

OFFICIAL TRANSCRIPT OF PROCEEDINGS
BEFORE THE
POSTAL RATE COMMISSION

Dec 17 4 55 PM '01

POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

In the Matter of:)
) Docket No. R2001-1
POSTAL RATE AND FEE CHANGES)

Volume: 2
Date: December 13, 2001
Place: Washington, D.C.
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POSTAL RATE COMMISSION

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Dec 17 4 55 PM '01
POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

In the Matter of:)
) Docket No. R2001-1
POSTAL RATE AND FEE CHANGES)

Suite 300
U.S. Postal Rate Commission
1333 H Street, N.W.
Washington, D.C.

Volume 2
Thursday, December 13, 2001

The above-entitled matter came on for hearing
pursuant to notice, at 9:33 a.m.

BEFORE:

HON. GEORGE A. OMAS, CHAIRMAN
HON. RUTH Y. GOLDWAY, VICE-CHAIRMAN
HON. DANA B. "DANNY" COVINGTON, COMMISSIONER

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C O N T E N T S

WITNESSES APPEARING:
GEORGE S. TOLLEY
THOMAS E. THRESS
GERALD L. MUSGRAVE
PETER BERNSTEIN

<u>WITNESSES:</u>	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>	<u>VOIR DIRE</u>
George S. Tolley	54 157	129			
Thomas E. Thress	161				
Gerald L. Musgrave	185	212			
Peter Bernstein	215	254			

<u>RULINGS</u>	<u>PAGE</u>
Ruling on Amended Schedule	52

<u>DOCUMENTS TRANSCRIBED INTO THE RECORD</u>	<u>PAGE</u>
Corrected designated written cross-examination of George S. Tolley, USPS-T-7-1	58
Interrogatories NAA/USPS-T-7-12 and 13	125
Answers of Postal Service witness Tolley to USP-XE-Tolley-1 & -2	135
Designated written cross-examination of Thomas E. Thress, USPS-T-8	165
Designated written cross-examination of Thomas E. Thress, by Greeting Card Association USPS-T-10-8	174
Response of Postal Service witness Thress to NAA Interrogatories, USPS-T-8-6	181
Direct testimony of Gerald L. Musgrave, USPS-T-9	188
Designated written cross-examination of Gerald L. Musgrave, USPS-T-9	220
Designated written cross-examination of Peter Bernstein, USPS-T-10	255
Witness Bernstein response to interrogatories from ABA & NAPM, USPS-T-10-5	257
Designated written cross-examination of Bernstein, by Greeting Card Association USPS-T-10	258

E X H I B I T S

<u>EXHIBITS AND/OR TESTIMONY</u>	<u>IDENTIFIED</u>	<u>RECEIVED</u>
Direct Testimony of George S. Tolley on behalf of the United States Postal Service, USPS-T-7	54	56
Corrected Designated Written Cross-Examination of George S. Tolley, USPS-T-7-1	57	57
NAA Interrogatories, USPS T-7-12 & 13	124	124
Chart re volume figures with additional calculations, UPS-XE-Tolley-1	130	134
Percent of Mail Sent by Residences or Businesses, UPS-XE-Tolley-2	132	134
Direct Testimony of Thomas E. Thres, USPS-T-8	162	163
Written Cross Exam of Thress, USPS-T-8	164	164
Interrogatory Response from Bernstein, USPS-T-10-8	173	173
NAA Interrogatories, USPS T-8-6, 7 & 8	180	180
Direct Testimony of Gerald L. Musgrave, USPS-T-9	185	186
Cross Exam of Mr. Musgrave	187	187
Direct of Peter Bernstein, USPS-T-10	216	218
Cross Exam of Mr. Bernstein, USPS-T-10	219	219
Answers, ABANAPM-T-10-5	254	254
GCA Interrogatory, USPS-T-10	257	257

P R O C E E D I N G S

(9:33 a.m.)

CHAIRMAN OMAS: Good morning. Today we begin the hearing to receive testimony of the Postal Service witnesses in support of Docket No. R-2001, Request for Rate and Fee Changes. I have a few brief procedural matters to discuss before we begin testimony today.

As you recall, at the prehearing conference in this case I urged the parties to consider the potential benefits of settling this case under the unusual circumstance currently facing the postal community. Since then, I have received five reports on the progress being made toward settling this case. Another report has been promised to me by the Postal Service for Monday, December 17.

The Commission would like to recognize the parties' efforts toward resolving the issues through negotiation. Whether your efforts are ultimately successful or not, the Commission recognizes that a good faith effort was made to follow up on our suggestion. We appreciate the time and effort in attempting to forge a settlement.

I have an announcement concerning the hearing schedule also today. The Commission has decided to clear Thursday, December 20, and to reschedule three witnesses previously scheduled to appear that day. It is my current

1 expectation that Witness Moeller will be rescheduled to
2 appear on Wednesday, December 19, and that Witness Hope and
3 Loetscher will be rescheduled to appear on January 10, 2002.
4 I will issue a written ruling confirming the new schedule.

5 Does anyone have any problem with those tentative
6 dates?

7 (No response.)

8 CHAIRMAN OMAS: The Commission will be maintaining
9 up-to-date information on the status of the hearings; that
10 is, which witnesses are scheduled and which witnesses have
11 completed their appearance, with scrolling banners on our
12 home page on the internet. Please check the website instead
13 of calling our docket section to get accurate information on
14 how the hearings are progressing.

15 The Commission will also accommodate counsels' use
16 of laptop computers. As you can see, the Commissioners are
17 using computers to facilitate references to documents
18 discussed during these hearings. If you would like to use a
19 computer during the hearing, please contact the Commission's
20 Administrative Office. They will try to make arrangements
21 to accommodate you on a first come/first served basis.

22 Does anyone have any procedural matters to discuss
23 before we continue?

24 (No response.)

25 CHAIRMAN OMAS: Four witnesses are scheduled to

1 appear today. They are Witness Tolley, Witness Thress,
2 Witness Musgrave and Bernstein.

3 Mr. Koetting, would you call your first witness,
4 please?

5 MR. KOETTING: Thank you, Mr. Chairman. The
6 Postal Service calls as its witness Dr. George Tolley.

7 CHAIRMAN OMAS: Dr. Tolley, would you please stand
8 and raise your right hand?

9 Whereupon,

10 GEORGE S. TOLLEY

11 having been duly sworn, was called as a witness
12 and was examined and testified as follows:

13 CHAIRMAN OMAS: Thank you.

14 (The document referred to was
15 marked for identification as
16 Exhibit No. USPS-T-7.)

17 DIRECT EXAMINATION

18 BY MR. KOETTING:

19 Q Could you please state your full name for the
20 record, please?

21 A George S. Tolley.

22 Q Dr. Tolley, I've handed you a document entitled
23 Direct Testimony of George S. Tolley on behalf of the United
24 States Postal Service, which has been designated as
25 USPS-T-7. Are you familiar with that document?

1 A Yes, I am.

2 Q Was it prepared by you or under your supervision?

3 A Yes, it was.

4 Q Does the copy that I have handed you contain the

5 revised pages filed earlier on October 18, 2001, and

6 December 10, 2001?

7 A Yes.

8 Q Do you have any other revisions to make today?

9 A No, I do not.

10 Q With those revisions, if you were to testify

11 orally today would this be your testimony?

12 A Yes, it would.

13 Q Is it your intention to sponsor the Category II

14 library references that are associated with this testimony?

15 A Yes, it is.

16 Q And are those the library references listed in the

17 table of contents as USPS-LRJ-122, Before Rates Fixed Weight

18 Price Indices; J-123, After Rates Fixed Weight Price

19 Indices; J-124, Data Used in Volume Forecast; J-125,

20 Documentation of Volume Forecasting Model; and J-126, Step

21 by Step Calculation of Volume Projection?

22 A Yes.

23 MR. KOETTING: Mr. Chairman, I'm handing two

24 copies of the testimony to the reporter, and I have

25 requested the testimony, USPS-T-7, Direct Testimony of

1 George S. Tolley on behalf of the United States Postal
2 Service and the associated Category II library references,
3 be entered into evidence.

4 CHAIRMAN OMAS: Is there any objection?

5 (No response.)

6 CHAIRMAN OMAS: Hearing none, I will direct
7 counsel to provide the reporter with two copies of the
8 corrected direct testimony of George S. Tolley. That
9 testimony is received into evidence. However, as is our
10 practice, it will not be transcribed.

11 (The document referred to,
12 previously identified as
13 Exhibit No. USPS-T-7, was
14 received in evidence.)

15 CHAIRMAN OMAS: Mr. Tolley, have you had an
16 opportunity to examine the package of designated written
17 cross-examination that was made available to you at the
18 hearing this morning?

19 THE WITNESS: Yes, I have.

20 CHAIRMAN OMAS: If the questions contained in the
21 packet were posed to you orally today, would your answers be
22 the same as you previously provided in writing?

23 THE WITNESS: Yes, they would.

24 CHAIRMAN OMAS: Are there any corrections or
25 additions you would like to make to those answers?

1 THE WITNESS: No, there are not.

2 CHAIRMAN OMAS: Counsel, would you please provide
3 two copies of the corrected designated written cross-
4 examination of Witness Tolley to the reporter? That
5 material is received into evidence, and it is to be
6 transcribed into the record.

7 (The document referred to was
8 marked for identification as
9 Exhibit No. USPS-T-7-1 and was
10 received in evidence.)

11 //

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes

Docket No. R2001-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF UNITED STATES POSTAL SERVICE
WITNESS GEORGE S. TOLLEY
(USPS-T-7)

Party

Interrogatories

Advo, Inc.

AAPS/USPS-T7-1

Association for Postal Commerce

PostCom/USPS-T7-1

Coalition of Religious Press
Associations and National Federation
of Independent Publications

CRPA-NFIP/USPS-T7-1-7

Direct Marketing Association, Inc.

AAPS/USPS-T7-1
CRPA-NFIP/USPS-T7-2
DMA/USPS-T7-1-7
MMA/USPS-T7-2
NAA/USPS-T7-3
PostCom/USPS-T7-1
VP/USPS-T7-1-3

Mail Order Association of America

AAP/USPS-T7-6-9
NAA/USPS-T7-7, 9
UPS/USPS-T7-1-12

Major Mailers Association

MMA/USPS-T7-1-2

Newspaper Association of America

NAA/USPS-T7-1-3, 7, 9-11
UPS/USPS-T7-1-12

United Parcel Service

PostCom/USPS-T7-1
UPS/USPS-T7-1-24, 32

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Steven W. Williams". The signature is fluid and cursive, with the first name "Steven" being more prominent.

Steven W. Williams
Acting Secretary

INTERROGATORY RESPONSES OF
UNITED STATES POSTAL SERVICE
WITNESS GEORGE S. TOLLEY (T-7)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory

AAP/USPS-T7-6
AAP/USPS-T7-7
AAP/USPS-T7-8
AAP/USPS-T7-9
AAPS/USPS-T7-1
CRPA-NFIP/USPS-T7-1
CRPA-NFIP/USPS-T7-2
CRPA-NFIP/USPS-T7-3
CRPA-NFIP/USPS-T7-4
CRPA-NFIP/USPS-T7-5
CRPA-NFIP/USPS-T7-6
CRPA-NFIP/USPS-T7-7
DMA/USPS-T7-1
DMA/USPS-T7-2
DMA/USPS-T7-3
DMA/USPS-T7-4
DMA/USPS-T7-5
DMA/USPS-T7-6
DMA/USPS-T7-7
MMA/USPS-T7-1
MMA/USPS-T7-2
NAA/USPS-T7-1
NAA/USPS-T7-2
NAA/USPS-T7-3
NAA/USPS-T7-7
NAA/USPS-T7-9
NAA/USPS-T7-10
NAA/USPS-T7-11
PostCom/USPS-T7-1
UPS/USPS-T7-1
UPS/USPS-T7-2
UPS/USPS-T7-3
UPS/USPS-T7-4

Designating Parties

MOAA
MOAA
MOAA
MOAA
Advo, DMA
CRPA-NFIP
CRPA-NFIP, DMA
CRPA-NFIP
CRPA-NFIP
CRPA-NFIP
CRPA-NFIP
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DMA
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DMA, MMA
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MOAA, NAA
MOAA, NAA
NAA
NAA
DMA, PostCom, UPS
MOAA, NAA, UPS
MOAA, NAA, UPS
MOAA, NAA, UPS
MOAA, NAA, UPS

UPS/USPS-T7-5	MOAA, NAA, UPS
UPS/USPS-T7-6	MOAA, NAA, UPS
UPS/USPS-T7-7	MOAA, NAA, UPS
UPS/USPS-T7-8	MOAA, NAA, UPS
UPS/USPS-T7-9	MOAA, NAA, UPS
UPS/USPS-T7-10	MOAA, NAA, UPS
UPS/USPS-T7-11	MOAA, NAA, UPS
UPS/USPS-T7-12	MOAA, NAA, UPS
UPS/USPS-T7-13	UPS
UPS/USPS-T7-14	UPS
UPS/USPS-T7-15	UPS
UPS/USPS-T7-16	UPS
UPS/USPS-T7-17	UPS
UPS/USPS-T7-18	UPS
UPS/USPS-T7-19	UPS
UPS/USPS-T7-20	UPS
UPS/USPS-T7-21	UPS
UPS/USPS-T7-22	UPS
UPS/USPS-T7-23	UPS
UPS/USPS-T7-24	UPS
UPS/USPS-T7-32	UPS
VP/USPS-T7-1	DMA
VP/USPS-T7-2	DMA
VP/USPS-T7-3	DMA

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF AAP

62

AAP/USPS-T7-6. Please state the volume of the BPM subclass that consists of catalogs for each of the years 1995-2000. Include source references to support your response.

RESPONSE:

I do not have exact information on the volume of BPM that consists of catalogs. The Household Diary Study provides numbers pertaining to bound printed matter catalogs received by households, shown in the table below. The HHDS does not provide information on catalogs received by nonhouseholds. It is my understanding that HHDS data for bound printed matter are based on a small number of observations, as often 100 pieces or less of BPM are received by the surveyed households in any given year. Information on individual components within BPM (e.g., catalogs) are based on even fewer pieces. Therefore, year-to-year results may be subject to great variation, as is evident from the table below. The 2000 Household Diary Study results are based on a somewhat different survey design and therefore may not be directly comparable with results from previous years.

Catalogs as Percentage of BPM Received by Households

1995	30.8%
1996	39.0%
1997	44.4%
1998	31.7%
1999	51.8%
2000	9.9%

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF AAP

63

AAP/USPS-T7-7. Please state the volume of the BPM subclass that consists of books for each of the years 1995-2000. Include source references to support your response.

RESPONSE:

I do not have exact information on the volume of BPM that consists of books. The Household Diary Study provides numbers pertaining to bound printed matter books received by households, shown in the table below. The HHDS does not provide information on books received by nonhouseholds. It is my understanding that HHDS data for bound printed matter are based on a small number of observations, as often 100 pieces or less of BPM are received by the surveyed households in any given year. Information on individual components within BPM (e.g., books) are based on even fewer pieces. Therefore, year-to-year results may be subject to great variation, as is evident from the table below. The 2000 Household Diary Study results are based on a somewhat different survey design and therefore may not be directly comparable with results from previous years.

Books as Percentage of BPM Received by Households

1995	47.5%
1996	40.4%
1997	41.7%
1998	59.5%
1999	41.1%
2000	65.5%

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF AAP**

64

AAP/USPS-T7-8. Please state the volume of the BPM subclass that consists of phone books for each of the years 1995-2000. Include source references to support your response.

RESPONSE:

I do not have exact information on the volume of BPM that consists of phone books. The Household Diary Study provides numbers pertaining to bound printed matter phone books received by households, shown in the table below. The HHDS does not provide information on phone books received by nonhouseholds. It is my understanding that HHDS data for bound printed matter are based on a small number of observations, as often 100 pieces or less of BPM are received by the surveyed households in any given year. Information on individual components within BPM (e.g., phone books) are based on even fewer pieces. Therefore, year-to-year results may be subject to great variation, as is evident from the table below. The 2000 Household Diary Study results are based on a somewhat different survey design and therefore may not be directly comparable with results from previous years.

Phone Books as Percentage of BPM Received by Households

1995	0.8%
1996	4.3%
1997	4.2%
1998	3.8%
1999	3.6%
2000	1.4%

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF AAP

65

AAP/USPS-T7-9. Please state the volume of the BPM subclass that does not consist of catalogs, books or phone books. Include source references to support your response.

