 that employment was lower in 2007 than it would have
24 been but for the 2001 recession, for example, that
25 would be implicit in the base from which we're

1 starting in 2007, and impact of employment in 2008 is
2 this is the effect of the fact that employment
3 declined from 2007 to 2008.

4 Q Okay. Can you tell me if you've used any
5 econometric techniques to separate the impacts of
6 recession-related diversion from overall diversion
7 impacts, or have you relied mostly on your own
8 judgment? And if that is the case, can you explain in
9 some detail why -- where you may have applied that
10 judgment and why it's so important?

11 A Well, the diversion trends -- the starting
12 points for the diversion trends are chosen, excuse me,
13 essentially mathematically, that is, the points in
14 time where there is evidence of a structural break in
15 the model. In terms of what caused those diversions,
16 why did the diversions change at that time, that's a
17 question that requires one to -- I've said in several
18 responses -- I think step outside of the econometric
19 model.

20 And in terms of the more recent trends and
21 why these more recent trends tie to the Great
22 Recession, I would point you to data I've presented in
23 several of my responses regarding account data,
24 regarding advertising expenditure growth. I cited
25 several pieces of data this morning in terms of

1 household formation, in terms of home ownership, in
2 terms of mortgage accounts, in terms of real median
3 household income. These are all factors that have
4 been affected by the Great Recession that continue to
5 be affected by the Great Recession and that have clear
6 and obvious translations into how those translate into
7 mail volume.

8 In addition, looking at the household diary
9 study data, which again I quoted this morning in
10 response to Chairman Goldway, the mail received,
11 first-class mail received, by household that is of a
12 more economic nature, bills, statements, advertising,
13 is the mail that declined in the wake of the Great
14 Recession.

15 Other kinds of mail, correspondence,
16 household-to-household, these things declined at a
17 similar rate to what they did before the Great
18 Recession, which suggests to me that these were
19 continuations of longstanding trends, which predate
20 the Great Recession, and which were already
21 incorporated into our model via these earlier trends.

22 CHAIRMAN GOLDWAY: Does that mean in your
23 calculations you did not include the volume losses for
24 those other forms of mail and identifying what the
25 loss at the Great Recession was?

1 THE WITNESS: We excluded -- for purposes of
2 calculating the impact of the Great Recession, we
3 excluded preexisting trends. We estimated that
4 preexisting trends lowered the volume of first-class
5 mail by 16 billion pieces from 2002 to 2007. That 16
6 billion pieces was going to stay lost. And in
7 addition, that trend was going to persist for the next
8 five years thereafter, and the mail loss attributable
9 to that trend persisting was also excluded from the
10 impact of the Great Recession.

11 BY COMMISSIONER ACTON:

12 Q When you speak of stepping outside the
13 econometric box, is that the instance where you are
14 applying your professional expertise and judgment?

15 A Yes.

16 Q I'd like to talk a bit about this artful
17 term, "the new normal." If you could sort of
18 summarize its general characteristics and when it
19 began, for instance.

20 A Okay. I think in order to understand the
21 new normal we need to start by understanding the old
22 normal. In the old normal, the world that we existed
23 in in 2006, 2007, the world under which the PAEA came
24 in being, first-class mail volume was declining.
25 First-class mail volume declined from 2001 to 2007 by

1 1 to 2 billion pieces per year. Standard mail volume
2 tracked well with the economy and grew on average
3 about 3 percent per year, 5 percent in good years. It
4 fell -- in the wake of the 2001 recession, it fell.
5 So we would have expected some of that. And the
6 overall mail volume was growing slightly.

7 In the new normal, first-class mail volume
8 is now declining 5 billion pieces per year. Standard
9 mail volume is no longer consistently growing, and its
10 growth seems somewhat less connected to the general
11 macro economy. We see that particularly in 2012.
12 2012, all things considered in terms of growth rates,
13 wasn't a bad year for the economy. Investment grew.
14 You know, the economy to some extent, there was
15 evidence that it had turned around and was growing.
16 And yet standard mail volume declined 5 percent in
17 2012.

18 That portion of it is not attributed to the
19 Great Recession. That is part of the new normal. So
20 in the new normal world, we have declining first-class
21 mail volume. We have standard mail volume that at
22 best isn't growing. And the result is we now have
23 declining mail volume. And importantly, that new
24 normal is being built from a baseline that's
25 essentially 20 percent lower than the old normal.

1 This new standard mail volume that's not
2 growing is coming in the wake of 20 percent decline in
3 standard mail volume in 2008 and 2009.

4 Q And so the new normal impacts different
5 classes of mail differently.

6 A Certainly, yes. The new normal has -- in
7 the new normal, the relationship of -- you know, the
8 relative growth of mail volumes between classes is
9 different than in the old normal, to some extent.

10 Q Does the impact -- does the beginning of the
11 impact vary by class?

12 A Somewhat, yes. Advertising -- overall
13 advertising expenditures as a percentage of total GDP
14 began to weaken in 2006 and 2007, which gross private
15 domestic investment began to decline in 2006. So we
16 saw a weakening in advertising sort of predating -- it
17 was one of the starting points of the Great Recession.

18 For first-class single-piece mail, we began
19 to see some softening in 2007. Home ownership rates
20 peaked in 2004, I believe, and home prices peaked in
21 2006. So there was beginning to be some softening
22 there, and it gradually spread to other places; of
23 course, accelerated and became dramatic in the case of
24 standard mail in 2009.

25 There is some evidence that, you know, some

1 people kind of -- I think some mail volumes tried to
2 hold on longer than others. Standard nonprofit seemed
3 to bottom out a little bit later than standard
4 regular. So the timing wasn't uniform. It's not that
5 we can point to, you know, a day in time or even a
6 quarter in time. But there is a -- you know, there is
7 a general time frame.

8 CHAIRMAN GOLDWAY: And your model, when does
9 it start counting those losses?

10 THE WITNESS: Well, the model -- the
11 intervention analysis model allows for the
12 intervention to be introduced at different times in
13 different models. So the intervention model
14 recognizes that the trend changed in first-class
15 single-piece in 2007, quarter four. The trend changed
16 in first-class work share in 2008, quarter one. This
17 big 20 percent drop in standard regular started in
18 2008, quarter two, in various equations.

19 The timing is chosen within the models as
20 the timing that best fits. Now, all that said, for
21 the purposes of this case, within my statement I'm
22 starting the counting in statement with FY2008. Those
23 are the first numbers that I'm presenting as
24 attributable to the Great Recession in my statement.

25 CHAIRMAN GOLDWAY: And then I think

1 Commissioner Acton asked when did the new normal
2 start, and did the new normal start for different
3 classes of mail at different times?

4 THE WITNESS: Well, I mean, it did start at
5 different times. In first class mail, the new normal
6 started kind of right away in this 2007-2008 period.
7 The trends that started then have not yet started to
8 reverse themselves. Now, for standard regular mail,
9 there was a weakening of the relationship with the
10 economy back in 2006-2007. There was a major
11 bottoming out in 2008-2009, but that bottom -- but we
12 sort of reached the bottom there. And so to some
13 extent I think it's fair to call maybe 2010 through
14 2013 the new normal for standard mail.

15 BY COMMISSIONER ACTON:

16 Q You may have answered this, but how do we
17 know when we've reached an economic new normal?

18 A I would say from my perspective as an
19 econometrician and a forecaster, I feel like we've
20 reached a new normal when -- to some extent when the
21 forecasts start working again. I mean, when we made a
22 forecast in 2008 and 2009, they were terrible,
23 terrible forecasts. You know, we completely missed
24 the boat on how much mail volume was going to be lost.

25 Now, 2011, '12, '13, we're back to a world

1 similar to where we were before in terms of we have a
2 better handle on our forecast. Errors have fallen
3 relatively more in line. That said, one feature of
4 the new normal in respect to that, however -- and I
5 think I mentioned it earlier -- is that standard mail
6 volume has become somewhat less predictable in that
7 standard mail volume is more prone to -- it doesn't
8 seem as well tied to clear and obvious macroeconomic
9 variables.

10 In 2011, it grew -- standard mail volume
11 grew 2.6 percent. In 2012, standard mail volume
12 declined 5.3 percent. In 2013, I believe standard
13 mail volume grew 1.1 percent. And it's hard to look
14 at the world, look at the general macro economy and
15 see the kinds of things that can explain that. So I
16 think one feature of the new normal for standard mail
17 volume, frankly, is that it's harder to forecast.

18 Q Occasionally when we're doing these sorts of
19 things, I look back at the statute and the provisions
20 in the law that apply for an exigent request. And
21 part of that includes the contents of an exigent
22 request. An earlier witness, when I posed the
23 question about this particular provision, which is an
24 explanation of when or under what circumstances the
25 Postal Service expects to be able to rescind the

1 exigent rate adjustments in whole or in part, they
2 suggested that you may have some insight about that.

3 A Well, I think there are two components to
4 what the Great Recession did to the Postal Service.
5 One component is mail volume fell 10, 15, 20 percent
6 in two or three years, and that's the big chunk that's
7 essentially on my table one, if you stop in 2009-2010.
8 I think by 2010, it's 44 billion pieces of mail lost.

9 I mean, that's just kind of -- a lot of that
10 is just kind of a level shift. So the answer to when
11 could the Postal Service get that back, sort of from
12 my perspective is a question of, well, is any of that
13 mail likely to come back. And I'm not sure that it
14 is.

15 Now, the second component -- and if you
16 extend the -- you know, my table extends out to 2012.
17 And there we have these trends, which are what we were
18 talking about, the new normal versus the old normal.
19 And this is to some extent beyond my level of
20 expertise. I mean, I don't necessarily -- I'm not
21 necessarily involved in the choice of when should we
22 file exigent rate cases and how much should we ask
23 for. I give them numbers and let them do what they
24 want with them.

25 So, I mean, to some extent the question does

1 become -- and again, I talked about this with Chairman
2 Goldway -- to the extent these trends continue in the
3 future, and this is the new normal, it does seem -- it
4 does make sense to me that there will come a point in
5 time where somebody has to just kind of bite the
6 bullet and say, okay, mail volume is -- first-class
7 mail volume is falling 5 billion pieces a year. You
8 have to do something to adjust to that. You can't
9 come back and ask for an exigent rate increase every
10 year for that.

11 But again, that's beyond -- you know, that's
12 a policy question that's not my real area of
13 expertise. I mean, from my perspective, the world
14 today is different from the world of 2007. One of the
15 ways it's different is these trends. Now, these
16 trends may attenuate. They may go away over time.
17 And if that's the case, certainly then we get a new,
18 new normal.

19 But to the extent that they persist, just
20 sort of mathematically and conceptually, I think it's
21 fair to say this is the Great Recession is what caused
22 this.

23 Q Has the Postal Service made any assessment
24 about how long the impact on mail volume that you
25 attribute to the Great Recession may last?

1 A I mean, well, for volume forecasting
2 purposes, I mean, we -- for volume forecasting
3 purposes, certainly within this case, we are assuming
4 that trends will persist through 2014. When you get
5 into -- you know, the longer time frame you get into
6 for forecasting, the more uncertain it becomes, and
7 the more important it becomes to bring in outside
8 considerations.

9 I mean, one of the things we've always
10 talked about in the -- with respect to diversion is,
11 is there a floor. You know, we talked about earlier,
12 you know, broadband was reaching a ceiling, and that
13 was implying that the rate of diversion for first-
14 class mail was slowing down. And for forecasting
15 purposes, it sort of implies, well, at some point
16 isn't it logical that everybody that is going to
17 divert mail will have already diverted it, and you
18 will have a very low level of mail. But the trend
19 should eventually attenuate somewhat.

20 Those are the sorts of considerations that
21 we take into account and we debate and discuss when
22 we're putting together a long-term forecast.

23 Q Another portion of the law when it comes to
24 the exigent request goes to the matter of
25 applicability. And these rate adjustments are

1 supposed to be due to extraordinary or exceptional
2 circumstances. And yet you describe this era that
3 we're in now as normal. How do I match those?

4 A Well, I -- you know, go back to advertising
5 expenditures as the one that I harp on because to me
6 it's so clear. Advertising expenditures fell 20
7 percent in two years. Total advertising expenditures
8 declined for three consecutive years. If you go back
9 and look in the history of advertising expenditures,
10 the last time advertising expenditures fell by even 15
11 percent or fell for more than two years in a row was
12 the Great Depression.

13 I mean, there is a reason why this recession
14 has a name that's not just the 2007 recession. It's
15 the Great Recession for a reason. It was
16 extraordinary.

17 Q Well, the Commission has opined in previous
18 findings that indeed there was an extraordinary
19 instance. I'm just trying to rectify a sort of
20 commonsense conflict that I had in my own decision
21 process about how you describe a new circumstance as
22 normal and use this ongoing situation as good cause to
23 keep charging exigent rates. And you may not have an
24 answer for that.

25 A Well, in terms of the question -- in terms

1 of how does this translate into Postal Service
2 pricing, that is beyond the scope of my testimony and
3 my work for the Postal Service. So maybe I'll just
4 leave it at that.

5 COMMISSIONER ACTON: I appreciate that.
6 Thank you for your contribution.

7 CHAIRMAN GOLDWAY: Commissioner Langley, do
8 you have some questions?

9 COMMISSIONER LANGLEY: No.

10 CHAIRMAN GOLDWAY: Vice Chairman Taub?

11 BY VICE CHAIRMAN TAUB:

12 Q Good afternoon again.

13 A Thank you.

14 Q I hope you had a good lunch. I wanted to
15 pick up a bit on what we were talking about earlier on
16 the macroeconomic factors --

17 A Okay.

18 Q -- and the intervention to composition. The
19 macroeconomic factors you have seen play in, and so
20 we've got trends that go on each year. What happens
21 when you have -- for example, let's take employment,
22 and the employment numbers turn positive in a given
23 year. Would that suggest that should be stopped being
24 used as a macroeconomic factor at that point because
25 of sudden -- now employment has turned to a positive,

1 or should it be handled in some way that might be
2 different than what is being proposed here? My
3 understanding is the way you've presented it, you
4 know, you've gone through experimentation. These are
5 the macroeconomic trends. These trend lines, even if
6 they might bubble up, are the ones that are not going
7 back to where they were. You haven't seen such a
8 turnaround to previous levels.