RESPONSE:

I do not have exact information on the volume of BPM that does not consist of catalogs, books or phone books. The Household Diary Study provides numbers pertaining to *bound printed matter received by households*, shown in the table below. The HHDS does not provide information on received by nonhouseholds. It is my understanding that HHDS data for bound printed matter are based on a small number of observations, as often 100 pieces or less of BPM are received by the surveyed households in any given year. Information on individual components within BPM are based on even fewer pieces. Therefore, year-to-year results may be subject to great variation, as is evident from the table below. The 2000 Household Diary Study results are based on a somewhat different survey design and therefore may not be directly comparable with results from previous years.

Remaining Percentage of BPM Received by Households
(BPM other than catalogs, books or phone books)

1995	20.8%
1996	16.3%
1997	9.7%
1998	5.1%
1999	3.6%
2000	23.2%

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF AAPS**

AAPS/USPS-T7-1. You explain at page 111 that the real own price of ECR mail dropped 5.2% over the past five years, leading to an increase of 3.95% in volume. Do you agree that, assuming competitors for the delivery of such mail experienced cost increases during that period, it is likely that a portion of the increased ECR volume represents pieces that were shifted from those competitors to the Postal Service?

RESPONSE:

No. The ceteris paribus conditions for this hypothetical question are not sufficiently specified. For example, the outcome would depend on such things as industrial organization and pricing policies of competitors, which have not been specified in the interrogatory. While hypothetical conditions might possibly be specified under which ECR mail pieces were shifted from competitors, I do not necessarily agree that the outcome is likely or, if it occurred, was quantitatively significant.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF CRPA

CRPA-NFIP/USPS-T7-1. On p. 78 of your testimony, part C, para 1, you set forth the various categories eligible for nonprofit periodical rates. Please provide all data which you consulted in preparation of this testimony, or data from any identified source with which you or USPS are familiar, which contains volume information for each qualifying organization set forth on lines 1 -13, p. 78.

RESPONSE:

In earlier testimonies, I presented information from the Preferred Rate Study, conducted by the Postal Rate Commission in 1986. The data, presented as Chart E of my testimony in R2000-1 (USPS-T-6), is reprinted on the following page. I chose not to include this information in my current testimony as the survey results are fifteen years old and in any case do not materially aid my mail volume projections.

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF CRPA**

**DISTRIBUTION OF PUBLICATIONS AND TOTAL ANNUAL VOLUME
OF PERIODICAL NONPROFIT MAIL
ACROSS MAILING CATEGORIES**

Source: Postal Rate Commission, Preferred Rate Study, 1986

<u>Nonprofit Category</u>	<u>Percent of Publications</u>	<u>Percent of Total Volume</u>
Religious	37.6	30.5
Educational	25.4	22.4
Scientific	12.0	8.3
Philanthropic	0.7	0.6
Agricultural	1.5	1.3
Labor	12.9	19.5
Veterans	0.5	0.3
Fraternal	4.2	2.8
Other & Unknown	5.2	14.3
All Nonprofit	100.0	100.0

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF CRPA**

CRPA-NFIP/T-7-2. On p. 78 of your testimony, lines 15-16, you state: "Nonprofit Periodicals volume is about the same today as in 1970, as illustrated in Figure 8." On pp. 116-117 of your testimony, you set forth numbers which show that Standard nonprofit mail has experienced "steady growth" from 1970 to 1990, and that by the year 2000, volume of this mail had increased from 4.2 billion pieces per year in 1970, to 11.3 billion pieces. Please set forth all factors which explain this difference in growth between the two kinds of nonprofit mail, and please rank the various factors in order of importance, with explanation of why each factor is ranked as it is.

RESPONSE:

Three factors may be discussed that appear to have contributed to the differences in growth rates which you have observed. First, Periodical nonprofit volume has been adversely affected by a long-term downward trend in newspaper and magazine reading which is discussed in my testimony at page 81. Second, Standard nonprofit mail volume was positively affected by technological advances in direct-mail advertising in the early 1980s which contributed to dramatic growth in the volumes of Standard commercial and nonprofit mail and bound printed matter, as well as significant growth in First-Class letters and cards. A third factor that may explain differences in growth rates is that since 1970, Periodical nonprofit rates have increased more than Standard nonprofit rates.

At this time, I have no basis for ranking the relative importance of these factors. This analysis goes beyond the scope of my testimony.

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF CRPA**

CRPA-NFIP/USPS-T7-3. On p. 78, lines 18-20, you state: "During the five-year period ending in 2001 Q3, Nonprofit Periodicals volume declined from 2,287 million to 2,165 million pieces, or by 5.48 percent."

- (a) Please confirm that Table One, "Volume Projections," found on p. 5 of your testimony projects that the Base Year (Q4, year 2000 to Q3, year 2001) volume of Nonprofit Periodical Mail would decline from 2,101.762 million pieces per year to 1,959.377 million pieces in the Before-Rates Test Year (GFY 2003), or approximately 6.8%.
- (b) Please confirm that the total decline in volumes of nonprofit periodicals from 1996 (five years prior to 2001, Q3) to the Test Year, Before Rates, according to your projection, would be 12.28 percent. If you do not confirm, explain in detail why you do not confirm.
- (c) Please confirm that comparing the Base Year volumes of Nonprofit Periodicals with TY After Rates volumes as shown in Table 1, demonstrate that the volume decline would equal 7.68% and that the total decline between 1996 through the Test Year 2003 After Rates would be, in percentages, 13.16%. If you do not confirm, explain why you do not confirm.
- (d) Are you aware of any price factor other than postal rate increases, that could have triggered a volume decline of 12.28% to 13.16 percent during the time periods discussed in part (b) and (c) above? If you are aware of such factor(s), please identify these, and explain why that factor(s) would be more influential in driving nonprofit periodicals volumes down than historical and proposed rate increases for nonprofit periodicals?

RESPONSE:

- a. Confirmed.
- b. Not confirmed. Mathematically, the total change in volume in the Before-Rates situation is calculated as follows: $(1 - 0.0548) \times (1 - 0.068) - 1 =$ or a total decline of 11.9 percent.
- c. Similarly, the total change in volume in the After-Rates situation is $(1 - 0.0548) \times (1 - 0.0768) - 1$ or a total decline of 12.7 percent.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF CRPA

- d. No. As I discussed in my testimony, a major cause of the decline in Nonprofit Periodicals mail volume is a continuation of the long-term trend away from reading in general. Postal rate changes have only a small impact on volumes because (i) nonprofit periodical prices have not changed much in real terms over the period discussed in your interrogatory and (ii) nonprofit periodicals are not particularly sensitive to postal price changes due to their low own-price elasticity.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF CRPA

CRPA-NFIP/USPS-T-7-4. Are you aware of or have you read any studies, reports, books, articles or data either produced by USPS or another entity which explain the decline in nonprofit periodical volumes other than your own testimony? If you have read such materials, please identify them and make them available for inspection.

RESPONSE:

No. While there has been discussion of factors affecting periodical mail in general as reviewed in my testimony, I have not been able to find materials explaining the decline in nonprofit periodicals specifically.

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF CRPA**

CRPA-NFIP/USPS-T7-5. In Table 8, p. 80 of your testimony, "Other Factors" than prices, income, and population are "estimated" to have reduced Nonprofit volumes by 12.26% for the five-year period ending in Q3, 2001. You then claim: "Nonprofit mail is subject to declining preference to spend time reading as described in the discussion of Within County mail." You similarly use Within County assumptions about reading time to apply to Regular Rate periodicals, USPS-T-7, at page 90, lines 2-3.

- (a) Please provide any independent studies, analyses, reports or data commission by the publishing industry, the Postal Service or any other government or private concern which demonstrate that decline in reading time over the period you refer is similar across the regular rate, nonprofit, and within-county categories of Periodicals Mail.
- (b) If you do not have or did not rely on such studies, etc., as referred to in part (a) of this interrogatory, what is the basis for your assumption?
- (c) Likewise verify your assumption that TV viewing by readers of nonprofit periodicals is the same as within-county or regular rate newspaper readers.
- (d) Why do you take the "specialty nature" or nonprofit mail into account when considering Internet substitution but not the "specialty nature" of nonprofit mail into account for any of the other "Other Factors" you briefly discuss on p. 81 of your testimony?
- (e) Confirm that as you explain it, "Other Factors" consist of time reading, TV viewing, and Internet.
- (f) Do you have a statistical basis for your claim that "nonprofit mail may be subject to less than average Internet substitution" as compared with other types of periodicals, and if so, identify and produce it.
- (g) Define and explain the term "Internet substitution," USPS-T-7. P. 81, line 16.

RESPONSE:

a. through c. I believe you have mischaracterized my testimony. I did not state that the impact of changing reading habits or television viewing were the same for all subclasses of Periodicals mail. Instead, my testimony explained that declining reading and increased time spent watching television (and on the

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF CRPA**

Internet) are factors explaining the decline in the volumes of Periodicals mail subclasses. I made no assumption that these factors have the same impact across the individual subclasses of Periodicals Mail. The impacts of these factors may well differ across the different subclasses, as illustrated for example, in the econometric finding that Internet usage has negatively impacted Regular rate mail but not the other subclasses. This is one factor that is adversely affecting Periodicals mail.

d. The "Other Factors" section of my testimony focuses on factors affecting volume over the past five years. The emergence of the Internet is a significant change occurring over this time period, as opposed to time spent reading or watching TV. For that reason, separate attention was given to the specialty nature of nonprofit periodicals with respect to the Internet.

e. Confirmed. My discussion of "Other Factors" affecting nonprofit periodicals volume considers time reading, TV viewing, and Internet.

f. Yes. The statistical basis is provided by the econometric work of Thomas Thress (USPS-T-8). He finds that Internet usage has a negative impact on regular rate volumes but not on the volumes of nonprofit periodicals. Please see his testimony at page 34, lines 16-19.

g. "Internet substitution" as it applies to Periodicals encompasses the substitution of time spent online for time spent reading newspapers and magazines and the accessing of information using the Internet as opposed to obtaining the information from a periodical.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF CRPA

CRPA-NFIP/USPS-T-7-6. In table 8, p. 80, you show own-price's effect on nonprofit periodical volume for the five year period ending in Q.3, 2001, as -0.004%. The table also shows "Other factors" as having an estimated effect on volume of the same type of mail for the same period, as -12.26%. Does this mean that other factors as you identify them on p. 81 of your testimony are 3,065 times more responsible for nonprofit periodical volume decline than changes in postal rates? If not, how would you characterize the influence on volume of "Other factors" as compared with "own price" on nonprofit periodicals over the time period used in Table 8?

RESPONSE:

It is true that 12.26% is 3,065 times greater than 0.004%. However, such a comparison is not necessarily meaningful. I would characterize the influences by comparing the percentage affects on volumes as is done in the table to which you refer, which also gives insights into the reasons for the changes. For example, the impact of postal prices on periodical nonprofit volumes over the past five years is particularly small because the real price of this subclass only changed by 0.1 percent from the beginning of the five-year period to the end of the five-year period.

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF CRPA**

CRPA-NFIP/USPS-T-7-7. Concerning regular-rate periodicals, on p. 90 of your testimony you state that "growth of the number of small-scale specialty magazines may be a positive influence on Regular Rate volume."

(a) Is this the first time you have offered this opinion in a postal rate case? If it is not, identify where else you made this supposition.

(b) If you have offered the opinion before, do you have any data to show the growth of periodical volumes due to specialty magazines in the regular-rate category and the time period of such growth.

(c) In offering that opinion, did you take into account Table 2 of MPA/USPS-T34-3 in this case, where it is shown that under the PERMIT system for calculating permit volumes and pieces, that 57 regular rate periodicals of circulations of 1 million + per issue mail 2,614,868,906 pieces, whereas 15,392 periodicals with circulations of 25,000 pieces or less per volume mail 1,284,100,635 pieces?

(d) When do you foresee periodicals of fewer than 25,000 pieces per issue generating equal or greater volumes than the 57 largest regular-rate publications, with circulations over 1 million pieces per issue?

RESPONSE:

(a) No. I have offered this opinion in Dockets No. R94-1 at USPS-T-2, page 130 at lines 3-15, and R2000-1 at USPS-T-6, page 104, lines 12-19.

(b) The 2000 Gale Directory of Publications and Broadcast Media reports that the number of bimonthly and quarterly publications increased from 3,120 in 1985 to 5,649 in 1999, an 81 percent increase. During the same period, the total number of periodicals declined by ten percent. [Data reprinted in the Statistical Abstract of the United States, 2000, Table 931.]

(c) No. I understand that this table was only recently prepared. In any case, it is for only one year. It does not give information on growth of small-scale specialty magazines, which is the subject you asked about. The table does provide evidence that small magazines represent a

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF CRPA

significant portion of total Periodical regular rate mail volume
(1,284,100,635 out of 7,250,346,168 total pieces in FY 2000, or 17.7
percent of Periodical regular rate mail), consistent with these magazines
being a contributor to volume growth.

(d) I have no opinion on this topic, as it is outside the scope of my
testimony.

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF DMA**

78

DMA/USPS-T7-1 On page 8 of your testimony you say, "A third factor considered is income. For some mail categories, the impact of changes in income on volume is decomposed into separate effects of long-term and short-term changes in income. The effect of long-term growth in real income per adult on mail volume is projected by combining the long-term income elasticity of demand (the percentage increase in volume resulting from a 1 percent increase in real long-term income per adult) for each mail category with the projected percentage increase in real long-term income."

(a) Please confirm that the measure of long term income for the fourth quarter of 1999 through the first quarter of 2005 that you use in estimating volumes appears in Table 124-32 of USPS-LR-J-124 in the column captioned "YD96PERM".

(b) Please confirm that the figures in the above-cited column are in thousands of dollars. If you can not confirm, please provide the units of measurement for these figures.

(c) Please provide this series in an Excel spreadsheet for the time period 1940 through the third quarter of 1999.

RESPONSE:

a. Confirmed.

b. Long-run income is expressed in thousands of 1996 dollars per adult.

c. Data from 1970 through the third quarter of 1999 may be found in the file LR-J-127.xls, which was filed with Library Reference USPS-LR-J-127. Data prior to 1970 have not been compiled and are outside the scope of my research.

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF DMA**

79

DMA/USPS-T7-2 Please refer to USPS-LR-J-124, Table 124-32 and to page 8 of your testimony where you state, "The effect of short-term income changes due to business fluctuations is projected by combining the short-term income elasticity with the projected change in short-term income between the Base Year and the Test Year."

(a) Please confirm that in projecting volumes you use the column captioned "UCAP" in this table to measure "projected change in short-term income."

(b) Please provide the units of measurement for the numbers in this column.

(c) Please provide this series in an Excel spreadsheet for the time period 1940 through the third quarter of 1999.

RESPONSE:

- a. Confirmed.
 - b. UCAP is expressed as a percentage of manufacturing capacity that is utilized in the given time period.
 - c. Please see my response to DMA/USPS-T7-1.c.
-

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF DMA**

DMA/USPS-T7-3 Please refer to USPS-LR-J-124, Table 124-32 and to page 100 of your testimony where you state, "Since direct mail is sent to encourage households to make purchases, advertisers often base their mailing decisions on expected levels of retail sales. Therefore, real retail sales per adult are included in the econometric analysis of Standard volumes. The estimated elasticity of Standard Regular volume with respect to retail sales is 0.700."

- (a) Please confirm that in projecting volumes you use the column captioned "STR96C" in this table to measure retail sales.
- (b) Please provide the units of measurement for the numbers in this column.
- (c) Please provide this series in an Excel spreadsheet for the time period 1940 through the third quarter of 1999.

RESPONSE:

- a. Confirmed.
- b. Retail sales are expressed in thousands of 1996 dollars per adult.
- c. Please see my response to DMA/USPS-T7-1.c.

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF DMA**

DMA/USPS-T7-4 Please refer to USPS-LR-J-124, Table 124-32 and to page 100 of your testimony where you state, "The volume of advertising mail depends on other costs beyond postage. The price of direct-mail advertising is calculated by the Bureau of Labor Statistics by surveying print shops regarding revenue and quantity of advertising printing. It is estimated that a 1 percent increase in the real price of direct mail advertising leads to a 1.006 percent decline in the volume of Standard Regular mail."

(a) Please confirm that in projecting volumes you use the column captioned "WP_ADVPR" in this table to measure the real wholesale price of direct-mail advertising.

(b) Please provide the units of measurement for the numbers in this column.

(c) Please provide this series in an Excel spreadsheet for the time period 1940 through the third quarter of 1999.

RESPONSE:

a. Confirmed.

b. Direct-mail advertising is expressed as an index, equal to one in 1982, deflated by a price index equal to one in 1996.

c. Direct-mail advertising data are only available beginning in June 1982. Data from the third quarter of 1982 through the third quarter of 1999 may be found in the Excel file LR-J-127.xls, which was filed with Library Reference USPS-LR-J-127.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF DMA

DMA/USPS-T7-5 Please refer to USPS-LR-J-124, Table 124-32 and to page 119 of your testimony where you state, "Real consumption expenditures per adult increased 18.6 percent of the 5 years. It is estimated that a 1 percent increase in this variable lead to a 1.019 percent increase in Standard Nonprofit volumes."

- (a) Please confirm that in projecting volumes you use the column captioned "C96C" in this table to measure real consumption expenditures per adult.
- (b) Please provide the units of measurement for the numbers in this column.
- (c) Please provide this series in an Excel spreadsheet for the time period 1940 through the third quarter of 1999.

RESPONSE:

- a. Confirmed.
 - b. Consumption is expressed in thousands of 1996 dollars per adult.
 - c. Please see my response to DMA/USPS-T7-1.c.
-

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF DMA**

DMA/USPS-T7-6 Please refer to USPS-LR-J-124, Table 124-32 and to page 88 of your testimony where you state, "It is estimated that a 1 percent decrease in the wholesale price of pulp and paper index leads to a 0.141 percent increase in the volume of Regular Rate mail."

- (a) Please confirm that in projecting volumes you use the column captioned "WPIP" in this table to measure the wholesale price of pulp and paper.
- (b) Please provide the units of measurement for the numbers in this column.
- (c) Please provide this series in an Excel spreadsheet for the time period 1940 through the third quarter of 1999.

RESPONSE:

- a. Confirmed.
- b. The price of pulp and paper is expressed as an index, equal to one in 1982, deflated by a price index equal to one in 1996.
- c. Please see my response to DMA/USPS-T7-1.c.

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF DMA**

DMA/USPS-T7-7 Please refer to USPS-LR-J-124, Table 124-32 and to page 100 of your testimony where you state, "Newspaper advertising is one of the most important alternatives to direct mail...It is estimated that a 1 percent increase in the real price of newspaper advertising leads to a 0.135 percent increase in the volume of Standard Regular mail."

- (a) Please confirm that in projecting volumes you use the column captioned "WP_NWS" in this table to measure the real price of newspaper advertising.
- (b) Please provide the units of measurement for the numbers in this column.
- (c) Please provide this series in an Excel spreadsheet for the time period 1940 through the third quarter of 1999.

RESPONSE:

- a. Confirmed.
 - b. The price of newspaper advertising is expressed as an index, equal to one in 1982, deflated by a price index equal to one in 1996.
 - c. Newspaper advertising price data are only available beginning in December 1980. Data from the first quarter of 1981 through the third quarter of 1999 may be found in the Excel file LR-J-127.xls, which was filed with Library Reference USPS-LR-J-127.
-

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO
MMA INTERROGATORIES**

MMA/USPS-T7-1 Please refer to pages 31-57 of your Direct Testimony where you discuss factors that affect First-Class volumes, particularly the shifting within First-Class of single piece letters to workshare letters over the past five years.

- A.** In evaluating this shift for letters, please describe those letters as they existed within First-Class single piece, prior to shifting to the worksharing category, assuming that the letters were later to be prepared by a presort bureau.
- B.** In evaluating this shift for letters, please describe those letters as they existed within First-Class single piece, prior to shifting to the worksharing category, assuming that the letters were later to be prepared in-house by the mailer.
- C.** Please quantify approximately which portion of these letters shifted because they were to be prepared by a presort bureau versus the letters prepared by an in-house by the mailer.

RESPONSE:

A-B. I do not understand what sort of description you have in mind. In most respects, I would expect that letters that shift from single-piece to workshared letters would be similar both before and after the shift, regardless of whether those mailings were to be prepared in-house or by a presort bureau.

C. I have not found information on which to base an estimate of the portion of letters that shifted from single-piece to workshared letters that were to be prepared by presort bureaus versus in-house by the mailer.

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO
MMA INTERROGATORIES**

MMA/USPS-T7-2 Please refer to Table 1 on page 5 of your Direct Testimony.

- A. Please confirm that between the base year and test year (before rates) you show that First-Class single piece letters will decline by about 3.5 billion pieces. If you cannot confirm, please explain.
- B. Please confirm that between the base year and test year (before rates) you show that First-Class workshare letters will increase by about 5.0 billion pieces. If you cannot confirm, please explain.
- C. Please estimate how many of the 5.0 billion piece increase in workshare letters originate from the single piece category but will shift to the workshare category. Please explain your answer.

RESPONSE:

- A. Confirmed.
- B. Confirmed.
- C. *The information available to me does not permit a reliable estimate of this shift.*
To illustrate the problem, migration from single-piece to workshared First-Class letters is reflected in the logistic time trends in the single-piece and workshared First-Class letters equations. Factors other than shifting may also influence the trends, preventing estimation of shifting based on the trends. The time trend terms account for a decline in single-piece First-Class letters volume of approximately 2 billion pieces from the base year to the test year, and an increase in workshared First-Class letters volume of a similar magnitude. While one might be tempted to infer from these results that 2 billion of the 5 billion piece increase in workshare First-Class letters is due to shifting, this inference is not warranted. For example, figures are not available on the portion of First-Class letters that are devoted primarily to advertising. If there was an increase in First-Class letter advertising over the period as seems reasonable in view of the increase in Standard A mail, and if it was concentrated in workshare letters as also seems reasonable in view of the multiple pieces involved in advertising mailings, part of

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO
MMA INTERROGATORIES

the workshare trend would be due to advertising and not shifting. Analogous considerations apply to single piece letters. Reasons for volume decline in single piece letters reflected in the trend term, in addition to shifting, include the long term decline in household to household mail and non-electronic diversion, as discussed in my testimony from line 3 page 48 to line 6 of page 49. It would be necessary to estimate the effects of these other influences on trends before an estimate of the amount of shifting could be made.

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO
NAA INTERROGATORIES**

NAA/USPS-T7-1. Please refer to your testimony at Page 26, lines 4-6.

- a. Please confirm that, contrary to line 4 of your testimony, First Class mail accounted for slightly less than half of total domestic mail volume.
- b. Please confirm that you project that First Class mail will account for less than half of total domestic mail volume in the Test Year.
- c. If you cannot confirm, please explain why not.

RESPONSE:

- a. Not confirmed. The number 101.8 at line 6 of my testimony is not correct. Total First-Class Mail volume in Postal Fiscal Year 2000 was 102.9 billion pieces out of a total of 205.1 billion total domestic mail pieces. Hence, First-Class Mail volume accounted for approximately 50.2 percent of total domestic mail volume over this time period. A revision of page 26 is being filed.
 - b. Confirmed.
-

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO
NAA INTERROGATORIES**

NAA/USPS-T7-2: What rates of inflation do you assume for FY2002 and for the Test Year?

RESPONSE:

The personal consumption deflator used to deflate prices in my forecasts is projected by DRI-WEFA to increase by 2.2 percent from FY 2001 to FY 2002 and by 2.2 percent from FY 2002 to FY 2003 (the Test Year).

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO
NAA INTERROGATORIES**

**NAA/USPS-T7-3. Please refer to your testimony at Page 111, lines 11 to 15.
Please explain what you mean by "the price of direct-mail advertising".**

RESPONSE:

**The "price of direct-mail advertising" is a term used by the Bureau of Labor
Statistics to describe their price index. It is my understanding that this price index is
measured by surveying printing companies which prepare direct mailings regarding the
prices charged for their services.**

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO
NAA INTERROGATORIES

NAA/USPS-T7-7. Please refer to Page 113, line 20, through Page 114, line 23. Please identify the factors that you believe contribute to the "net trend" causing a 13.43 percent decline in Standard ECR mail volume, and please indicate the extent to which each factor contributed to the 13.43 percent net trend.

RESPONSE:

The factors contributing to the net trend are identified in the passage of my testimony to which you refer. They include improved market targeting of direct mail and developments in catalogs, as discussed on lines 6-23 page 114. I also state on line 24 page 113 to line 2 page 114: "The section on Standard Regular mail discussed recent developments affecting Standard Mail volumes. Much of this discussion applies to enhanced carrier route mail as well." That section is found on line 21 page 101 to line 16 page 107.

It has not been found feasible to separate out the extent to which the various individual factors contributed to the net trend.

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO
NAA INTERROGATORIES**

NAA/USPS-T7-9. Witness Bernstein, at Page 64, lines 20-22 of his testimony, states that Standard Regular non-carrier route mail "has grown, in part at the expense of ECR mail, due to improvements in database marketing which have allowed advertisers to target customers more effectively." Please state whether you agree with this statement and, if so, how this phenomenon is reflected in your volume forecasts.

RESPONSE:

I agree with this statement. The growth of Standard Regular mail at the expense of Standard ECR mail is reflected in the inclusion of a positive time trend in my forecast of Standard Regular mail and a negative time trend in my forecast of Standard ECR mail. See also my response to NAA/USPS-T7-7.

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO
NAA INTERROGATORIES**

NAA/USPS-T7-10. Please refer to LR-J-125, work paper vf_ar.xls. Please provide calculations for the prices (on the sheet entitled "Prices") for all subclass ECR tiers/density levels.

RESPONSE:

Standard ECR prices are calculated in USPS-LR-J-123, within the spreadsheet PRICES_AR.xls, on sheet "StdA" at rows 680 - 687, at columns AW - AZ.

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO
NAA INTERROGATORIES**

NAA/USPS-T7-11. Please refer to Appendix Table 14 of your testimony and state whether a positive value for a forecast average means that volumes were under forecasted or overforecasted.

RESPONSE:

Underforecasted. As Appendix Table 14 says, the forecast errors presented in my Appendix Tables are equal to the natural logarithm of volume minus the natural logarithm of forecasted volume. Hence, a positive forecast error indicates that actual volume is greater than forecasted volume.

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF ASSOCIATION FOR POSTAL COMMERCE**

POSTCOM/USPS-T7-1. Please refer to sections II.C.1.a-b of your testimony where you discuss the own-price and cross-price elasticities of the volume of single-piece letters. Please further refer to sections II.D.1.a-b of your testimony where you discuss the own-price and cross-price elasticities of the volume of workshare letters.

- (a) Please confirm that these are the only two cases where USPS testimony in R2001-1 provides own-price or cross-price elasticities for mail volumes below the subclass level. If not confirmed, please explain fully.
- (b) Has the Postal Service or its contractors conducted analyses of the own-price or cross-price elasticities for mail volumes below the subclass level for any subclasses of mail other than the subclass(es) referred to in your answer to section (a)? If so, please provide a copy of each such analysis.

RESPONSE:

(a) Separate price elasticities are also provided for stamped and private cards in my testimony at sections II.E.3.a. and II.F.3.a-b.

(b) In this case, separate equations for destination entry and non-destination entry parcel post were analyzed, but ultimately not used in making volume forecasts. These equations can be found in USPS-LR-J-129 at pages 436 and 453 through 460.

In past cases, separate equations for single-piece and workshared private First-Class cards have also been analyzed but not used. See, for example, in Docket No. R97-1, USPS-T-7, Workpaper 3, pages 180 - 228.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-1. Provide for BY2000 (i) the volume of First Class letter mail that was sent by residential customers, and, separately, (ii) the volume that was sent by businesses. If this information is not available, provide the Postal Service's best estimate of such volumes.

RESPONSE:

According to Postal Service estimates, in Postal Year 2000 (i) 21.1 percent of First-Class letter mail was sent by residential customers, and (ii) 74.8 percent was sent by businesses.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-2. Provide for BY2000 (i) the volume of First Class letter mail that was sent to residential customers, and, separately, (ii) the volume that was sent to businesses. If this information is not available, provide the Postal Service's best estimate of such volumes.

RESPONSE:

According to Postal Service estimates, in Postal Year 2000 (i) 45.1 percent of First-Class letter mail was sent to residential customers, and (ii) 51.8 percent was sent to businesses.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-3. Provide for First Class letter mail the volume that was sent by businesses to residences in BY2000. If this information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

The Postal Service estimate is that 38.6 percent of First-Class letter mail was sent by businesses to residences in Postal Year 2000.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-4. Provide for First Class letter mail the volume that was sent by businesses to businesses in BY2000. If this information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

The Postal Service estimate is that 37.2 percent of First-Class letter mail was sent by businesses to businesses in Postal Year 2000.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-5. Provide for First Class letter mail the volume that was sent by residential customers to businesses in BY2000. If this information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

The Postal Service estimate is that 14.6 percent of First-Class letter mail was sent by residential customers to businesses in Postal Year 2000.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-6. Provide for First Class letter mail the volume that was sent by residential customers to residences in BY2000. If this information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

The Postal Service estimate is that 6.5 percent of First-Class letter mail was sent by residential customers to residences in Postal Year 2000.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-7. Provide for BY2000 (i) the volume of single piece First Class letter mail that was sent by residential customers, and, separately, (ii) the volume that was sent by businesses. If this information is not available, provide the Postal Service's best estimate of such volumes.

RESPONSE:

According to Postal Service estimates, in Postal Year 2000 (i) 32.8 percent of single piece First-Class letter mail was sent by residential customers, and (ii) 64.2 percent was sent by businesses.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-8. Provide for BY2000 (i) the volume of single piece First Class letter mail that was sent to residential customers, and, separately, (ii) the volume that was sent to businesses. If this information is not available, provide the Postal Service's best estimate of such volumes.

RESPONSE:

According to Postal Service estimates, in Postal Year 2000 (i) 38.3 percent of single piece First-Class letter mail was sent to residential customers, and (ii) 58.7 percent was sent to businesses.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-9. Provide for single piece First Class letter mail the volume that was sent by businesses to businesses in BY2000. If this information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

The Postal Service estimate is that 36.6 percent of single piece First-Class letter mail was sent by businesses to businesses in Postal Year 2000.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-10. Provide for single piece First Class letter mail the volume that was sent by businesses to residential customers in BY2000. If this information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

The Postal Service estimate is that 27.6 percent of single piece First-Class letter mail was sent by businesses to residential customers in Postal Year 2000.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-11. Provide for single piece First Class letter mail the volume that was sent by residential customers to residences in BY2000. If this information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

The Postal Service estimate is that 10.7 percent of single piece First-Class letter mail was sent by residential customers to residences in Postal Year 2000.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-12. Provide for single piece First Class letter mail the volume that was sent by residential customers to businesses in BY2000. If this information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

The Postal Service estimate is that 22.1 percent of single piece First-Class letter mail was sent by residential customers to businesses in Postal Year 2000.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-13. Provide for BY2000 (i) the volume of First Class parcels that was sent by residential customers, and, separately, (ii) the volume that was sent by businesses. If this information is not available, provide the Postal Service's best estimate of such volumes.

RESPONSE:

I am unaware of any information the Postal Service has which breaks down First Class parcels in this way.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-14. Provide for BY2000 (i) the volume of First Class parcels that was sent to residential customers, and, separately, (ii) the volume that was sent to businesses. If this information is not available, provide the Postal Service's best estimate of such volumes.

RESPONSE:

I am unaware of any information the Postal Service has which breaks down First Class parcels in this way.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-15. Provide for First Class parcels the volume that was sent by businesses to residences in BY 2000. If this information is not available, provide the Postal Service's best *estimate of such volumes*.

RESPONSE:

I am unaware of any information the Postal Service has which breaks down First Class parcels in this way.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-16. Provide for First Class parcels the volume that was sent by businesses to businesses in BY 2000. If this information is not available, provide the Postal Service's best estimate of such volumes.

RESPONSE:

I am unaware of any information the Postal Service has which breaks down First Class parcels in this way.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-17. Provide for First Class parcels the volume that was sent by residential customers to businesses in BY 2000. If this information is not available, provide the Postal Service's best estimate of such volumes.