9 But as we look at the model and try to
10 assure ourselves there is the connection of volume,
11 when we see positive individual years on some of these
12 trends, how should that be factored in?

13 A Well, what the model would say is that if
14 employment grows in a particular year, the model would
15 say all other things being equal, we would expect
16 first-class mail volume to grow. But the model would
17 also say, but all other things are not equal because
18 we have these other factors that are affecting the
19 mail. And one of those factors is these negative
20 trends, which more than offset the positive -- the
21 potential positive impact of employment growth.

22 Q So the way I understand some of the backup
23 Excel sheets, when you've -- in terms of actually
24 assigning a numerical value, if it turns positive,
25 you're putting that at zero.

1 A Right. In terms of what we're attributing
2 to the Great Recession, we're saying once employment
3 turns positive, then the impact of employment on the
4 Great Recession is over, and that impact going forward
5 is zero.

6 Q If it turns negative, though, the next year,
7 would it be picked up again, or it's just zero going
8 forward from the point of --

9 A The way the spreadsheet is set up, the
10 maximum impact of the macro variable for any
11 particular year is zero. It's a non-negativity
12 constraint.

13 Q Why not -- or to what extent would there be
14 issues with actually assigning a positive value to it?

15 A Well, the issue there is what is the --
16 well, what is the alternative normal that we're
17 judging things against. And in the absence of the
18 Great Recession, we would have expected employment to
19 grow. Employment grows outside of recessions.

20 So and particularly with the rate at which
21 employment has begun to grow since the Great
22 Recession, it's a sufficiently slow growth rate that
23 it's sort of a return to normal more so than catch-up
24 is kind of -- you know, to some extent the question is
25 where would we have been in 2012 had there not been a

1 Great Recession. Where would employment have been in
2 2012? And employment -- in my view, employment would
3 have been higher in 2008 and 2009, would have grown
4 slightly instead of fallen, and then 2010, 2011, and
5 2012, where we did see employment grow, that growth
6 rate is kind of what we would have expected anyway, I
7 think.

8 So that's why we're not including that
9 portion as sort of offsetting the Great Recession.

10 Q If one were to think that it should be
11 included, how far of an impact on your numbers would
12 you see that playing out, if at all? Obviously the
13 macroeconomic factors are the 16 billion --

14 A Right. Well, I mean --

15 Q -- out of the equation versus the 37.

16 A I mean, presumably there will come a point
17 in time. It hasn't happened yet, but I believe -- I
18 assume it will, and I don't remember if it falls
19 within the forecast period here or if it's beyond
20 that, where total private employment per adult, which
21 is the variable we use, will exceed total private
22 employment per adult before the Great Recession.

23 But we would have expected total private
24 employment to grow anyway. So even when it gets to
25 that point, even when investment gets to the point

1 where, okay, investment now is the same as investment
2 was in 2007, it still begs the question, but is
3 investment now where we would have expected investment
4 to be now had it not fallen 30 percent in the interim.
5 And I think at that point the answer is no.

6 Q And that even includes the idea of -- your
7 description there is the equalization, shall we say,
8 back to the pre-recession level. My earlier
9 discussion was just the fact of turning to a
10 positive --

11 A Right.

12 Q -- trend as opposed to the level itself. So
13 your point being this variable should continue, or
14 certainly would continue unless and until you get to
15 an equalization level, and even then one would need to
16 think through, would have even that be the right
17 number if for not the Great Recession.

18 A Yes.

19 CHAIRMAN GOLDWAY: Would your models accept
20 the fact that there are business cycles, economic
21 cycles?

22 THE WITNESS: Yes, yes. The models allow
23 for --

24 CHAIRMAN GOLDWAY: So why would you have to
25 assume that employment will be higher in 2012 or '13

1 than it was in 2008? Maybe there was a business --
2 not a Great Recession, but a business cycle, and
3 things were level. Why is there an assumption that
4 there is going to be --

5 THE WITNESS: Well, in past business cycles,
6 typically what we see is macroeconomic variables
7 decline in the cycle, and then in the recovery they
8 grow more rapidly than their historical average so
9 that they ultimately end up back on the trend line
10 that they were all along.

11 CHAIRMAN GOLDWAY: So, for instance, in your
12 investment category, are you figuring in the fact that
13 the stock market is now much higher than it was in
14 2007 and '08? Or have you just zeroed that out as
15 well?

16 THE WITNESS: I mean, the investment
17 variable we use is gross private domestic investment,
18 as reported by the Bureau of Economic Analysis. Our
19 forecast of it comes from IHS Global Insight. I don't
20 know --

21 CHAIRMAN GOLDWAY: You don't know what is in
22 that forecast.

23 THE WITNESS: I don't know how they forecast
24 that variable, no.

25 CHAIRMAN GOLDWAY: And if it's positive,

1 you're just inputting it as zero.

2 THE WITNESS: Well, again, for forecasting
3 purposes, in terms of actually explaining mail volume,
4 in terms of forecasting, no. We're forecasting that
5 whatever the model says investment would have added to
6 standard mail volume, that's incorporated into --
7 that's broken out in the sources of change on sheet
8 volume counted the EFG. I think I want to say
9 investment is column F, but I could be wrong.

10 There are positive numbers there, and that
11 explains part of what we've seen with mail volume.
12 And for forecasting purposes, we forecast that
13 investment will grow.

14 In terms of which of these columns do we
15 attribute to the Great Recession, that's where the
16 impact of the Great Recession was negative, was non-
17 positive, and that's essentially by assumption.

18 BY VICE CHAIRMAN TAUB:

19 Q So if we could take a look at your POIR
20 number six.

21 A Sure.

22 Q And it's question two. And while you're
23 doing that, I had intended to also note your POIR
24 number three -- and I'm not looking to refer to that.
25 That's not the one in terms of my question. But it

1 was just a comment. I certainly for one really
2 appreciated your answer to number one in terms of the
3 attempt to be responsive in a comprehensive way.

4 We, you know, many times are used to seeing
5 answers that just try to limit it to the four corners,
6 and regardless of how one might view some of the
7 arguments made that, I just wanted to say I
8 appreciated your attempt in POIR number three,
9 question one, to really try to walk through the story,
10 shall we say, on what your model is doing.

11 A Thank you.

12 Q But if you've got number six up, and it's
13 number two, you have a --

14 A I didn't answer question two of POIR number
15 six. Steve Nickerson did.

16 Q I'm sorry. It was the number one.

17 A Okay, fine.

18 Q You've got number one?

19 A Yeah.

20 Q It was my second page.

21 A Okay.

22 Q Who is on first? I don't know if you have
23 your color chart there.

24 A I do.

25 Q Excellent. So this is a graphic

1 representation of -- and we break it out by class --
2 of mail volume. And I'm not looking for you to reread
3 and restate everything that's in there. But you do
4 this for each class of mail. And I think this is
5 relevant to some of what we've been talking about this
6 morning and this afternoon.

7 Could you walk through for the oral record
8 here what these lines are showing and the extent to
9 which in some cases on first-class, for example,
10 they're demonstrating that the non-exigent factors, if
11 you will, are not being claimed?

12 A Sure. Well, I'll -- let me walk through
13 first-class single-piece because to some extent it's
14 the cleanest, and then if you want me to say more,
15 I'll say more.