RESPONSE:

I am unaware of any information the Postal Service has which breaks down First Class parcels in this way.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-18. Provide for First Class parcels the volume that was sent by residential customers to residences in BY 2000. If this information is not available, provide the Postal Service's best estimate of such volumes.

RESPONSE:

I am unaware of any information the Postal Service has which breaks down First Class parcels in this way.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-19. Provide for BY2000 (i) the volume of Parcel Post that was sent by residential customers, and, separately, (ii) the volume that was sent by businesses. If this information is not available, provide the Postal Service's best estimate of such volumes.

RESPONSE:

According to Postal Service estimates, in Postal Year 1997 (i) approximately 10 percent of Parcel Post volume was sent by residential customers, and (ii) approximately 90 percent of Parcel Post volume was sent by businesses.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-20. Provide for BY2000 (i) the volume of Parcel Post that was sent to residential customers, and, separately, (ii) the volume that was sent to businesses. If this information is not available, provide the Postal Service's best estimate of such volumes.

RESPONSE:

According to Postal Service estimates, in recent years (i) approximately 54 percent of Parcel Post volume has been sent to residential customers, and (ii) approximately 46 percent of Parcel Post volume has been sent to businesses.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-21. Provide for Parcel Post the volume that was sent by businesses to residences in BY 2000. If this information is not available, provide the Postal Service's best estimate of such volumes.

RESPONSE:

The Postal Service estimate is that approximately 46 percent of Parcel Post volume has been sent by businesses to residences in recent years.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-22. Provide for Parcel Post the volume that was sent by businesses to businesses in BY 2000. If this information is not available, provide the Postal Service's best estimate of such volumes.

RESPONSE:

The Postal Service estimate is that approximately 43 percent of Parcel Post volume has been sent by businesses to businesses in recent years.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-23. Provide for Parcel Post the volume that was sent by residential customers to businesses in BY 2000. If this information is not available, provide the Postal Service's best estimate of such volumes.

RESPONSE:

The Postal Service estimate is that approximately 3 percent of Parcel Post volume has been sent by residential customers to businesses in recent years.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-24. Provide for Parcel Post the volume that was sent by residential customers to residences in BY 2000. If this information is not available, provide the Postal Service's best estimate of such volumes.

RESPONSE:

The Postal Service estimate is that approximately 8 percent of Parcel Post volume has been sent by residential customers to residences in recent years.

RESPONSE OF POSTAL SERVICE WITNESS TOLLEY TO UPS INTERROGATORIES

UPS/USPS-T7-32. Provide for BY2000 (i) the volume of Destination Entry Parcel Post (DBMC, DSCF, DDU) that was sent by residential customers, and, separately, (ii) the volume that was sent by businesses. If this information is not available, provide the Postal Service's best estimate of such volumes.

RESPONSE:

I am unaware of any information the Postal Service has which breaks down Parcel Post in this way.

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF VAL-PAK**

VP/USPS-T7-1 Assume that witness Moeller (USPS-T-28) had reduced the revenue requirement for Standard ECR by \$100 million below the \$5,555.656 million After Rates revenue requirement shown in Exhibit USPS-28B.

- a. What would have been the After Rates volume forecast for Standard ECR?
- b. If you provided any breakdowns of projected Standard ECR volumes below the subclass level (e.g., for presort categories), please provide a similar breakdown here.

RESPONSE:

In order to make an after-rates volume forecast, it is necessary to have a complete set of after-rates prices. The after-rates forecast that I have done is at the rates proposed by the Postal Service. Parties wishing to do other after-rates forecasts using alternative sets of proposed rates could do so themselves using the documentation materials I have provided. Since your question does not provide a complete set of specific after-rates prices, however, it would not be possible to run a forecast under the conditions you have hypothesized.

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF VAL-PAK**

VP/USPS-T7-2 Assume that witness Moeller (USPS-T-28) had reduced the revenue requirement for Standard ECR by \$125 million below the \$5,555.656 million After Rates revenue requirement shown in Exhibit USPS-28B.

- a. What would have been the After Rates volume forecast for Standard ECR?
- b. If you provided any breakdowns of projected Standard ECR volumes below the subclass level (e.g., for presort categories), please provide a similar breakdown here.

RESPONSE:

Please see my response to VP/USPS-T7-1.

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO INTERROGATORIES OF VAL-PAK**

VP/USPS-T7-3 Assume that witness Moeller (USPS-T-28) had reduced the revenue requirement for Standard ECR by \$150 million below the \$5,555.656 million After Rates revenue requirement shown in Exhibit USPS-28B.

- a. What would have been the After Rates volume forecast for Standard ECR?
- b. If you provided any breakdowns of projected Standard ECR volumes below the subclass level (e.g., for presort categories), please provide a similar breakdown here.

RESPONSE:

Please see my response to VP/USPS-T7-1.

1 CHAIRMAN OMAS: Is there any additional written
2 cross-examination for Witness Tolley? Mr. Baker?

3 MR. BAKER: Thank you. For the record, I'm
4 William Baker representing the Newspaper Association of
5 America. I have not been able to see if the interrogatories
6 I just handed to the witness were previously designated, so
7 I will do this, and we will sort it out later.

8 Dr. Tolley, I have handed you two copies of your
9 responses to Interrogatories NAA/USPS-T-7-12 and 13. If I
10 would ask you those questions today, would your answers be
11 the same?

12 THE WITNESS: Yes, they would.

13 MR. BAKER: With that, Mr. Chairman, I move they
14 be accepted as additional written cross.

15 (The document referred to was
16 identified and received as
17 Exhibit Nos. NAA/USPS-T-7-12
18 and 13.)

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**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO NAA INTERROGATORIES**

NAA/USPS-T7-12: Please confirm that your volume forecasts for the Test Year were prepared before the September 11, 2001, attacks and the more recent discovery of anthrax-laden letters in the mail.

RESPONSE:

Confirmed.

**RESPONSE OF POSTAL SERVICE WITNESS TOLLEY
TO NAA INTERROGATORIES**

NAA/USPS-T7-13: Please describe, in general terms, how you would take the changes in mail volumes since the September 11 attacks and the anthrax letters into account in the future if you were to prepare volume forecasts for a later year. In particular, please explain whether you would need to make a judgment as to whether declines in mail volume since September 11 are essentially "one-time" phenomena, or whether they reflect persistent trends in mail volume that your model would need to take into account. In addition, please indicate the minimum period of time that you believe would be necessary in order to make that judgment.

RESPONSE:

For the reasons given below, the situation will become clearer with the passage of time. Beyond the reality that actual volumes are substantially below volumes forecasted prior to September 11 and will almost certainly continue be so, the situation is so unprecedented that it is difficult to estimate how rapidly clarification will occur. While one may have hoped that some rays of clarity would have been present by now if it were only the events of September 11th and the ensuing military conflict and economic slowdown that were newly affecting mail volume, the incidents of anthrax contamination and infection have made the future all the murkier.

The volume effects relating to September 11th and anthrax could be some combination of several phenomena. First is a one-time phenomenon, with no expected impact beyond the period following the terrorist attacks (for example, people choosing to send fewer packages in the days immediately following September 11th). These one time impacts may be partly accounted for by the decrease in economic activity that resulted from the attacks, and, if so, would be represented by the values of macroeconomic variables when the econometric demand equations are updated.

There will also almost certainly be enduring shifts in volume levels. Volume

levels can decline with no subsequent recovery (for example, an individual mailer who decided to begin to pay bills online immediately following the anthrax attacks, who *continues to do so in the future*). Or the phenomenon could be the beginning of a changed trend effect on mail volume (for example, more rapid adoption over time of alternate bill payment and presentment options).

Evidence in estimating the magnitude of these effects will be provided by looking at unexpected volumes, shifts in volume trends and whatever extrinsic or secondary evidence may become available. Judgments will need to be made concerning the contribution of these several effects. The validity of these judgments will improve over time. When we first will be able to give an assessment of these phenomena, depends largely on what happens moving forward and when the related data become available.

1 CHAIRMAN OMAS: Without objection. So ordered.

2 This brings us to the oral cross-examination.

3 Three parties have requested oral cross-examination, the
4 Association of Postal Commerce, the Direct Marketing
5 Association, and the United Parcel Service.

6 Is there any other party that would like to cross-
7 examine Witness Tolley today?

8 MR. HALL: Yes, Mr. Chairman.

9 CHAIRMAN OMAS: Mr. Hall, would you please state
10 your name?

11 MR. HALL: Yes. Mike Hall on behalf of Major
12 Mailers Association. I will have some very brief clarifying
13 cross.

14 CHAIRMAN OMAS: All right. Mr. Wiggins, would you
15 please begin?

16 MR. WIGGINS: Thank you, Mr. Chairman. Frank
17 Wiggins for the Association for Postal Commerce. To start
18 things out right, the Association for Postal Commerce has no
19 questions for Dr. Tolley.

20 CHAIRMAN OMAS: Thank you, Mr. Wiggins.

21 Next is counsel for the Direct Marketing
22 Association, Mr. Ackerly.

23 (No response.)

24 CHAIRMAN OMAS: It doesn't seem as Mr. Ackerly is
25 here.

1 The United Parcel Service, Mr. McKeever?

2 MR. MCKEEVER: Good morning, Commissioner Omas.

3 We do have some very brief questions.

4 CROSS-EXAMINATION

5 BY MR. MCKEEVER:

6 Q Good morning, Dr. Tolley.

7 A Good morning.

8 Q Dr. Tolley, the other day we faxed to your counsel
9 a chart which contained some volume figures for the base
10 year that you use in your testimony and for the test year
11 after rates for a number of mail classes. Those figures
12 were taken from Table 1 in your testimony on pages 5 and 6.

13 The chart also contained an additional bit of
14 information, a calculation by us of the percentage change in
15 volume from the base year to the test year after rates.
16 Have you had an opportunity to take a look at that chart?

17 A Yes.

18 Q Were you able to confirm that the numbers we took
19 from your testimony and the calculations presented were
20 accurate?

21 A Yes.

22 MR. MCKEEVER: Mr. Commissioner, with your
23 permission I would like to present to the witness a copy of
24 that document, which I propose to mark as UPS-XE-Tolley-1 as
25 a cross-examination exhibit.

1 CHAIRMAN OMAS: Yes.

2 (The document referred to was
3 marked for identification as
4 Exhibit No. UPS-XE-Tolley-1.)

5 BY MR. MCKEEVER:

6 Q Dr. Tolley, that chart, UPS-XE-Tolley-1, indicates
7 that under the volume projections presented in your
8 testimony in your Table 1, the volume of first class letters
9 and flats would increase from the base year to the test year
10 after rates by approximately one-half of one percent, .48
11 percent. Is that correct?

12 A Yes, it is.

13 Q And for first class total the volume increase
14 would be about .31 percent, three-tenths of one percent?

15 A Yes.

16 Q For periodicals mailed there would be a decline in
17 volume of about minus 2.3 percent correct?

18 A Yes.

19 Q And for standard mail in total -- I'm skipping
20 down now to total standard mail -- there would be a volume
21 increase of about plus 5.3 percent?

22 A Yes.

23 Q Parcel post volume would be expected to increase
24 by plus 9.6 percent?

25 A Yes.

1 Q And in fact destination entry parcel post would be
2 expected to increase by 25 percent?

3 A Yes.

4 Q All mail would be expected to increase by about
5 2.4 percent?

6 A Yes.

7 Q So parcel post has by far the highest growth rate
8 of these mail classes? Is that correct?

9 A Yes.

10 Q Dr. Tolley, we also presented to your counsel this
11 morning another document which did not contain any
12 calculations, but rather took the information you presented
13 in two of your interrogatory answers that have been
14 introduced in the record today and put that information on
15 one sheet of paper. Have you had a chance to look at that
16 document?

17 A I'm not sure what you're referring to.

18 MR. MCKEEVER: Mr. Commissioner, with your
19 permission --

20 THE WITNESS: I have it. I have it. That's about
21 the percent by businesses and residences?

22 MR. MCKEEVER: Correct.

23 THE WITNESS: I have that. Sorry.

24 BY MR. MCKEEVER:

25 Q Yes. Just for the record, the document is

1 entitled Percent of Mail Sent by Residences or Businesses.

2 Is that correct?

3 A Yes.

4 MR. MCKEEVER: Mr. Commissioner, I have marked
5 that document as Exhibit UPS-XE-Tolley-2, and I request
6 permission to present a copy to the witness.

7 (The document referred to was
8 marked for identification as
9 Exhibit No. UPS-XE-Tolley-2.)

10 CHAIRMAN OMAS: All right.

11 MR. MCKEEVER: Mr. Commissioner, I do have other
12 copies of both exhibits for the parties in the room if they
13 would like them.

14 CHAIRMAN OMAS: Please. Thank you.

15 BY MR. MCKEEVER:

16 Q Dr. Tolley, were you able to confirm that the
17 information in UPS-XE-Tolley 2 does accurately portray the
18 information you provided in your responses to UPS
19 Interrogatories 7 and 19?

20 A Yes.

21 Q And that information indicates that in the case of
22 first class mail single piece letters, approximately 33
23 percent of the volume was sent by residences and 64 percent
24 was sent by businesses. Is that correct?

25 A Yes.

1 Q And in the case of parcel post, about ten percent
2 of the volume, and this is based on postal year 1997
3 information, correct?

4 A Yes.

5 Q We asked you for base year 2000. I take it that
6 postal year 1997 was the best information you had available?

7 A That's correct.

8 Q Okay. That information, though, indicates that
9 about ten percent of parcel post volume is sent by
10 residences, and 90 percent is sent by businesses. Is that
11 correct?

12 A Yes, it is.

13 Q Now, would you expect that the percentage of
14 parcel select pieces, and that is destination BMC, DSCF and
15 DBU parcel post. Would you expect that the percentage of
16 parcel select pieces sent by businesses would be greater
17 than the 90 percent shown for parcel post as a whole?

18 Put another way, would you expect that parcel
19 select is used to a greater extent by businesses than by
20 individuals than is parcel post as a whole?

21 A Yes, I would expect that.

22 MR. MCKEEVER: Mr. Commissioner, I move that
23 Exhibits UPS-XE-Tolley-1 and UPS-XE-Tolley-2 be admitted
24 into evidence in this proceeding.

25 CHAIRMAN OMAS: Without objection. So ordered.

(The documents referred to,
previously identified as
Exhibit Nos. UPS-XE-Tolley-1
and UPS-XE-Tolley-2, were
received in evidence.)

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UPS - XE - TOLLEY - /

**PROJECTED VOLUME CHANGES
FOR SELECTED MAIL CLASSES
(USPS-T-7, TABLE 1)**

<u>Class of Mail or Service</u>	<u>Base Year</u> (2000Q4- 2001Q3)	<u>After-Rates</u> <u>Test Year</u> GFY 2003	<u>% Change</u>
FIRST CLASS LETTERS & FLATS	97,717.469	98,187.484	+ 0.48%
TOTAL FIRST CLASS MAIL	103,137.023	103,454.162	+ 0.31%
TOTAL PERIODICAL MAIL	10,192.380	9,962.508	- 2.3%
STANDARD MAIL			
Regular Rate Bulk	76,071.365	80,421.874	+ 5.7%
Nonprofit Rate Bulk	14,627.290	15,119.320	+ 3.4%
TOTAL STANDARD MAIL	90,698.655	95,541.195	+ 5.3%
PARCEL POST	339.014	371.533	+ 9.6%
Destination Entry	251.596	314.684	+ 25.1%
TOTAL STANDARD B MAIL	1,101.706	1,145.778	+ 4.0%
TOTAL DOMESTIC MAIL	206,806.314	211,755.380	+ 2.4%

**PERCENT OF MAIL
SENT BY RESIDENCES
OR BUSINESSES**

	FCM Single <u>Piece Letters</u> (PY 2000)	Parcel <u>Post</u> (PY 1997)
Sent By Residences	32.8%	10%
Sent By Businesses	64.2%	90%

Source: Answers of Postal Service witness Tolley to UPS/USPS-T7-7 and UPS/USPS-T7-19.

1 MR. MCKEEVER: That concludes our cross-
2 examination.

3 CHAIRMAN OMAS: Thank you, Mr. McKeever.
4 Is there any other party wishing -- Mr. Hall?

5 MR. MCKEEVER: Mr. Commissioner, if I may?

6 CHAIRMAN OMAS: Yes.

7 MR. MCKEEVER: Mr. Wiggins was kind enough to
8 remind me that I should provide two copies of those exhibits
9 to the reporter so that they may be transcribed into the
10 record. With your permission, I will do so now.

11 CHAIRMAN OMAS: Please do so.

12 MR. MCKEEVER: Thank you.

13 CHAIRMAN OMAS: Thank you, Mr. Wiggins.
14 Mr. Hall?

15 BY MR. HALL:

16 Q Good morning, Mr. Tolley. My name is Mike Hall,
17 and I'm appearing today to ask you some questions on behalf
18 of the Major Mailers Association.

19 First just a housekeeping matter perhaps more for
20 me than for you, but it will help me because it's the
21 interrogatory response that I'm going to be dealing with a
22 little further as well. Could you turn to your response to
23 Interrogatory MMA/USPS-T-7-2?

24 A Yes. I have that.

25 Q On the second page of that interrogatory response

1 you refer us to pages of your prepared direct testimony, and
2 I want to make sure we're both on the same page as it were
3 with respect to that.

4 You referred us to pages 48 and 49, and I wonder
5 if perhaps you mean to refer us to pages 46 and 47 instead?

6 A Yes. You're right. I'm sorry about that.

7 Q If you can turn to the prior page? They're
8 discussing the possibility of shifts of mail volumes, and
9 you say in part the time trend terms account for a decline
10 in single piece first class letters volume of approximately
11 two billion pieces from the base year to the test year and
12 an increase --

13 A Excuse me. Could you tell me just where you're
14 reading from?

15 Q I'm sorry. It's your response to part C of that
16 same interrogatory beginning about four or five lines down.

17 A I see it. Now I see it.

18 MR. HALL: If the reporter can tell me where I
19 left off, I'll finish the sentence. Perhaps it would be
20 just easier if I would read the whole thing again.

21 BY MR. HALL:

22 Q There you say in part the time trend terms account
23 for a decline in single piece first class letters volume of
24 approximately two billions pieces from the base year to the
25 test year and an increase in work shared first class letters

1 volume of a similar magnitude.

2 You go on to say that although somebody would be
3 tempted to say that that represents a shift from single
4 piece to work shared, that would not be warranted. Can you
5 tell us why you think that conclusion would not be
6 warranted?

7 A Right. Well, I think it's stated, but I'll just
8 repeat the idea of what I said in the interrogatory, the
9 response, and that is that --

10 CHAIRMAN OMAS: Excuse me, Mr. Tolley. Would you
11 speak into the microphone?

12 THE WITNESS: As is indicated in the response
13 here, there are other factors affecting those contracts. It
14 talks about the increase in advertising mail, for example,
15 for work shared letters. The part of the testimony that is
16 referred to there that we went over refers to time trend
17 influences on single piece letters, the decline in household
18 mail in general and the boom in electronic diversion.

19 Because those are also in the contract, then you
20 cannot just attribute those shifts due to the time trend,
21 even though they're about equal. You cannot attribute that
22 all to shifts from work shared, from single piece to work
23 shared.

24 BY MR. HALL:

25 Q Let's focus on the increase in letter advertising.

1 How does that impact? How does that explain that it's not a
2 shift?

3 A Well, here we have this time trend, and part of
4 the time trend is due to advertising, and part of it is due
5 to the shift. The total time trend reflects at least those
6 two influences there. We don't know how much we can
7 separate, how much the time trend is due to shift and how
8 much is due to advertising.

9 Q So advertising is something that would lead to
10 growth, for example?

11 A Yes.

12 Q So you would say growth is not a shift? It's an
13 additional outside factor?

14 A Yes.

15 Q For example, would the growth in the use of
16 cellular telephones be an example of what you are talking
17 about in terms of what you call advertising here? In other
18 words, what I have in mind is that within the last ten or so
19 years, maybe 15 years, an absolutely new product has come on
20 the market, the cellular telephone, and has gained
21 widespread acceptance in the United States and elsewhere.

22 Perhaps this is something entirely new since I
23 would say, and perhaps you could tell us, that people don't
24 give up their old land lines necessarily when they get a
25 cellular phone. Is this an example of what you would term

1 growth?

2 A Well, I think we're not talking about mail now.
3 We're talking about telephone communication. I would
4 suppose that's true just thinking about it out loud, but the
5 cell phone that's walking down the street has led to a lot
6 of growth in telephone messaging, but not very much for
7 phone transfer from land, from attached phones. Yes, that's
8 an example.

9 Q I wasn't meaning to get away from the central
10 focus of your testimony here; in other words, mail. What I
11 had in mind is the cellular phone industry also sends out
12 bills, and to the extent there has been a great acceptance
13 of that service, that leads to massive new volumes or growth
14 in work shared mail.

15 A Yes. I'm sorry. Yes. I would agree.

16 Q And that wouldn't mean necessarily in the case of
17 that particular example of growth, that wouldn't mean that
18 there would be a reduction necessarily in bills going out to
19 customers that have land lines?

20 A Not necessarily. There's a lot of separate cell
21 phone bills. Correct. Right.

22 Q Now, for example, with respect to the decline of
23 single piece letters over the long term, you show in your
24 initial table here on page 5, I believe it is, that your
25 after rates volumes in the test year for single piece

1 letters and flats look to me like they're going to be
2 decreasing by approximately an additional billion pieces.
3 Is that correct?

4 A That's the way I see it, yes.

5 Q At the same time, you don't have work shared
6 volumes increasing materially anyway from the before rates
7 test year volumes. Is that correct?

8 A Yes, that's correct.

9 Q So that would be an example, wouldn't it, of
10 simply single piece volumes going away and not shifting over
11 to work shared mail?

12 A That's one possibility. Another possibility is
13 that some shifting is still going on, and there's a negative
14 trend there in the work shared mail. That would be another
15 possibility.

16 Q Okay. Have you been able to quantify that?

17 A No.

18 Q So you don't know how much is shifting from single
19 piece to work shared?

20 A That's correct. We do not know.

21 MR. HALL: Okay. Thank you. Those are all the
22 questions I have.

23 CHAIRMAN OMAS: Thank you, Mr. Hall.

24 That now brings us to are there any questions from
25 the bench. I'd like to start out, Mr. Tolley.

1 Mr. Tolley, could you please refer to your
2 response to Interrogatory NAA/USPS-T-7-13? Starting at the
3 second line of your response you state, "The actual volumes
4 are substantially below those forecasted prior to
5 September 11 and will almost certainly continue to be so."

6 Could you please roughly quantify in percentage
7 terms the word substantially in your statement?

8 THE WITNESS: Okay. I'll try to do that. May I
9 just --

10 CHAIRMAN OMAS: Take your time.

11 (Pause.)

12 THE WITNESS: Well, let's see. We see very
13 preliminary numbers that volume is down by six percent for
14 the data we have so far for the present quarter. The
15 present quarter is not over yet, so substantially -- I've
16 never tried to quantify the word substantially.

17 In my mind, six percent or five percent or even
18 four percent would be substantial. As I say, I've never
19 tried to quantify that. One or two percent might not be
20 substantial. Five or six percent over that would be
21 substantial. I'm trying. That's about the best I can do.

22 CHAIRMAN OMAS: Are you saying five to six
23 percent?

24 THE WITNESS: Yes, I guess I am.

25 CHAIRMAN OMAS: All right. Thank you, Mr. Tolley.

1 Commissioner Goldway?

2 VICE-CHAIRMAN GOLDWAY: Thank you, Chairman Omas.

3 Yes.

4 Dr. Tolley, I have a few questions. The first one
5 goes back to the conversation you were just having with Mr.
6 Hall about whether or not there's a shift from first class
7 single piece to work shared mail.

8 As I understand it, you said you really couldn't
9 tell because there are many different factors involved in
10 the changes of mail mix, and it's hard to track. What could
11 be done to track that shift? What would you do if you
12 wanted to measure that shift?

13 THE WITNESS: Well, I would collect more numbers
14 one way or the other. I think that one possibility would be
15 to enhance the Postal Service's reporting system so that
16 they could look at mail and make a judgement about whether
17 that mail would have been sent by single piece. Again, I'm
18 not sure how much is simple reporting of the mail when it
19 comes to the post office can really do much about that, but
20 it can do something about it. That would give a better
21 idea.

22 I suppose another thing would be a survey of
23 mailers, business mailers primarily, and get a report from
24 them of what they have done. I think probably that would be
25 a way to track the migration of the mail. I can think of

1 those two things that one might do.

2 VICE-CHAIRMAN GOLDWAY: Do you, in your work, see
3 from the Postal Service profiles of some of their large
4 mailers and what kinds of mail they are mailing over time?

5 THE WITNESS: No, not in the ordinary course of
6 events.

7 VICE-CHAIRMAN GOLDWAY: Would it be possible to
8 let's say get an aggregate of large mailers and track the
9 proportion of mail that they are sending in single piece
10 versus bulk and make any determination about shift from
11 looking at that?

12 THE WITNESS: That's an interesting idea. I'm
13 just not sure that any mailer -- that you could tell from
14 the mail of any mailer what's going on. I mean, you have
15 this mail. Some of it is single piece, but the large
16 mailers are also having a lot of different things going on
17 with their mail.

18 I would really just have to think about that.
19 It's an interesting idea.

20 VICE-CHAIRMAN GOLDWAY: Okay. I have a couple of
21 other questions, if you don't mind.

22 You presented to us a forecast for the next couple
23 of years, and Chairman Omas just pointed out this sudden
24 drop that's occurred because of 9-11. We don't know whether
25 there's a lasting impact to that, but certainly there seems

1 to be a more severe recession and lower interest rate
2 growth, in fact decline, and perhaps lower income, average
3 annual income growth, than we may have thought was the case
4 when these numbers that you prepared were developed.

5 Do you think that the general economic downturn
6 that we've experienced separate from the 9-11 shock is
7 significant enough that your figures might need to be
8 revised?

9 THE WITNESS: Well, our forecasts were done in
10 June, and that was the outlook at that time. I think
11 there's no question the recession has turned out to be worse
12 than was projected by DRI, whose forecasts we used. Part of
13 this decline in volume is due to the fact that the recession
14 was forecasted not to be as bad as it turned out.

15 Does the forecast need revision? At some point it
16 does. I'm not sure we're in a position at this moment to
17 revise the forecast.

18 VICE-CHAIRMAN GOLDWAY: Okay. Something for us to
19 consider. I have another question for you.

20 In this case you modeled the use of the internet
21 and the demand equations of first class single piece
22 standard mail and even other mail services. In all
23 instances you found that the internet has a negative impact
24 on mail volume.

25 With respect to first class single piece mail, you

1 found a substantial diversion to the internet. From your
2 research, do you find any potential positive impact of the
3 internet on mail volume?

4 THE WITNESS: Let's see. I believe we used the
5 internet variable in the single piece source class, as you
6 said, and then also in regular rate second class. We found
7 there was a much more modest effect on the regular rate,
8 which is magazines and newspapers.

9 One thing that comes up is that newspapers in
10 particular are using the internet themselves a great deal,
11 and there have been some surveys that indicate that people
12 who start using the internet for the newspaper actually will
13 then start subscribing to the hard copies of it, so there is
14 an example of a positive effect of the internet.

15 VICE-CHAIRMAN GOLDWAY: What about in package
16 deliveries? Did you factor the internet into package
17 deliveries?

18 THE WITNESS: Not explicitly. It is not one of
19 the independent variables.

20 VICE-CHAIRMAN GOLDWAY: There is some discussion
21 that, first of all, catalog sales, catalog publication and
22 distribution through the mail, may be increasing in relation
23 to the growth of internet retailers. Then there would be
24 packages delivered as a result of internet purchases.

25 THE WITNESS: Yes.

1 VICE-CHAIRMAN GOLDWAY: Has any of that been
2 factored into your equations?

3 THE WITNESS: Not into the equations because we
4 couldn't find a variable for kind of the internet. We don't
5 have that, but as our residual factors. We have other
6 factors other than the specific independent variables, and
7 we certainly did discuss this.

8 The e-tailers will first be on line, and then they
9 find that they need to issue a hard copy of the mail catalog
10 and mail it out, so that's certainly an example there, as
11 well as e-tailing in itself generates package mail. We've
12 discussed that among factors affecting the mail. We haven't
13 been able to quantify that particular piece of it yet.

14 VICE-CHAIRMAN GOLDWAY: Do you expect in the
15 future you'll be able to develop some measurement?

16 THE WITNESS: We hope so. I don't want to promise
17 too much.

18 VICE-CHAIRMAN GOLDWAY: As Mr. Hall suggested,
19 we've come up with this new product of cellular phones,
20 which has in fact increased, one could say, mail volume by
21 creating a whole new national billing system.

22 Have you factored in perhaps the growth of
23 internet, everyone having an e-mail account and creating and
24 needing a separate bill for that or some other use of the
25 internet that would generate more mail volume? Do you think

1 that's possible?

2 THE WITNESS: I think it's possible, and we're
3 discussing some of these things now. Our horizon here is
4 basically through 2003 or 2004. There are many, many
5 possibilities.

6 We look a few years ahead, and we're looking at
7 those things and thinking about them, but I can't think of
8 any way that they're in our forecast for 2003 and 2004.

9 VICE-CHAIRMAN GOLDWAY: Okay. Thank you.

10 CHAIRMAN OMAS: Commissioner Covington?

11 COMMISSIONER COVINGTON: Thank you, Chairman Omas.

12 As I was looking, Professor Tolley, at the direct
13 testimony you submitted here to the Commission, I have to
14 commend you. I have to give credit where credit is due. I
15 noticed that this is your seventh rate case, and you've also
16 been before the Commission on two mail classification
17 issues. For that I think, you know, you should be
18 commended. I hope that I'm not here through seven rate
19 cases myself.

20 Following up on what Commissioner Goldway had
21 touched on, I guess when you prepared your testimony in
22 R2000-1 none of us were aware of the impact or knew that the
23 circumstances were going to come about with the September 11
24 incident. Quite naturally, in addition to that the
25 situation with the anthrax scare or the anthrax situation

1 that we're dealing with here in the U.S. Postal Service is
2 having a profound effect on volume.

3 Have you been asked or have you been thinking
4 about as we proceed with R2000-1 whether you would have to
5 go back with your volume forecast as it relates to this case
6 that we're hearing now?

7 THE WITNESS: Well, certainly I've thought about
8 it. I haven't been asked to do any new forecasts. It would
9 be very difficult to do that at this point.

10 As my answer here says, the situation is quite
11 unprecedented, particularly with respect to the anthrax. We
12 don't have any data at this point really. The anthrax has
13 been so recent. It just started in October, so we have no
14 data really. We don't even have a quarter's worth of data.
15 Certainly when we get that data we'll look at it and see
16 what it indicates about what's happening.

17 Even so, the forecasted situation is very
18 difficult now because the anthrax is unprecedented. If you
19 look at past incidents where consumers have been frightened
20 somehow, whether justifiably or not, by something, you can
21 have tremendous decreases in sales. We don't know whether
22 this is that serious. We don't know how serious this is.

23 We may get day by day information, but I really
24 couldn't say when we'll be able to make a reliable forecast.
25 It might be soon, but it might take a while.

1 COMMISSIONER COVINGTON: Okay. Thanks, Professor
2 Tolley.

3 That's all I have, Chairman Omas.

4 VICE-CHAIRMAN GOLDWAY: Could I follow up on that?
5 One of the scares that I recall most vividly was the Tylenol
6 scare where there was poisoning in the pills. Is there some
7 sense of what amount of time is needed to indicate whether
8 it's just a sudden downturn or whether there's a long-term
9 trend? Do economists, as they do with a recession, say you
10 need three quarters or something or other or two quarters?

11 Do you have a sense that if this decline goes on
12 for two quarters then you absolutely need to do a
13 reconfiguration, but if it's just one quarter then you can
14 go along with the figures that you've now submitted? Do you
15 have a sense of what the time frame is in which you would
16 need to make that decision?

17 THE WITNESS: Well, it's very difficult. My sense
18 is that these incidents can be very different. The Tylenol
19 was probably handled rather well, but still they recalled
20 all their products, and there was a lag there. If you go to
21 some other cases like the Perrier water, the benzene in the
22 Perrier water, that took a year or two, and it was
23 permanent. It never regained its preeminent position there.