16 Q Fair enough.

17 A First-class single-piece, the blue line,
18 which is the single line to the left, if anyone is
19 looking at a black and white version, is actual mail
20 volume from 1992 to 2007, and in particular from about
21 1997 to 2000 it trends downward. There is a little
22 bit of a dip down in 2002-2003, and the trend becomes
23 a little stronger there. And then it breaks off into
24 three different possible paths.

25 The green line, the bottom line, is what

1 actually happened. That's actual volume. Actual
2 volume, it took another downward turn, and the trend
3 became sharper. The middle line or the red line is
4 that's what would have happened excluding what I have
5 attributed to the Great Recession in my statement.
6 And essentially in this case the trend that we see
7 starting in about 2003-2004 continues, and you have a
8 relatively smooth, straight line.

9 Then the top line, the yellow line, is
10 excluding -- this is what -- this is excluding
11 preexisting diversion. And there was preexisting
12 diversion explained why the trend turned more negative
13 over the mid-2000s. And again, the baseline
14 assumption of ours is that we're not counting that as
15 part of the Great Recession. We're treating that
16 separately.

17 So the gap between the red and the yellow
18 line is diversion trends that we are not attributing
19 to the Great Recession, and the gap between the red
20 and the green line becomes -- and this is what we are
21 attributing to the Great Recession.

22 Q And then so the issue there is to the extent
23 a 50,000-foot level if one were to suggest you throw
24 everything and the kitchen sink in there on the Great
25 Recession, there is a backing out here, an attempt to,

1 at least when it came to first-class mail, of the
2 diversion issue --

3 A Right. There is a recognition first-class
4 single-piece mail volume was already falling. First-
5 class single-piece mail volume surely would have
6 continued to fall even had there not been a Great
7 Recession. And the red line is our best estimate of
8 what first-class single-piece mail volume would have
9 been but for the Great Recession. And it is because
10 we are pulling out the trends that get you -- that
11 separate the red line from the yellow line.

12 VICE CHAIRMAN TAUB: Go ahead.

13 CHAIRMAN GOLDWAY: The yellow line just
14 seems to me to be why bother. It wasn't going to
15 happen anyway.

16 THE WITNESS: The yellow line -- I don't
17 think it's right to think of the yellow line as a
18 forecast. I mean, in some sense it is a forecast in
19 the sense of what if nobody else diverted any mail
20 starting in 2007. And, yes, nobody believes that. I
21 mean, we certainly wouldn't have put that forward as a
22 forecast.

23 The purpose of the line, I think, is to --
24 the key is the difference between the lines. That's
25 the preexisting diversion that already existed. It's

1 an attempt to directly answer the question POIR six,
2 number one, which you talk about, you know, the Postal
3 Service must factor out the financial impact of non-
4 exigent circumstances such as the continuing effects
5 of electronic diversion. The gap between those lines
6 is specifically our attempt to factor out the
7 continuing effects of electronic diversion.

8 BY VICE CHAIRMAN TAUB:

9 Q And a little bit later you then look at
10 standard mail, and we don't have the yellow line issue
11 there. And again, if you could just amplify the
12 standard mail, how that played out differently than
13 the first-class mail now.

14 A Well, in standard mail, to the extent that
15 there was diversion prior to 2007, it was subsumed by
16 other factors that were positive. Standard mail as a
17 share of total advertising expenditures was relatively
18 stable. I think it might have even possibly been
19 growing slightly over this time period. So there was
20 growing Internet advertising, and to the extent that
21 it was eating into other types of advertising,
22 standard mail didn't seem to be particularly
23 negatively affected, and it may have been less
24 affected by other things. Newspapers in particular
25 were particularly badly hurt by Internet advertising

1 over this time period.

2 So we have again the blue line is historical
3 mail volume for standard mail, and historically
4 standard mail volume looks very much like sort of a
5 classic macroeconomic variable. It's an upward trend,
6 you know, interrupted by business cycles. And in the
7 absence of the Great Recession, we would have expected
8 similar behavior of -- now, that said, but for the
9 Great Recession, from 2007 to 2012 the yellow line
10 here is only average growth of 1.1 percent per year
11 for standard mail. That's our but-for forecast,
12 whereas as I said, in 2004, 2005, standard mail volume
13 grew 5 percent per year.

14 So we weren't projecting -- you know, to
15 follow up somewhat on the conversation with Chairman
16 Goldway right before lunch, we weren't expecting a
17 bubble to continue. We were expecting sort of a
18 return to a much longer run normal. And in fact, in
19 2012, standard mail volume fell 5 percent, and that is
20 for my purposes here judged to have been -- it's
21 sufficiently beyond the Great Recession that we're not
22 going to lump that with the Great Recession. And so
23 that's why you see both the yellow and the green line
24 dip down there in 2012.

25 That has been excluded from what I'm

1 attributing to the Great Recession here.

2 Q And I appreciate that. I appreciate you
3 walking through what on paper is written out. But,
4 you know, these graphs I thought were helpful
5 demonstrations, something to walk through.

6 So on standard, because there is that line
7 -- not missing the idea there is not the electronic
8 diversion you were seeing in first class or expecting
9 in first class because of the makeup in the
10 advertising marketplace.

11 A Right. Well, again if you look at total
12 advertising, and you look at standard mail revenue as
13 a share of that -- and I show that in several of my
14 POIRs. I want to say POIR one, question four, is the
15 first place I show it, I believe.

16 And basically, the story -- what you see
17 from 1991 through 2006 or 2007 is the total
18 advertising expenditure are a relatively constant
19 share of GDP. So they follow the business cycle
20 pretty nicely. And standard mail revenue is a
21 relatively constant share of total advertising.

22 There was a little bit of a dip in 2000-
23 2001, and I think some of that I think was -- that
24 would have been the Internet bubble, and there
25 probably was some general shifting. Internet was

1 starting to displace the rest of advertising kind of
2 in general. I think standard mail share of non-
3 Internet advertising I think was relatively stable
4 there.

5 But it came back somewhat. So by 2006 is
6 kind of a typical year. Total advertising was 1-1/2
7 percent of GDP, and standard mail was 9.6 percent of
8 total advertising. And then the Great Recession hit,
9 and we see that standard -- that total advertising
10 fell 3 percent in 2008, 16 percent in 2009, and then
11 basically bottomed out in 2010. So it fell 20 percent
12 in two years, which was a lower share of GDP as a
13 result because GDP didn't fall 20 percent in two
14 years.

15 But standard mail's share of total
16 advertising actually went up slightly. If anything,
17 standard mail might have been hurt slightly less by
18 the Great Recession than other types of advertising,
19 so that even when you go out now -- when you go out to
20 2012, total advertising did grow a little, but less
21 than GDP. So its share would continue to decline.
22 And standard mail's share did fall a little bit there.
23 And that, as I said, standard mail volume fell 5
24 percent. And that portion we are -- you know, so that
25 portion we're excluding.

1 But in one of my POIR responses, I believe
2 it was POIR 6, number 20 --

3 Q This is the 1933 number you cite in the
4 Great Depression in your answer on 20?

5 A Okay. It's actually 19. Excuse me, 19 is
6 the question I was thinking of. If we take the total
7 advertising numbers, and we look historically
8 advertising expenditures were a relatively stable
9 share of GDP. And if we say -- if we go back to 2007,
10 U.S. advertising percentages were 1.49 percent of GDP.
11 If total advertising expenditures were 1.49 percent of
12 total GDP in FY2012, then U.S. advertising
13 expenditures would have totaled \$231.9 billion, which
14 is \$57 billion more than they actually were.