24 It is on our agenda to look at these experiences
25 much more closely, and we will be doing some of this, what

1 you're talking about of finding out what the lags are and
2 how long it takes. There's been a little bit of attention
3 in the literature on this, but not very much. We're in the
4 process we're just going to begin now tracing these other
5 incidents very carefully trying to get some insights about
6 what's going on.

7 As far as whether you can do it in one quarter,
8 I'm just not sure about that. There is an electronic
9 diversion where people shift out of mail into something else
10 because of this incident. There's a possibility they'll
11 never come back. It might be that the effects will not be
12 felt so much in the first quarter as later, but this is a
13 little bit uncharted territory, and we're now scrambling
14 to look at that kind of experience. We're just in the
15 preliminary stages, I think.

16 VICE-CHAIRMAN GOLDWAY: Thank you.

17 CHAIRMAN OMAS: Commissioner Covington?

18 COMMISSIONER COVINGTON: Yes. Professor Tolley,
19 I'd like to follow up on the previous question that I asked
20 you. In light of what we have seen here, and I think
21 Commissioner Goldway touched on a good point there in
22 comparing what's going on with the anthrax situation to
23 other scares that we've seen out here in a consumer
24 basically driven market.

25 Now, previously I asked whether or not, you know,

1 you had been asked to look at your volume forecast and
2 whether or not you felt that you would be asked to look at
3 it in the future by the United States Postal Service,
4 correct?

5 THE WITNESS: You asked me that, yes.

6 COMMISSIONER COVINGTON: Right.

7 THE WITNESS: I said we had not been asked to do a
8 new forecast at this point. I don't know what will be
9 requested in the future.

10 COMMISSIONER COVINGTON: Okay. All right. Now
11 let me give you a prime example, Professor Tolley, bringing
12 it home.

13 Personally, we haven't actually had any mail
14 delivered here to our Commission, to our business, I would
15 say since October, the last week in October. We know the
16 effects that have been running pretty rampant through the
17 Brentwood facility over here, and we know, you know, the
18 amount of volume that goes through there, the employees and
19 the fact that they deliver to 300,000 plus residents and in
20 excess of 30,000 businesses, you know, in and around Capitol
21 Hill.

22 When you look at your volumes, not only, Dr.
23 Tolley, were we not getting mail delivered, but there was no
24 mail being picked up here at this building, and I would
25 imagine at other mail boxes situated, you know, around

1 Washington, D.C., mail was laying dormant. If you don't
2 have the collection, then quite naturally you don't have
3 that cancellation. In other words, for every letter that's
4 been laying in these boxes around just Washington, D.C., if
5 we don't cancel out that 34 cent first class letter, then
6 that has a profound impact.

7 I would imagine or I would think that with this
8 case having been filed and announced on the morning of the
9 September 11 attack, I would think it would be a little
10 puzzling that no one from headquarters, from postal
11 headquarters, has asked either you or Dr. Thress or Mr.
12 Bernstein or Mr. Musgrave to revisit, you know, your
13 forecast in light of the fact that we're all in pretty much
14 a financial hold, and we don't know what our 2001-1 is going
15 to generate as far as revenue for the Postal Service.

16 Logically, aren't you expecting a call from them,
17 or shouldn't someone be contacting either you or Mr. Thress
18 or Mr. Bernstein or Mr. Musgrave about that fallout in
19 volume?

20 THE WITNESS: Yes. I expect it will happen, but I
21 don't want to speak for the Postal Service decisions. I
22 expect that it will happen.

23 COMMISSIONER COVINGTON: Okay. But you do realize
24 that when we talk about volume, that volume is basically
25 what drives the economy of the United States Postal Service?

1 THE WITNESS: Yes, I certainly do.

2 COMMISSIONER COVINGTON: Okay. With what
3 transpired on September 11 and with what has occurred since,
4 the anthrax situation, the quarter that you keep mentioning,
5 would that be about in line with when these events occurred?

6 THE WITNESS: Well, we're talking about the first
7 quarter, which began in September. It's basically
8 September, October and November.

9 COMMISSIONER COVINGTON: And November, which is
10 where we are now, right?

11 THE WITNESS: Exactly.

12 COMMISSIONER COVINGTON: All right.

13 THE WITNESS: We have done a lot of looking at our
14 forecast versus the actual events. I thought your question
15 was have we done a new forecast.

16 COMMISSIONER COVINGTON: Or will you be doing one?
17 It wouldn't be out of the ordinary if you were asked to?

18 THE WITNESS: It certainly wouldn't be. I expect
19 that we'll be asked.

20 VICE-CHAIRMAN GOLDWAY: Can I? Your own research
21 institute or staff of colleagues is doing this evaluation
22 and looking into these things on your own? You haven't been
23 asked to do any general work about volume by the Postal
24 Service? You said you had not been asked to do a new
25 forecast.

1 THE WITNESS: Right.

2 VICE-CHAIRMAN GOLDWAY: But have you been asked to
3 do other work about --

4 THE WITNESS: Oh, yes. We're communicating all
5 the time about these things we're talking about.

6 VICE-CHAIRMAN GOLDWAY: I see. So you are
7 providing the Postal Service with information about impacts
8 on volume and what may or may not have occurred in previous
9 scare instances, et cetera, et cetera, so you're consulting
10 with them on a regular basis on things?

11 THE WITNESS: Absolutely. With the effects of the
12 under forecasting of the recession, we've done a lot of work
13 on that. We know that a great deal of this fall off in
14 volume is due to that, but it's too soon to say that it's
15 all due to that and so forth. Yes, we're talking, as you
16 can imagine, every day practically about it.

17 VICE-CHAIRMAN GOLDWAY: Thank you. That clarifies
18 that.

19 CHAIRMAN OMAS: Mr. Koetting, would you like some
20 time with your witness to review whether there is a need for
21 re-cross?

22 MR. KOETTING: I think a minute or two would be
23 sufficient, Mr. Chairman.

24 CHAIRMAN OMAS: Fine. Thank you.

25 (Whereupon, a short recess was taken.)

1 COMMISSIONER OMAS: Mr. Koetting?

2 MR. KOETTING: Thank you, Mr. Chairman.

3 We do think it might be beneficial to go into a
4 little bit of detail of the, following up on one of the
5 Commission's questions about the magnitude of the
6 substantials that was cited in the interrogatory response
7 from the NAA-13.

8 DIRECT EXAMINATION

9 BY MR. KOETTING:

10 Q Dr. Tolley, could you give a little bit more of an
11 explanation of the number that you cited of five to six
12 percent? What type of analysis is behind that magnitude of
13 figure?

14 A I'll do that. I might start back with our
15 forecast in June because we have to go through a lot of
16 things to formulate a rate case. The forecast has to go
17 through the Postal Service which goes through a testing
18 model and then the costing people have to come back and say
19 no, the break-even requirement wasn't satisfied by those
20 prices. That kind of thing. So it takes a long time to
21 build a rate case and therefore we had to do our projections
22 in June.

23 The base year that we chose, as you know, as used
24 here is quarter three of this year, which means basically in
25 the spring of this year. So we have one full quarter to

1 look at how that forecast is doing, basically the summer of
2 this year. So one thing we've done, of course, is to look
3 how the forecast did for that one quarter and it came within
4 less than one-half of one percent. And if I may say so, our
5 forecasts usually perform in that way. So that was saying
6 that our model seemed to be working fine up to that point.

7 Now if we look behind those numbers a little bit
8 we do see something going on. We see that that standard
9 mail, business mail, was down compared to what we forecasted
10 and there was a signal that there was a recession going on,
11 the recession had been under-forecast.

12 About half of it, at least partially is made up by
13 the fact that first class letters surged a bit during the
14 summer quarter which we attribute to the tax rebate.
15 Everybody getting a letter and then many people getting
16 checks during that period.

17 So as often happens, the under- and over-forecast
18 for that period, for the various classes of mail, some
19 classes, tend to average out. That's kind of the law of
20 averages and that certainly happened in this case.

21 Those under- and over-forecasts, incidentally,
22 were not serious for those two kinds of mail.

23 Then we come to an interesting thing. The Postal
24 year is different from the government fiscal year. The
25 Postal year has 364 days instead of 365 days, so it gets out

1 of kilter with the government fiscal year. Without going
2 into all the details, this year the Postal year ended on
3 September 7th and the fiscal year ended on September 30th as
4 all fiscal years -- that's normal. Everybody else but the
5 Postal Services is fiscal year.

6 So we collect two kinds of numbers, particularly
7 in a rate case situation. We found that the mail volume
8 that was recorded on September 30th for the fiscal year was
9 below expectation. September 7th was just before September
10 11th, so then we had two and a half weeks or so of post-
11 September 11th. What happened during that period is, for
12 the Postal year we had predicted, not predicted, the actual
13 volume was a slight positive over last year, the volume was
14 not growing very much but it still was a slight positive.

15 If we go to the fiscal year, the difference was
16 enough so that for a fiscal year the volume was actually
17 down, a negative. It was enough to switch volumes from
18 being positive to negative over the year. So we're moving
19 further toward the uncertain events.

20 Now we come into the present quarter that we're
21 in. What kind of insulation do we have there? We have the
22 example that the budget is coming in at \$875 million or so
23 short of what was forecasted. The revenue figures come in a
24 little bit before the volume figures so you can get an idea
25 there. That's suggesting that volume may be down say six

1 percent, something like that, for the quarter. There are
2 also some very soft numbers on volume, even though for the
3 first part of the quarter, and they also suggest declines in
4 volume of that amount.

5 Let's take a simple calculation. If the volume
6 was down for the first quarter of this year, September,
7 October, November, if it's down six percent then that alone
8 is going to mean that the volume for the year will be down
9 1.5 percent, that's six percent spread over four quarters
10 instead of one quarter. And that 1.5 percent as a fraction
11 of the \$70 billion roughly of revenue of the Postal Service
12 is about a billion dollars. So there's a billion dollar
13 loss going on there for the six percent. That's why I chose
14 the number of five percent, although I [haven't] been asked
15 to quantify what the schedule means. It may be an
16 interesting exercise.

17 In any case, that's where we are at this point and
18 that's why I call it substantial. We still are in an
19 uncertain situation. We have had very little, we don't have
20 any numbers yet on November which is when we'll get
21 something on the anthrax, and the quarterly numbers will be
22 assembled in a week or so, so we can begin to re-run a model
23 in a preliminary way, but we still don't know what that will
24 show us when we get to it because we still have all these
25 things we were talking about about consumer reaction and so

1 forth.

2 I hope that helps clarify.

3 COMMISSIONER OMAS: Thank you.

4 Any other questions?

5 (No audible response)

6 COMMISSIONER OMAS: Mr. Tolley, that completes
7 your testimony here today. We appreciate your appearance
8 and your contribution to our record.

9 Thank you again, and you're excused.

10 THE WITNESS: Thank you.

11 (Witness excused)

12 COMMISSIONER OMAS: Mr. Koetting, will you
13 introduce the next Postal witness please?

14 MR. KOETTING: Postal calls as it's next witness
15 Tom Thress.

16 Whereupon,

17 THOMAS THRESS

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

20 COMMISSIONER OMAS: Thank you.

21 DIRECT EXAMINATION

22 BY MR. KOETTING:

23 Q Could you please state your full name for the
24 record, please?

25 A Thomas Thress.

1 Q Mr. Thress, I'm handing you a document entitled
2 Direct Testimony of Thomas E. Thress on behalf of the United
3 States Postal Service which has been designated as USPS-T-8.

4 (The document referred to was
5 marked for identification as
6 USPS-T-8.)

7 BY MR. KOETTING:

8 Q Are you familiar with this document?

9 A Yes, I am.

10 Q Was it prepared by you or under your supervision?

11 A Yes, it was.

12 Q Do you have any revisions or errata to make to
13 that testimony?

14 A No, I don't.

15 Q If you were to testify orally today, then would
16 this be your testimony?

17 A Yes, it would.

18 Q Mr. Thress, is it also your intent to sponsor with
19 that testimony certain Category II Library References?

20 A Yes.

21 Q Are those the Library References listed in the
22 Table of Contents as USPS-LR-J127, Data Programs and Results
23 for Witness Thress' econometric work; LR-J128, Estimation of
24 Permanent Income Elasticities; and LR-J129, Witness Thress'
25 Econometric Choice Trail?

1 A Yes.

2 COMMISSIONER OMAS: Mr. Chairman, I'm handing the
3 Reporter two copies of the Direct testimony of Thomas E.
4 Thress on behalf of the United States Postal Service, USPS-
5 T-8, and I request the testimony along with the associated
6 Category II Library References be admitted into evidence.

7 COMMISSIONER OMAS: Is there any objections?

8 (No response)

9 COMMISSIONER OMAS: Hearing none, I will direct
10 counsel to provide the Reporter with two copies of the
11 corrected Direct testimony of Thomas E. Thress. The
12 testimony is received into evidence. However, as is our
13 practice it will not be transcribed.

14 (The document previously
15 identified as USPS-T-8 was
16 received in evidence.)

17 COMMISSIONER OMAS: Mr. Thress, you have had an
18 opportunity to examine the package of designated written
19 Cross-Examination that was made available to you in the
20 hearing room this morning. If the questions contained in
21 that packet were posed to you orally today, would your
22 answers be the same as were previously provided in writing?

23 THE WITNESS: Yes.

24 COMMISSIONER OMAS: Are there any corrections or
25 additions you would like to make to those answers?

1 THE WITNESS: No.

2 COMMISSIONER OMAS: Counsel, would you please
3 provide two copies of the corrected, designated written
4 Cross-Examination of the witness to the Reporter, and the
5 material is received into evidence. It is to be transcribed
6 into the record.

7 (The document identified as
8 USPS-T-8/Cross-Examination
9 received in evidence.)

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes

Docket No. R2001-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF UNITED STATES POSTAL SERVICE
WITNESS THOMAS E. THRESS
(USPS-T-8)

Party

Direct Marketing Association, Inc.

Mail Order Association of America

Newspaper Association of America

Interrogatories

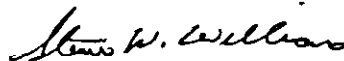
NAA/USPS-T8-3

NAA/USPS-T8-2-3

NAA/USPS-T8-1-4

POIR No. 4, Question 13

Respectfully submitted,



Steven W. Williams
Acting Secretary

INTERROGATORY RESPONSES OF
UNITED STATES POSTAL SERVICE
WITNESS THOMAS E. THRESS (T-8)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory

NAA/USPS-T8-1

NAA/USPS-T8-2

NAA/USPS-T8-3

NAA/USPS-T8-4

POIR No. 4, Question 13

Designating Parties

NAA

MOAA, NAA

DMA, MOAA, NAA

NAA

NAA

**RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
NAA INTERROGATORIES**

NAA/USPS-T8-1. Please refer to your testimony at Page 18, lines 1 through 13.

- a. Please explain how consumption expenditures on Internet Service Providers, through which consumers obtain access to a range of information and services, affects First Class mail volume.**
- b. Do you assume that any particular percentage of consumption expenditures on Internet Service Providers equates to a substitute of electronic mail or Instant Messaging for First Class mail?**
- c. Does your model take into account free e-mail accounts? If so, how?**
- d. Does your model take into account consumer use of Internet services, including e-mail, through their workplaces, where the cost of Internet service is borne by the employer?**

RESPONSE:

a. First-Class Mail volume is affected by the Internet in a number of ways. For example, E-mail can substitute for personal letters, and bills may be paid electronically instead of through the mail. The extent to which consumers use the Internet in general may be indicative of the extent to which consumers use the Internet as a substitute for First-Class Mail. Consumption expenditures on Internet Service Providers is a measure of the extent to which consumers use the Internet. Hence, it reflects the extent to which consumers use the Internet as a substitute for First-Class Mail.

See Peter Bernstein's testimony, USPS-T-10, Chapter IV, especially section IV.B., for a discussion of this issue.

b. No.

c-d. Not explicitly. These issues are discussed by witness Bernstein in USPS-T-10 at page 31, line 20 through page 32, line 14.

**RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
NAA INTERROGATORIES**

NAA/USPS-T8-2: Please confirm that your testimony indicates that Standard ECR has a higher cross-price elasticity with Internet advertising than does Standard Regular mail. Please explain why this is a reasonable result in light of the capability offered by the Internet to target consumers on the basis of factors other than geography.

RESPONSE:

Confirmed.

Consider two means of targeting direct-mail advertising, demographic targeting – that is, targeting on the basis of characteristics such as age, income, or other demographic factors – and purchase targeting – that is, targeting a person on the basis of whether the person has previously bought from a catalog.

Demographic targeting may result in some geographic targeting (e.g., wealthy people tend to live in wealthy neighborhoods), and may therefore be conducive to the use of Standard ECR as opposed to Standard Regular. Purchase targeting, on the other hand, would be less likely to have a geographic component, and would therefore be more conducive to the use of Standard Regular mail.

As witness Bernstein discusses in his response to NAA/USPS-T10-8, there are a number of different types of Internet advertising. Some of these, such as direct e-mail, may be quite conducive to purchase targeting, while others, such as banner ads, may be more conducive to demographic targeting.

Depending on the nature of the specific type of Internet advertising, therefore, different types of Internet advertising may be expected to compete more heavily with either Standard Regular or Standard ECR mail.

**RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
NAA INTERROGATORIES**

NAA/USPS-T8-3: Please refer to your testimony at Page 50, line 21. Please explain your understanding of how the price of newspaper advertising affects Standard Enhanced Carrier Route mail volumes. Please include in your answer:

- a. Whether the price of newspaper advertising to which you refer reflects run-of-press newspaper advertising or of insert advertising or some combination of both;**
- b. An explanation of how the cited price of newspaper advertising relates to ECR volume, as distinct from the volume of advertising preprints delivered via ECR mail.**

RESPONSE:

A potential advertiser can choose from among many possible advertising media, including newspapers as well as direct mail. If the price of newspaper advertising increases, then this is likely to make other advertising media, including direct-mail advertising, more attractive to potential advertisers. Hence, an increase in the price of newspaper advertising would be expected to lead to an increase in the use of non-newspaper advertising media, including direct mail.

- a. It is my understanding that the price of newspaper advertising includes both run-of-press newspaper advertising as well as insert advertising.**
- b. My focus is on ECR volume in general. I did not undertake any separate analysis on the "volume of advertising preprints delivered via ECR mail" distinct from other types of ECR mail.**

**RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
NAA INTERROGATORIES**

NAA/USPS-T8-4: Does your testimony regarding Standard Enhanced Carrier Route mail take into account, in any way, the prices charged by ECR shared mailers to advertisers for inclusion into a shared mailing? Please explain your answer fully.

RESPONSE:

No. The focus of my testimony is on the volume of Standard ECR mail, and is not concerned with the size or number of advertisers within a particular shared mailing.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
PRESIDING OFFICER'S INFORMATION REQUEST

POIR-4-13. Table II-1 at page 25 of USPS-T-8 shows the cumulative impact of time trends on First-Class single-piece and workshared letters for the years 1987 through 2001. Please provide the estimated impact of the same time trends on First-Class single-piece and workshared letters for each of the forecast years 2002, 2003(test year) and 2004.

RESPONSE:

Please see the attached Table.

Table Accompanying Response of Postal Service Witness Thress to Presiding Officer's Information Request 4, Question 13
Impact of Time Trends in First-Class Letters Equations
(millions of pieces, cumulative since 1987)

	<u>Single-Piece</u>			<u>Workshared</u>			<u>Total Letters</u>
	<u>Logistic Trend</u>	<u>Internet</u>	<u>Total</u>	<u>Logistic Trend</u>	<u>Discount Ratio</u>	<u>Total</u>	
1988	(541.155)	(101.801)	(642.956)	880.449	317.813	1,198.261	555.305
1989	(1,213.630)	(283.145)	(1,496.775)	1,770.062	646.508	2,416.570	919.795
1990	(1,988.646)	(398.350)	(2,386.996)	2,629.041	948.618	3,577.659	1,190.664
1991	(2,848.052)	(602.992)	(3,451.044)	3,477.897	1,288.771	4,766.668	1,315.625
1992	(3,727.396)	(769.491)	(4,496.886)	4,325.526	1,619.045	5,944.571	1,447.685
1993	(4,650.356)	(891.858)	(5,542.214)	5,159.388	1,606.382	6,765.770	1,223.556
1994	(5,618.229)	(1,210.991)	(6,829.220)	5,971.865	1,925.003	7,896.868	1,067.648
1995	(6,597.245)	(1,763.106)	(8,360.351)	6,804.419	2,273.462	9,077.881	717.530
1996	(7,569.847)	(2,404.782)	(9,974.629)	7,650.155	2,505.051	10,155.206	180.577
1997	(8,561.754)	(2,895.681)	(11,457.435)	8,459.731	2,430.423	10,890.153	(567.282)
1998	(9,567.222)	(3,252.560)	(12,819.782)	9,255.657	2,730.599	11,986.256	(833.526)
1999	(10,568.597)	(3,938.613)	(14,507.210)	10,054.725	3,031.737	13,086.462	(1,420.748)
2000	(11,563.617)	(5,240.705)	(16,804.322)	10,861.872	3,320.445	14,182.317	(2,622.005)
2001	(12,531.732)	(7,480.088)	(20,011.819)	11,674.613	3,601.853	15,276.466	(4,735.353)
2002	(13,471.274)	(9,163.455)	(22,634.729)	12,476.903	3,872.240	16,349.143	(6,285.586)
2003	(14,375.884)	(10,808.405)	(25,184.089)	13,287.260	4,140.816	17,428.076	(7,756.013)
2004	(15,254.803)	(12,305.457)	(27,560.260)	14,110.323	4,407.400	18,517.723	(9,042.537)

1 Is there any additional Cross-Examination for
2 Witness Thress?

3 Would counsel come forward? Please identify
4 yourself and your organization.

5 MR. STOVER: Mr. Chairman, David Stover appearing
6 pro hac vice for the Greeting Card Association. Mr. Swendinan
7 is in another proceeding today and can't be here.

8 We have one additional interrogatory response. It
9 is one which was redirected to Mr. Thress from Witness
10 Bernstein. It was originally designated USGCA-USPS-T10-8.
11 We would like to move its admission.

12 COMMISSIONER OMAS: Without objection.

13 (The document referred to was
14 marked for identification as
15 USGCA-USPS-T10-8, and was
16 received in evidence.)

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

RECEIVED
Dec 12 3 14 PM '01

POSTAL RATE COMMISSION
OFFICE OF THE CLERK


Postal Rate and Fee Changes, 2001

Docket No. R2001-1

**DESIGNATION OF WRITTEN CROSS-EXAMINATION OF
USPS WITNESS THRESS (USPS-T-10-8) BY
GREETING CARD ASSOCIATION
(December 12, 2001)**

Greeting Card Association (GCA) hereby designates the following interrogatories to and responses by USPS witness Thress as written cross-examination: GCA/USPS-T-10-8, redirected from USPS witness Bernstein. Two copies of this cross-examination have been filed at the Docket Room of the Commission. This designation is being filed two days late due to the Postal Service's filing of the responses at 5:15 p.m. on December 10, 2001 and the inability of counsel to consult with GCA's expert witness.

Respectfully submitted,



Alan R. Swendiman

Counsel for
GREETING CARD ASSOCIATION

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CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document upon all participants of record in accordance with section 12 of the Commission's Rules of Practice.


Alan R. Swendiman

Counsel for
GREETING CARD ASSOCIATION

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

POSTAL RATE AND FEE CHANGES, 2001

Docket No. R2001-1

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS THRESS
TO GCA INTERROGATORY GCA -T10- 8,
REDIRECTED FROM WITNESS BERNSTEIN
(December 10, 2001)

The United States Postal Service hereby provides the response of witness Thress to the following interrogatories of GCA: GCA/USPS-T10-8, filed on November 26, 2001, and redirected from witness Bernstein. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorney:



Eric P. Koetting

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-2992; Fax -5402
December 10, 2001

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
GCA INTERROGATORY RE-DIRECTED FROM WITNESS BERNSTEIN

GCA/USPS-T10-8. You state your testimony does not address "past technological developments such as the telephone", page 2, line 8.

a. Isn't telecommunications deregulation over the past twenty (20) years right through to the present a major factor reducing the growth in demand for First-Class letter mail communications?

b. Is the growth of long distance communications from the reduction in long distance prices the past two decades a variable that has ever entered RCF's demand equation work? Please fully detail your answer.

c. If your answer to b. is "No.", please explain why you have not included what is arguably the strongest substitute for FCM letter mail in your demand work.

d. Was it to make the own price elasticity appear lower than it really is?

e. In your view, over the longer term has the advent of "universal" telephone service acted as a strong substitute for FCM letter mail, e.g. personal letters, holiday calls and greetings, birthday calls, etc.

RESPONSE:

a. It would seem likely that telephone deregulation would have some impact on First-Class Mail volumes. The evidence suggests, however, that this has not been a "major factor reducing the growth in demand for First-Class letter mail communications."

b. Long-distance telephone communications have never been included in any demand equations used by the Postal Service in any rate cases. See, however, my response to subpart (c) below.

c. Telephone prices have been investigated in the Postal Service's First-Class Mail equations on several occasions in the past. Generally, these experiments have been unsuccessful, with the estimated telephone price elasticity either having an unexpected sign or being statistically insignificant or, most often, both.

A simple look at long-distance telephone prices and First-Class Mail volume reveals why this is likely to be the case. My econometric regressions for single-piece

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
GCA INTERROGATORY RE-DIRECTED FROM WITNESS BERNSTEIN

and workshared First-Class letters use a sample period starting in the first quarter of Postal Fiscal Year 1983.

From Postal Fiscal Year (PFY) 1983 through PFY 1991, real long-distance telephone prices declined at an average annual rate of 6.89 percent. Over this same time period, First-Class letter volume grew at an average annual rate of 4.18 percent. From PFY 1991 through PFY 2000, the declines in long-distance telephone prices slowed considerably, to an average annual rate of 2.15 percent.

If First-Class letters and long-distance telephone communication are close substitutes, then less rapid declining long-distance telephone prices should benefit First-Class letter volume. In fact, however, from 1991 through 2000, First-Class letter volume grew at an average annual rate of only 1.54 percent, or more than 60 percent slower than over the previous eight years.

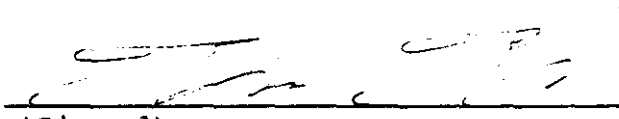
d. No.

e. I would agree that, over the longer term, the advent of "universal" telephone service provided a substitute for First-Class Mail. The existence of universal telephone service pre-dates the time period analyzed within my econometric regressions, however.

As noted above, my econometric regressions for single-piece and workshared First-Class letters use a sample period starting in 1983Q1. The percentage of households with telephone service has barely changed over this time period, however, rising from 93.0 percent in 1980 to 94.1 percent in 1998. (source: Statistical Abstract of the United States, 2000 edition, Table 910).

DECLARATION

I, Thomas Thress, declare under penalty of perjury that the foregoing answers are true and correct to the best of my knowledge, information and belief.



(Signed)12-8-01
(Date)

1 COMMISSIONER OMAS: Mr. Baker?

2 MR. BAKER: Mr. Chairman, thank you.

3 I am handing the witness --

4 COMMISSIONER OMAS: Please identify yourself and
5 your --

6 MR. BAKER: William Baker for the Newspaper
7 Association of America.

8 I've handed the witness two copies of his
9 responses to interrogatories NAA/USPS-T8-6, 7, and 8. I
10 would ask him if his answers would be the same today?

11 THE WITNESS: Yes, they would.

12 MR. BAKER: With that, I'd move to add those to
13 the written testimony on Cross-Examination.

14 COMMISSIONER OMAS: Thank you, Mr. Baker.

15 (The document referred to was
16 marked for identification as
17 NAA/USPS-T8-6, 7 and 8, and
18 was received in evidence.)

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RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
NAA INTERROGATORIES

NAA/USPS-T8-6. Please refer to your response to NAA/USPS-T8-1. If, as you say, consumers' use of the Internet in general "may" be indicative of the extent to which they use it as a substitute for mail, and consumer expenditures on Internet access is "a" measure of their use of the Internet, why can you be sure that consumer expenditures on Internet access in fact "reflects the extent" to which consumers use the Internet as a substitute for mail?

RESPONSE:

In attempting to model the demand for First-Class Mail volume, I developed and investigated a number of hypotheses regarding the effect of various things on mail volume. One such hypothesis was that a measure of consumption expenditures on Internet Service Providers might help to quantify the extent to which the Internet has diverted First-Class Mail volume over time. This hypothesis was summarized in my response to NAA/USPS-T8-1, when I opined that "[t]he extent to which consumers use the Internet in general may be indicative of the extent to which consumers use the Internet as a substitute for First-Class Mail."

I tested this hypothesis by introducing consumption expenditures on Internet Service Providers into the single-piece First-Class letters and private First-Class cards equations. The magnitude and significance of this variable in these equations was consistent with my hypothesis. Hence, I concluded that my hypothesis was correct, and that consumption expenditures on Internet Service Providers "reflects the extent to which consumers use the Internet as a substitute for First-Class Mail."

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
NAA INTERROGATORIES

NAA/USPS-T8-7. Please refer to your response to NAA/USPS-T8-4. The question asked whether your testimony takes into account the prices charged by shared mailers to advertisers that participate in a shared mailing. Your answer is couched in terms of the size and number of advertisers within a shared mailing. Please answer the interrogatory as posed: that is, does your testimony take into account, in any way, the prices charged by Standard ECR shared mailers to the advertisers that participate in those shared mailings.

RESPONSE:

I fail to see how my answer to NAA/USPS-T8-4 failed in any way to answer the question that was asked. To reiterate my answer: No, my testimony does not take into account, in any way, the prices charged by Standard ECR shared mailers to the advertisers that participate in those shared mailings. Please see my answer to NAA/USPS-T8-8 for a further explanation.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
NAA INTERROGATORIES

NAA/USPS-T8-8. Is it your testimony that the price charged to advertisers by ECR mailers is not relevant when one is estimating the volume of ECR mail? Please explain any answer that is not entirely in the affirmative.

RESPONSE:

Yes. My testimony attempts to model the demand for Standard Enhanced Carrier Route mail volume. Hence, my testimony focuses exclusively on the demand of mailers and potential mailers of Standard ECR mail. The costs faced by Standard ECR mailers (as well as potential ECR mailers), such as the price of postage, directly affect the demand for Standard ECR mail. In some cases, such costs may be passed on to others, such as through the prices charged by shared mailers.

The specific means by which and extent to which these costs can and are passed on will affect the price elasticity of Standard ECR (and potential ECR) mailers. This effect is properly reflected in my work.

As I explained in my earlier response to NAA/USPS-T8-4, however, neither the prices charged by ECR shared mailers nor the ultimate number of advertisers within a particular shared mailing have any direct bearing on the volume of Standard ECR mail, which is the focus of my testimony.

1 COMMISSIONER OMAS: Are there any questions from
2 the bench?

3 Mr. Covington?

4 COMMISSIONER COVINGTON: No.

5 COMMISSIONER OMAS: Mr. Koetting, would you like
6 some time with your witness to review, if there's a need for
7 Redirect?

8 MR. KOETTING: Thank you, Mr. Chairman, but I
9 think we can dispense with that.

10 COMMISSIONER OMAS: Mr. Thress, that completes
11 your testimony here today.

12 THE WITNESS: Thank you.

13 COMMISSIONER OMAS: We appreciate your appearance
14 and your contribution to our record. Thank you, and you are
15 now excused.

16 (Witness excused)

17 COMMISSIONER OMAS: Mr. Koetting, would you
18 introduce your next Postal witness, please?

19 MR. KOETTING: Thank you, Mr. Chairman. The
20 Postal Service calls as its next witness Gerald Musgrave.
21 Whereupon,

22 GERALD L. MUSGRAVE
23 having been first duly sworn, was called as a witness
24 herein, and was examined and testified as follows:

25 COMMISSIONER OMAS: Please be seated.

1 DIRECT EXAMINATION*

2 BY MR. KOETTING:

3 Q Dr. Musgrave, could you please state your complete
4 name for the record?

5 A Gerald L. Musgrave.

6 Q Dr. Musgrave, I've handed you the document
7 entitled Direct Testimony of Gerald L. Musgrave on behalf of
8 the United States Postal Service, designated as USPS-T-9.9 (The document referred to was
10 marked for identification as
11 USPS-T-9.)