15 Now, in FY2012, standard mail revenue was
16 9.6 percent of total advertising expenditures. So if
17 they all -- 9.6 percent of that missing 57 billion
18 would be \$5.5 billion more in standard mail revenue,
19 and converting them into pieces, that's 26 billion
20 pieces of standard mail, which is very close to the 29
21 billion in my analysis, and in fact this doesn't even
22 take into account the fact that GDP was weak in 2008-
23 2009, and GDP remains about 5 percent below its
24 potential, and it also, by starting in 2007, if you go
25 back and look at the actual chart, 2006 and 2007, as I

1 said, the advertising expenditures was already
2 beginning to weaken because of, you know, the bursting
3 of the housing bubble had actually occurred in 2006.

4 So again, you know, this completely
5 independent analysis at the industry level for
6 advertising, I think it's very easy to see how you get
7 to a very similar number to what my analysis gets you
8 to, that the Great Recession reduced standard mail
9 volume by 25 to 30 billion pieces of mail.

10 Q And two points on that. You use the term,
11 for example, on the GDP that it isn't back to its
12 potential.

13 A Yes.

14 Q So reiterate again for my understanding,
15 what you're focused on here is, yeah, there may be a
16 new normal, but what you're looking for is some kind
17 of return to historical level and rate. And because
18 you're not seeing that, this trend would continue
19 in --

20 A Right, right. I mean, GDP is sort of --
21 it's a classic level shift. I think to some extent
22 the Great Recession was a level shift more so than a
23 business cycle. In a traditional -- GDP, real GDP,
24 grows about 3 percent per year. That's the historical
25 norm for the U.S. I want to say post-World War II,

1 but I think even if you go back far enough. I mean, 3
2 percent is a pretty solid number.

3 Typically, what happens in a recession is
4 GDP will fall by a percent, say, and then you'll get a
5 year or two where GDP grows 4 or 5 percent, and you're
6 right back on that 3 percent trend line. What
7 happened in this recession, GDP fell 4 percent. GDP
8 has not grown even 3 percent per year since then.
9 It's growing more like 2 to 2-1/2 percent, which is
10 possibly indication of a lower trend line in general,
11 but at a minimum is not sufficient to kind of catch
12 you back up and get you back on to the old trend line.

13 Q I appreciate that. We had talked earlier
14 today before lunch about the idea of the household
15 broadband -- or broadband penetration, and certainly
16 that conceptually is within the context of first-class
17 mail largely, but across all large classes. When it
18 comes to advertising, in a similar vein, we have had a
19 development since it existed before, but it would
20 seem, not knowing the numbers myself, but, for
21 example, the advertising that Facebook gets from
22 revenue in advertising, mediums that maybe weren't
23 seeing large expenditures in advertising, but because
24 of new technologies or new ways in which users use --
25 and let's use Facebook for just the sake of

1 discussion. There is diversion there of advertising
2 that maybe had gone through the mail.

3 How would you, you know, sort that through?
4 Is it similar to as you've described this morning vis-
5 à-vis trying to tease out Smart phones that it --

6 A Well, it is. I mean, if we go back to the
7 advertising expenditures data that we were just
8 looking at, again in POIR number four, that total
9 advertising expenditure data includes Internet
10 advertising, includes mobile advertising, includes
11 Facebook advertising. And we can see that even with
12 those things included, standard mail's share has not
13 gone down that much, if at all.

14 To the extent that advertisers are spending
15 money on Facebook instead of other things, it's not
16 clear that the other things they're not spending money
17 is necessarily direct mail. I mean, I think YouTube
18 advertisers maybe are not advertising on television as
19 much, for example. Certainly early Internet
20 advertising, I know a lot of that was diverted to --
21 was diversions from newspaper advertising. Classified
22 advertising was a big one there. Newspaper classified
23 advertising was taken over by Craigslist and various
24 things.

25 To the extent that these types of

1 advertising are growing, that should be a -- if
2 they're diverting mail, that should be affecting the
3 direct mail advertising's share of the total
4 advertising market. And we see -- like I said, in
5 2012 we saw a little bit of that, and we are excluding
6 that from our measure of the Great Recession.

7 We're saying, okay, that may not be the
8 Great Recession. That could be Facebook and social
9 media and whatever. And, you know, to that extent
10 we'll exclude that. But there is not -- the data
11 don't seem to suggest that the story in 2008, '09,
12 '10, certainly in '11, was diversion of direct mail
13 advertising to other forms of advertising.

14 CHAIRMAN GOLDWAY: Wait. Would you see 2012
15 as perhaps the cutoff year when we stopped counting
16 the impact of the recession, if you're recognizing the
17 impact of other diversions as taking precedence?

18 THE WITNESS: Well, I think the question --
19 from my perspective as an econometrician and
20 forecaster, the mathematical question is when does the
21 trend stop. And the trend doesn't stop in 2012, no.
22 The trend continues, and it continues in 2013. As a
23 policy question as it relates to the exigent case and
24 the ability of the Postal Service to recover exigent
25 circumstances, that's beyond the scope of my work.

1 CHAIRMAN GOLDWAY: Do you have more
2 questions?

3 VICE CHAIRMAN TAUB: Yes. Again, this is
4 our last chance to have you here alive, unless for
5 some reason we're going to bring you back. So if my
6 colleagues and you don't mind doing a few more
7 questions.

8 BY VICE CHAIRMAN TAUB:

9 Q POIR number six, answer seven --

10 A Answer seven.

11 Q This question was getting into the related
12 to and the triggered by of the terms there. And as
13 you explain that, is the view that related to and
14 triggered both fall under the rubric of due to?

15 A Yes.

16 Q Okay. Just wanted to clarify if that was
17 the thinking. One of the points you had talked about
18 in the earlier version of this case, R2010-4, that the
19 modeling missed the sluggish recovery and the extent
20 of the continuing effect of the Great Recession.

21 A Yes.

22 Q And that the current approach -- we talked a
23 bit about it this morning. Feel free to elaborate if
24 you like. This intervention analysis is based on
25 testing and experience since then.

1 A Yes.

2 Q Objectively looking at it with your
3 experience, if we were to from three years now, as we
4 are sitting and looking back at R2010-4, and you --
5 hey, on that one, we missed the sluggish recovery and
6 the extent of the continuing effect of the Great
7 Recession. What would be the weaknesses or what would
8 be the areas that you think should have been improved
9 in what is presented here? What will we maybe have
10 missed with what is presented?

11 A Well, I don't know. I mean, to the best of
12 my -- you know, I hope three years from now people
13 will marvel at how accurate the forecast was, and
14 that's the case.

15 Q To the extent that R2010-4 then missed the
16 sluggish recovery and the extent of the continued
17 effects of the Great Recession, are those issues --
18 how are they dealt with in the current case?

19 A Well, in the current case -- you know, I
20 think -- again, I think this goes back to -- I believe
21 it was Chairman Goldway talking about, you know, the
22 new normal versus the old normal, and how do we decide
23 when we've gotten into the new normal. And my
24 explanation, I believe, at the time, it kind of does
25 boil down to at what point do our models seem to get

1 it. And in R2010, somewhat in retrospect, but to be
2 honest, even at the time there was an uneasiness that
3 our models hadn't quite gotten it.

4 I do feel like this approach gets it better,
5 and our models get it.

6 Q And I appreciate the thought and the
7 experience you bring to it, the testing that was done.
8 I'm sure there may be others that may come up with or
9 think there is a better way. Are there different ways
10 to have done this that you feel may have been
11 providing results that provide more confidence? Or,
12 you know, for example, you had mentioned in one of the
13 answers, you know, certainly there is -- you can't
14 assign -- there is no statistical confidence intervals
15 that can be assigned to this.

16 Can one try to tease out what is due to the
17 Great Recession on mail volume in a way to end up with
18 statistical confidence levels?

19 A I don't think so. I mean, I believe that
20 the approach I took to this exercise was the best
21 approach and that the answers I got are the best
22 answers. I believe them to be right to the extent
23 that something like this can be right.

24 VICE CHAIRMAN TAUB: That's fair. I was
25 just seeing if on the academic side of the equation

1 you had some thoughts. I have some additional
2 questions, but if other folks -- I can come back to
3 it.

4 CHAIRMAN GOLDWAY: Do you have some more
5 questions?

6 COMMISSIONER ACTON: I don't have a
7 question, Chairman Goldway. But I just would say that
8 earlier, Mr. Thress, when you sort of spelled out the
9 two issues that I was trying to focus on as opposed to
10 -- the soundness of econometric projections and a
11 continuing application of the exigent rate adjustment,
12 those are two different concerns.

13 I feel like there is a pretty good certainty
14 that your projections and this description of the new
15 normal will bear scrutiny. But where this may turn in
16 some respects is one whether or not the service can
17 continue to collect an exigent rate from the mailers
18 for a new normal beyond the extraordinary or
19 exceptional circumstance.

20 THE WITNESS: Right. And I appreciate that.

21 CHAIRMAN GOLDWAY: I think he confirmed
22 that.

23 COMMISSIONER ACTON: He did confirm that,
24 yeah. And I just wanted to be sure that he understood
25 that I understood that.

1 CHAIRMAN GOLDWAY: So I have I guess a few
2 more questions.

3 BY CHAIRMAN GOLDWAY:

4 Q Somehow in my unskilled way that seemed
5 counterintuitive, it looks to me that in your tables
6 for the impact of the recession that -- this is in
7 your testimony tables -- that the impact of the Great
8 Recession on market mail volumes was larger in 2012
9 than it was in 2011. Is that correct?

10 A The total impact of the Great Recession from
11 2008 to 2012 was greater than the total impact on the
12 Great Recession from 2008 to 2011.

13 Q But the year 2011 was greater than 2012? Or
14 did we somehow get more of a recession in 2012 than we
15 had in 2011?

16 A No. If you go to table two of my statement,
17 the very last page, it ends up being the very last
18 page before my technical appendix. Total market
19 dominant mail, I break out the factors, and the next-
20 to-last column is macro economy and recession-induced
21 factors.

22 The numbers for individual years are this is
23 the impact -- so the 2008 number, 11,061.1, that's the
24 impact of mail volume change from 2007 to 2008.
25 Because of the Great Recession within that year, mail

1 volume declined by 11 billion pieces.

2 In 2009 -- from 2008 to 2009, because of the
3 Great Recession, mail volume declined by an additional
4 23.7 billion pieces. That's the 23,698. The combined
5 2008 and 2009 -- from 2007 to 2009, it's the sum of
6 those, when mail volume declined by 3 percent.
7 Anyway, in 2011, the impact of the Great Recession in
8 going from 2010 to 2011, because of lingering effects
9 of the Great Recession, mail volume was reduced by
10 5,648.0, and that's expressed in millions, so it's 5.6
11 billion pieces.

12 In 2012, the number is 5,564.7, which is a
13 slightly smaller number, but admitted also rounds to
14 5.6 billion. Essentially, that's the point where --
15 at this point, we're to the point where the effect is
16 the lingering trends. And so they're going to persist
17 at a similar rate. Actually, what it's going to be is
18 they're going to persist at a constant percentage
19 rate, but they're being applied to mail volumes that
20 are declining over time, so the number of pieces will
21 decline over time.

22 Q So we're approaching the new normal.

23 A I think -- I think in that respect, yes.
24 2011 and 2012 here to some respect represent that new
25 normal.

1 Q Okay. So that's clear. Now, going back to
2 the issue of technology diversion again, I'm
3 wondering, is there a way mathematically or in your
4 modeling to instead of measuring broadband acceptance
5 or Internet acceptance, simply measuring the available
6 processing speeds or storage capacity or the shrinking
7 size of computers as a way to trend in factors? Could
8 you develop a model that --

9 A Well, certainly one can try various
10 variables. And we -- in the past, we have explored
11 these ideas. I remember -- and I can't remember if it
12 made it into a rate case or not, but I remember at one
13 point playing with a measure of Internet experience
14 where the idea was it was cumulative. So everybody --
15 the new broadband people this year got a weight of
16 one, but last year's broadband people got a weight of
17 two, and three years got a weight of three, the idea
18 that it would continue to trend even after broadband
19 attenuated on -- I mean, you can do that sort of
20 thing.

21 But part of the problem is just because
22 you've given a variable in name doesn't mean the
23 econometric model is going to limit what it puts in
24 that variable to what you've named it. Yes, you could
25 put in a variable that in some ways tracks the trend

1 in mail volume since 2008, and you could in good faith
2 give that variable an honest name that somehow relates
3 it to Smart phone usage or CPU capacity or whatever.
4 And that variable would in fact pick up the same
5 effects that my trend variable is picking up,
6 basically because you're replacing my trend variable
7 with your trend variable, and trend variables are
8 going to pick up the same thing.

9 Q But if you're measuring something different,
10 they measure -- they pick up different things.

11 A Again, the econometric equation doesn't know
12 that -- the econometric equation doesn't know that
13 this variable is measuring employment. The
14 econometric variable knows that this is measuring a
15 variable that has a volume of 110 this year and 109
16 last year and 114 five years ago. That's all the
17 econometric model knows.

18 Q Right. So but if you had another model that
19 said you're measuring broadband acceptance, but then
20 another one that's measuring Internet speed or
21 Internet storage or wireless hot spots or something
22 like that, and you start from one number, and it
23 increases over the years --

24 A Well, again --

25 Q -- then you would have a way to isolate that

1 particular effect, just as you do with --

2 A I mean, again, my equation for first-class
3 single piece includes a trend variable that starts in
4 2007, quarter four. It goes one, two, three, four,
5 five, six, seven, eight. If you put in a variable
6 that measures hot spots that goes two, four, six,
7 eight, 10, 12, 14, and you take my variable out and
8 put that variable in, it's going to be the exact same
9 equation because one, two, three, four, five --

10 Q But don't you have more variables?

11 A -- is the exact same as two, four, six,
12 eight, 10. You can't put -- well, you can't put both
13 variables into the equation because they're the same
14 variable, just with different names. I mean, you
15 can't --

16 Q They're not the same variable. I think
17 that's the point they're trying to make.

18 A They follow the same --

19 Q They're not the same variable, just like
20 employment is not the same variable as the Internet
21 substitution that you're tracking. The broadband
22 acceptance is not the same variable as this other
23 technology that's developing alongside of it that's
24 creating a different use path.

25 A I mean, you could try to separately model

1 negative trends in -- related to home ownership and
2 credit card usage and bill payments and some kind of
3 macro trend variable, and simultaneous put in some
4 kind of Smart phone trend variable.

5 I'm saying mathematically you're going to
6 get a very good estimate of the combined effect of
7 those two things and fairly unreliable estimates of
8 the unique effects of those things.

9 Q Okay. I understand that. I understand.
10 Okay. When we last considered this, an exigency case,
11 one of the parties involved gave us a very detailed
12 analysis of comparing the Great Recession to what was
13 considered a normal recession, and trying to focus on
14 the differentiation between the two. Would that be
15 possible?

16 A Potentially.

17 Q So you said that there are normal business
18 cycles.

19 A Yes. And the feature of normal business
20 cycles is that a couple of years out from the business
21 cycle we've gotten back on the old trend line. I
22 think I even in my statement -- yeah, page 7 of my
23 statement. In previous -- we'll start at the top of
24 the page. "In previous recessions, mail volume trends
25 were essentially the same after the recession as

1 before. For example, in the two fiscal years prior to
2 the 2001 recession, standard mail volume grew at an
3 average annual rate of 4.8 percent. In the first two
4 fiscal years following the end of the 2001 recession,
5 standard mail volume grew at an average annual rate of
6 4.7 percent.

7 Unlike after the 2001 recession, however,
8 where standard mail volume returned to pre-recession
9 growth rates, standard mail volume has had only one
10 year of meaningful growth since the declared end of
11 the Great Recession. And in fact, in the case of the
12 2001 recession, immediately before and immediately
13 after the 2001 recession, standard mail volume was
14 actually slightly above its long-run trend line.

15 The long-run trend in standard mail volume
16 is to grow about 3 -- I think it's 3 point --

17 Q Well, that's if it grows --

18 A -- 3 percent.

19 Q -- if it's related to the GDP --

20 A About 3 percent --

21 Q -- and the GDP grows.

22 A Right.

23 Q And then we're having differences --

24 A Right, exactly, because -- you know, and it
25 goes down in a recession, and it comes back, and you

1 end up with the 3 percent. So to some extent we're at
2 the point in time now where in a typical recession the
3 effect on mail volume by now would have been zero. We
4 would have lost some volume. We would have gotten
5 some catch-up growth coming out, and we'd be fine.
6 We'd be back in our long-run path.

7 Q Right. So what I'm saying is shouldn't we
8 be measuring the difference rather than you're saying
9 what would be -- we're at the new normal now. The new
10 normal is a little --

11 A Well, what I'm saying is I -- while I'm not
12 explicitly measuring it as the difference, to some
13 extent I am because I think if you were to go back and
14 look at the 1990-91 recession, the 2001 recession, I
15 can go five years past those. I think we would be at
16 a point where the Postal Service would no longer be
17 feeling the ill effects of those recessions.

18 The Postal Service was not still feeling the
19 ill effects of the 2001 recession by 2006. The Postal
20 Service was doing fine by 1995, five years after the
21 1990 recession. The problem is that the Postal
22 Service is not doing fine in 2013, five years after
23 the Great Recession.

24 Q But is that the fault of the recession or
25 some structural change in the economy?

1 A It's the fault of the recession.

2 Q You believe.

3 A Well, I do.

4 COMMISSIONER ACTON: That may be still be
5 the problem. But the exigent rate adjustment into
6 perpetuity may not be the solution.

7 CHAIRMAN GOLDWAY: Right.

8 COMMISSIONER ACTON: It could be other
9 management changes, as empowered by Congress or
10 whatnot that instead could accommodate the new normal.

11 COMMISSIONER LANGLEY: I also think
12 technology is outpacing many of the issues that we've
13 been talking about. And Chairman Goldway was bringing
14 up very good points about the trends that continue to
15 happen now. And Smart phones are very different today
16 than Smart phones were two years ago. And the ability
17 to use a Smart phone as your personal computer -- and
18 when I look at the first computer I bought in 1983 and
19 compare what is available now on just a telephone, a
20 Smart phone, it's astounding.

21 So I think one of the things that we are
22 trying to explore is what other changes are occurring
23 that are impacting what is now this new normal.

24 CHAIRMAN GOLDWAY: I need to have you stop
25 before you respond so that the --

1 (Pause.)

2 CHAIRMAN GOLDWAY: Okay. So --

3 THE WITNESS: Can you repeat the question
4 you'd like me to answer?

5 COMMISSIONER LANGLEY: Really it isn't as
6 much of a question as just a statement in that I think
7 we're somewhat going in circles here because we've
8 been asking questions about the new normal. We've
9 been asking questions about Internet diversion. But
10 also the technologies that a couple of years ago were
11 just emerging technologies that are no longer
12 emerging, they're a fact of life. And concerns or
13 just thoughts are being raised that we're really
14 trying to identify -- and you've been very good about
15 walking me through and others through where the Postal
16 Service, through your expert testimony, believes this
17 impact has been as far as on mail volume.

18 So it really is not a question. I just --
19 and listening to everything swirling around and seeing
20 that we're talking about many different issues here,
21 but I think Commissioner Acton also is raising a good
22 point as to how long does an exigent rate increase
23 stay in effect if the effects of the Great Recession
24 are tapering off.

25 CHAIRMAN GOLDWAY: Do you have a comment

1 you'd like to make on --

2 THE WITNESS: Sure. I'm not sure if I have
3 anything new to do beyond the conversation.

4 COMMISSIONER LANGLEY: There is no question
5 there.

6 CHAIRMAN GOLDWAY: Thank you. I think what
7 Nanci's comments are indicating is that the
8 commissioners are getting a clearer sense among
9 ourselves of what the issues are that we have to
10 contemplate. We may not have answers, but this
11 discussion has given us some clearer thoughts about
12 that.

13 Vice Chairman Taub, do you have some more
14 questions?

15 VICE CHAIRMAN TAUB: Yes.

16 CHAIRMAN GOLDWAY: Good.

17 BY VICE CHAIRMAN TAUB:

18 Q Do you need a break, even five minutes?

19 A No. I'm fine.

20 Q And I appreciate the comments of my
21 colleagues. As I look at your testimony, as I
22 mentioned at the beginning of our questioning, this is
23 really trying to put our arms around the effect of the
24 recession on mail volumes. At base, this is what your
25 testimony is hoping to provide us, that view.

1 We started to touch upon a little here with
2 some questioning. If you don't mind looking at POIR
3 number six, answer fourteen.

4 A Okay. I got it.

5 Q This is the table where the presiding
6 officer asks that you update the source of change by
7 year by in essence extending it out to 2013-2014.

8 A Yes.

9 Q And I think it's important to underscore, as
10 has been talked about, the Postal Service, the case
11 before us is looking at 2008 to 2012. So the 2013-
12 2014 isn't before us, but it's I think helpful to
13 illuminate some of the discussion here.

14 A Right, okay.

15 Q Looking at 2013-2014, we would be going from
16 projecting to 53.5 to 63.9. Is that correct?

17 A Yes, that's correct.

18 Q And this idea of the effects based on that
19 continue to decline each year.

20 A Yes. This is sort of an extension of what I
21 was talking about with Chairman Goldway, where you're
22 building on it so the cumulative becomes bigger each
23 year, but what you're adding each year becomes
24 slightly smaller over time, yes.

25 Q And the Postal Service is seeking --

1 obviously going through 2012, it's estimating it to be
2 a \$6.6 billion contribution loss, but it has said it's
3 only asking for the 1.78. Assuming for a moment that
4 one were to see an adjustment undertaken, and it
5 includes the 1.78, we would then see that it would
6 seem part of the rate base, and it would be
7 compounding for each year thereafter. Would I be off
8 on that?

9 A I'm not a pricing person, but, yes. If the
10 prices gain you \$1.78 billion this year, and they stay
11 in effect next year, they will presumably gain you
12 some number probably close to that going forward, yes.

13 Q So theoretically at some point in the
14 future, if this was part of the rate base, it could
15 not only equal, but then exceed the effects of the
16 Great Recession itself.

17 A I'm going to have to bow out --

18 Q Oh, sure.

19 A -- from this. I think --

20 Q And this may be more for Nickerson tomorrow.

21 A -- maybe Mr. Nickerson --

22 Q Yeah.

23 A -- can better go to this.

24 Q But, you know, given that you had laid it
25 out there, I just wanted to explore that, and given

1 that you were here today and are a forecaster, hence
2 my questions earlier on maybe trying to predict how
3 your model would play out in a few years. I was
4 trying to see from that end.

5 But put that question aside on the pricing
6 -- maybe again this is for Nickerson. But based on
7 the effect of the recession on mail volumes and what
8 has been put forward, the 53.5 and the 6.6, it's your
9 view that that should be part of the rate base, that
10 that was lost due to the Great Recession and
11 therefore, as you said, in some cases it's not coming
12 back, so --

13 A It is my view that 53.5 billion pieces of
14 mail were lost between FY2008 and FY2012 cumulatively
15 due to the Great Recession. The extent to which that
16 translates into an exigent case is beyond the scope of
17 my work.

18 Q That's fair. In this same packet of
19 questions on POIR number six, there was a question 16,
20 and although you did not answer it, and it was an
21 institutional response --

22 CHAIRMAN GOLDWAY: Why don't I have it?

23 VICE CHAIRMAN TAUB: Again POIR number six,
24 question 16. The question was related to your
25 statement. I'll wait while you get that.

1 (Pause.)

2 THE WITNESS: Okay. Got it, sorry.

3 BY VICE CHAIRMAN TAUB:

4 Q Oh, no. So as you see here, the presiding
5 officer's information request was highlighting the
6 statement from pages 9 to 10 of the request, where it
7 says, "Your statement documents the source of change
8 analysis, decomposes the volume losses of the last
9 five years, and those stemming from the recession and
10 those stemming from other factors." You conclude in
11 '12 alone the amount lost was 53.5. And then it went
12 on to talk about -- on page 11 there is the table that
13 before the recession the Postal Service would have
14 processed approximately 54 billion more pieces in '12
15 alone.

16 And then it jumps to table two on page 10,
17 and it says, "This appears to attribute those figures
18 to the cumulative requests of page 12." Have you had
19 a chance to read the response that the Postal Service
20 had provided to us? Are you aware of --

21 A I -- yes, I read this one, yes.

22 Q What do you think of it?

23 A I mean, I think it's accurate in terms of
24 the math that it's explaining.

25 Q From your perspective, given your experience

1 as an economist, is the number before us the 53.5 that
2 we're working from, or 189.7?

3 A In terms of volume, I think of it as 53.5.
4 I mean, I think -- I mean, I think it's true. If you
5 go to, you know, my graphs in POIR three, question
6 one, and you look at my total market dominant mail
7 graph, the gap between the but-for, and you add up all
8 of those numbers, yes, I think it does come to 189
9 whatever. But to me, that number doesn't necessarily
10 mean anything. I mean, I think of it as 53.5. I
11 think of it as this year's volume is 157 billion, and
12 it should have been 208 billion.

13 Q Right. No. I appreciate that. Of course,
14 under the theory of this question, it would seem one
15 could take the 6.6 contribution and sum that all up
16 and say we're dealing with a \$23 billion contribution
17 loss.

18 A Well, and if one were to go to the money --
19 I mean, I suppose one could make that argument, that
20 the Postal Service lost X billion last year and Y
21 billion the year before and Z billion before, and
22 their total losses are X plus Y plus Z. But they're
23 you're moving beyond the scope of my testimony, so --

24 VICE CHAIRMAN TAUB: Sure. You know, there
25 was the -- you had gone out to '13 and '14, and basing

1 it on the numbers. I wanted to get your feedback.

2 Thank you. That's --

3 CHAIRMAN GOLDWAY: I had just one more
4 question.

5 BY CHAIRMAN GOLDWAY:

6 Q Did you do the forecasting that the Postal
7 Service used for its FY2013 budget plans where they
8 estimated what their volume was going to be and what
9 it actually --

10 A Yes. I mean, my models are the starting
11 point for that. For budgeting purposes, the Postal
12 Service sometimes makes their own adjustments.

13 Q And the Postal Service reported that its
14 volumes were greater than what they had expected.
15 Were the volumes greater than what you had forecast?

16 A For 2013?

17 Q Yes.

18 A I think 2013 volume came in a little bit
19 stronger than what I forecast.

20 CHAIRMAN GOLDWAY: Okay. That's my final
21 question for you, just to point out we never have a
22 certainty, but you were close.

23 I think we've exhausted the concerns that we
24 had with regard to your testimony and have asked and
25 answered a lot of questions. As I said a few moments

1 ago, I think the dialogue we've had has helped the
2 commissioners to focus on the issues that we have at
3 hand, some of which deals specifically with numbers
4 and some of which deal with the policy in interpreting
5 those numbers. And we are clear now on what we will
6 have to do in terms of your testimony to do that.

7 So I appreciate your help here and your
8 forthcoming responses. And I thank you for
9 participating in this proceeding and in the many
10 others that you've done in front of the Commission,
11 and wish you a happy afternoon.

12 THE WITNESS: Thank you.

13 CHAIRMAN GOLDWAY: And if we have more
14 questions, I think we can provide or them in writing.
15 I don't know that we will need another hearing. At
16 the moment, we're not planning on it.

17 (Witness excused.)

18 CHAIRMAN GOLDWAY: So with that, I will
19 adjourn the meeting until tomorrow morning at 9:30,
20 where we will hear Witness Nickerson. Thank you all.

21 (Whereupon, at 3:00 p.m., the hearing in the
22 above-entitled matter was adjourned, to reconvene at
23 9:30 a.m. the following day, Wednesday, November 20,
24 2013.)

25 //

REPORTER'S CERTIFICATE

DOCKET NO.: R2013-11
CASE TITLE: Rate Adjustment Due to Extraordinary
or Exceptional Circumstances
HEARING DATE: November 19, 2013
LOCATION: Washington, D.C.

I hereby certify that the proceedings and evidence are contained fully and accurately on the tapes and notes reported by me at the hearing in the above case before the Postal Regulatory Commission.

Date: November 19, 2013

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