12 Q Are you familiar with this document?

13 A Yes, I am.

14 Q Was it prepared by you or under your supervision?

15 A Yes.

16 Q Do you have any errata or revisions to make?

17 A No.

18 Q If you were to testify orally today, would this be
19 your testimony?

20 A Yes.

21 Q Was it also your intention to sponsor the
22 associated Category II Library References?

23 A Yes.

24 Q Are those the Category II Library References
25 listed in the Table of Contents as USPS-LR-J26, Derivation

1 of Fixed Rate Price Indices; J27, Regression Material and
2 Data; and J28, Volume Multipliers and Forecasts?

3 A Yes.

4 MR. KOETTING: Mr. Chairman, I'm handing two
5 copies of the Direct testimony of Gerald L. Musgrave on
6 behalf of the United States Postal Service designated USPS-
7 T-9 to the Reporter, and I request that that testimony as
8 well as the associated Category II Library References be
9 received into evidence.

10 COMMISSIONER OMAS: Are there any objections?

11 (No response)

12 COMMISSIONER OMAS: I will direct counsel to
13 provide the Reporter with two copies of the corrected
14 testimony of Gerald L. Musgrave. That testimony is received
15 into evidence. As is our practice it will not be
16 transcribed.

17 (The document previously
18 identified as USPS-T-9 was
19 received in evidence.)

20 COMMISSIONER OMAS: Mr. Musgrave, have you had an
21 opportunity to examine the package of designated written
22 Cross-Examination that was made available to you in the
23 hearing room this morning?

24 THE WITNESS: Yes.

25 COMMISSIONER OMAS: If the questions contained in

1 that packet were posed to you orally today would your
2 answers be the same as those you previously provided in
3 writing?

4 THE WITNESS: Yes.

5 COMMISSIONER OMAS: Are there any corrections or
6 additions you would like to make?

7 THE WITNESS: No.

8 COMMISSIONER OMAS: Counsel, would you please
9 provide two copies of the corrected designated written
10 Cross-Examination of Witness Musgrave to the Reporter? That
11 material is received into evidence and it will be
12 transcribed into the record.

13 (The document identified as
14 USPS-T-9/Cross-Examination
15 received in evidence.)

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes

Docket No. R2001-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF UNITED STATES POSTAL SERVICE
WITNESS GERALD L. MUSGRAVE
(USPS-T-9)

Party

Office of the Consumer Advocate

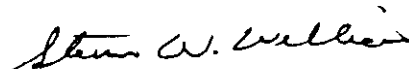
United Parcel Service

Interrogatories

UPS/USPS-T9-1-6, 8-13

UPS/USPS-T9-1-6, 8-13

Respectfully submitted,



Steven W. Williams
Acting Secretary

INTERROGATORY RESPONSES OF
UNITED STATES POSTAL SERVICE
WITNESS GERALD L. MUSGRAVE (T-9)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

<u>Interrogatory</u>	<u>Designating Parties</u>
UPS/USPS-T9-1	OCA, UPS
UPS/USPS-T9-2	OCA, UPS
UPS/USPS-T9-3	OCA, UPS
UPS/USPS-T9-4	OCA, UPS
UPS/USPS-T9-5	OCA, UPS
UPS/USPS-T9-6	OCA, UPS
UPS/USPS-T9-8	OCA, UPS
UPS/USPS-T9-9	OCA, UPS
UPS/USPS-T9-10	OCA, UPS
UPS/USPS-T9-11	OCA, UPS
UPS/USPS-T9-12	OCA, UPS
UPS/USPS-T9-13	OCA, UPS

**RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS
MUSGRAVE TO INTERROGATORIES OF UNITED PARCEL SERVICE**

UPS/USPS-T9-1. Provide for BY2000 (i) the volume of Express Mail that was sent by residential customers, and, separately, (ii) the volume that was sent by businesses. If this information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

It is my understanding, based on figures provided by the Postal Service, that the best available estimates are provided below.

1(i). The estimate for GFY 2000 is approximately 24 percent.

1(ii). The estimate for GFY 2000 is approximately 76 percent.

**RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS
MUSGRAVE TO INTERROGATORIES OF UNITED PARCEL SERVICE**

UPS/USPS-T9-2. Provide for BY2000 (i) the volume of Express Mail that was sent to residential customers, and, separately, (ii) the volume that was sent to businesses. If the information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

It is my understanding, based on figures provided by the Postal Service, that the best available estimates are provided below.

2(i). The estimate for GFY 2000 is approximately 26 percent.

2(ii). The estimate for GFY 2000 is approximately 74 percent.

**RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS
MUSGRAVE TO INTERROGATORIES OF UNITED PARCEL SERVICE**

UPS/USPS-T9-3. Provide for Express Mail the volume that was sent by businesses to residences in BY2000. If this information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

It is my understanding, based on figures provided by the Postal

Service, that the best available estimate for GFY 2000 is approximately 13 percent.

**RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS
MUSGRAVE TO INTERROGATORIES OF UNITED PARCEL SERVICE**

UPS/USPS-T9-4. Provide for Express Mail the volume that was sent by businesses to businesses in BY2000. If this information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

It is my understanding, based on figures provided by the Postal Service, that the best available estimate for GFY 2000 is approximately 63 percent.

**RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS
MUSGRAVE TO INTERROGATORIES OF UNITED PARCEL SERVICE**

UPS/USPS-T9-5. Provide for Express Mail the volume that was sent by residential customers to businesses in BY2000. If this information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

It is my understanding, based on figures provided by the Postal Service, that the best available estimate for GFY 2000 is approximately 12 percent.

**RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS
MUSGRAVE TO INTERROGATORIES OF UNITED PARCEL SERVICE**

UPS/USPS-T9-6. Provide for Express Mail the volume that was sent by residential customers to residences in BY2000. If this information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

It is my understanding, based on figures provided by the Postal Service, that the best available estimate for GFY 2000 is approximately 13 percent.

**RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS
MUSGRAVE TO INTERROGATORIES OF UNITED PARCEL SERVICE**

UPS/USPS-T9-8. Provide for BY2000 (i) the volume of Priority Mail that was sent by residential customers, and, separately, (ii) the volume that was sent by businesses. If this information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

It is my understanding, based on figures provided by the Postal Service, that the best available estimates are provided below.

8(i). The estimate for GFY 2000 is 150 million pieces.

8(ii). The estimate for GFY 2000 is 1072 million pieces.

**RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS
MUSGRAVE TO INTERROGATORIES OF UNITED PARCEL SERVICE**

UPS/USPS-T9-9. Provide for by BY2000 (i) the volume of Priority Mail that was sent to residential customers, and, separately, (ii) the volume that was sent to businesses. If this information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

It is my understanding, based on figures provided by the Postal Service, that the best available estimates are provided below.

9(i). The estimate for GFY 2000 is 378 million pieces.

9(ii). The estimate for GFY 2000 is 845 million pieces.

**RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS
MUSGRAVE TO INTERROGATORIES OF UNITED PARCEL SERVICE**

UPS/USPS-T9-10. Provide for Priority Mail the volume that was sent by businesses to businesses in BY2000. If this information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

It is my understanding, based on figures provided by the Postal

Service, that the best available estimate for GFY 2000 is 797 million pieces.

**RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS
MUSGRAVE TO INTERROGATORIES OF UNITED PARCEL SERVICE**

UPS/USPS-T9-11. Provide for Priority Mail the volume that was sent by businesses to residential customers in BY2000. If this information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

It is my understanding, based on figures provided by the Postal

Service, that the best available estimate for GFY 2000 is 275 million pieces.

**RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS
MUSGRAVE TO INTERROGATORIES OF UNITED PARCEL SERVICE**

UPS/USPS-T9-12. Provide for Priority Mail the volume that was sent by residential customers to residences in BY2000. If this information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

It is my understanding, based on figures provided by the Postal

Service, that the best available estimate for GFY 2000 is 103 million pieces.

**RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS
MUSGRAVE TO INTERROGATORIES OF UNITED PARCEL SERVICE**

UPS/USPS-T9-13. Provide for Priority Mail the volume that was sent by residential customers to businesses in BY2000. If this information is not available, provide the Postal Service's best estimates of such volumes.

RESPONSE:

It is my understanding, based on figures provided by the Postal

Service, that the best available estimate for GFY 2000 is 48 million pieces.

1 COMMISSIONER OMAS: Is there any additional
2 written Cross-Examination for Witness Musgrave?

3 (No audible response)

4 COMMISSIONER OMAS: This brings us to oral Cross-
5 Examination.

6 No participants have requested oral Cross-
7 Examination. Is there any party that would like to come
8 forward now and Cross-Examine Witness Musgrave?

9 (No audible response)

10 COMMISSIONER OMAS: Are there any questions from
11 the bench?

12 COMMISSIONER COVINGTON: Yes, Mr. Chairman, I have
13 a couple of questions for Dr. Musgrave.

14 COMMISSIONER OMAS: Mr. Covington.

15 COMMISSIONER COVINGTON: Good morning, Dr.
16 Musgrave. We're pleased to have you with us today.

17 THE WITNESS: Good morning.

18 COMMISSIONER COVINGTON: I was noticing in
19 response to an interrogatory you received from the United
20 Parcel Service you identified the volume of priority mail by
21 various market segments such as business-to-business and
22 then business-to-residential areas. In light of that, do
23 you have any sense of what is the Postal Service's share of
24 the total business-to-residential market and business-to-
25 business market in a two to three day timeframe?

1 THE WITNESS: No, I don't.

2 COMMISSIONER COVINGTON: Have you been asked to
3 look at that specific area?

4 THE WITNESS: No.

5 COMMISSIONER COVINGTON: Could you discuss, in
6 light of the fact that you can't answer that question, that
7 prevents me from going to the second question. But in your
8 opinion, I would like to see as far as the USPS position
9 would be concerned, it would not be, I would say, out of the
10 ordinary if a study of that nature was undertaken, correct?

11 THE WITNESS: I think that's correct. Yes.

12 COMMISSIONER COVINGTON: And I would imagine if we
13 needed, as this hearing progressed in our 2001-1, if we
14 needed to look at total business-to-residential and then
15 total business-to-business type activities, that would be
16 something that we would have to engage the Postal Service on
17 basically from a Commission standpoint of view.

18 THE WITNESS: Yes.

19 COMMISSIONER COVINGTON: Okay.

20 Thank you, Dr. Musgrave. That's all I have,
21 Chairman Omas.

22 COMMISSIONER OMAS: Commissioner Goldway?

23 COMMISSIONER GOLDWAY: I have a lot of questions
24 that are trying to get some information on what may have
25 been and may well be a greater shift from priority mail to

1 parcel select DPU. And it relates to your testimony in
2 terms of volume estimates.

3 I want to begin by asking you what may be a
4 question based on ignorance on my part.

5 In your Technical Appendix D of your testimony you
6 talk about the estimated own price elasticity of priority
7 mail decreasing and the parcel post cross price elasticity
8 increasing. Could you explain that to me?

9 THE WITNESS: Well, the main reason that the own
10 price elasticity for priority mail increased was there was a
11 change in the classification. In the classification in the
12 last rate case removed the 11 to 13 ounce light weight mail.
13 That was the mail that was the most easily transferred from
14 priority to first class. That mail was easily substituted
15 and could easily previously leave priority mail and go into
16 first class mail. When that mail was removed from the
17 priority mail stream the remaining mail elasticity went
18 down.

19 COMMISSIONER GOLDWAY: So people using priority
20 mail had fewer options.

21 THE WITNESS: Right. The higher weight pieces had
22 fewer options, correct.

23 COMMISSIONER GOLDWAY: Do you know what percentage
24 of priority mail is in what we would call the monopoly?

25 THE WITNESS: Subject to --

1 COMMISSIONER GOLDWAY: Yeah, subject to --

2 THE WITNESS: -- to the express --

3 COMMISSIONER GOLDWAY: -- express --

4 THE WITNESS: Right. No, I don't.

5 COMMISSIONER GOLDWAY: But a significant portion
6 of that is in the express statute so it doesn't really have
7 a choice.

8 THE WITNESS: I don't know.

9 COMMISSIONER GOLDWAY: And has less of a choice if
10 it can't even go to first class.

11 What about the cross price elasticity of parcel
12 post increasing?

13 THE WITNESS: I'm not sure why that happened.
14 That was a result of our econometric estimation.

15 COMMISSIONER GOLDWAY: What do you think it might
16 mean?

17 THE WITNESS: I don't know. I wish I could be
18 more helpful, but I just don't know. I've puzzled about it
19 myself, but I just don't know.

20 COMMISSIONER GOLDWAY: Do you believe that with
21 priority mail rates rising rapidly, and the Postal Service
22 has recommended that they go up almost 14 percent; and
23 parcel select prices going up much more slowly; that there
24 has been a significant shift in large parcel shippers from
25 priority to parcel select?

1 THE WITNESS: I don't know.

2 COMMISSIONER GOLDWAY: If in fact that's one of
3 the reasons for this shift that you've indicated, or the
4 volumes that we've seen change in the last year, and the
5 contribution to institutional costs for parcel select is
6 about 44 cents, whereas the contribution for priority mail
7 is on average about \$2.23, do you think that such a shift
8 from priority to parcel select could have a significant
9 impact on Postal finances?

10 THE WITNESS: I guess the arithmetic would
11 indicate that, but my testimony doesn't involve the cost or
12 the revenue.

13 COMMISSIONER GOLDWAY: Does your volume forecast
14 include any priority mail shift to parcel select?

15 THE WITNESS: No. Not explicitly, no.

16 COMMISSIONER GOLDWAY: Not explicitly.

17 THE WITNESS: Right.

18 COMMISSIONER GOLDWAY: DO you know if the Postal
19 Service has done any other studies to learn how much
20 priority mail is being diverted to parcel select or might be
21 diverted in the future?

22 THE WITNESS: No, I know of no studies.

23 COMMISSIONER GOLDWAY: Do you know how such a
24 study could be done?

25 THE WITNESS: I haven't thought about it so I

1 guess I don't know.

2 COMMISSIONER GOLDWAY: Wouldn't you think that
3 when you do your studies about price elasticity and you
4 study things like a UPS strike or seasonality or other
5 things that you would also consider cross price elasticity
6 between relatively comparable services within the Postal
7 Service? Wouldn't that be a standard measurement tool for
8 economists?

9 THE WITNESS: It might be, but I just haven't
10 really, I haven't been asked or I haven't thought of it
11 independently. I just really haven't considered that we had
12 enough information really to study that yet.

13 COMMISSIONER GOLDWAY: Do you know what portion of
14 priority mail currently consists of what would be the
15 competitive parcel segment, the business-to-business,
16 business-to-residence over the express statute weight? Do
17 you know what percent would fall into that category?

18 THE WITNESS: Not in the express statute, no. One
19 of the interrogatories asked the Postal Service what was
20 that distribution and we provided that.

21 COMMISSIONER GOLDWAY: Okay.

22 Does the Postal Service know how much priority
23 mail is sent bulk as opposed to --

24 THE WITNESS: They might know, but I don't, and I
25 don't recall seeing that.

1 COMMISSIONER GOLDWAY: If you were to get that
2 figure would that help you in being able to estimate what
3 portion of priority mail might be subject to shift to parcel
4 select?

5 THE WITNESS: We would need several or many years
6 of data to put that into our models. The reason why they
7 work so well is because we have a data history. Just one or
8 two sample points will help.

9 COMMISSIONER GOLDWAY: In your forecast you have
10 trends that show the priority mail total volume. Maybe not
11 market share, but total volume was increasing except in the
12 last year.

13 THE WITNESS: I think that's correct.

14 COMMISSIONER GOLDWAY: I'm pretty sure that's
15 right.

16 I think there are those of us in this small little
17 postal world who think that that last year's shift
18 represents a more permanent trend. Parcel select shift
19 being one of those reasons. There may be others. The
20 adequacy of priority mail service in comparison to its
21 competition might be another one.

22 But it seemed to me in your model you've averaged
23 in that small decrease in this last year and still are
24 forecasting an increase in priority mail volume, is that
25 correct?

1 THE WITNESS: That's true, even though we have
2 this negative trend in our model that counts for some of
3 that, or might account for some of it. We still, I think
4 we're optimistic compared to what the current economic
5 outlook would indicate.

6 COMMISSIONER GOLDWAY: Do you think the current
7 economic outlook at this moment would make you rethink that
8 priority mail volume forecast?

9 THE WITNESS: I think we might. I think that, I'm
10 not sure, but I think that the weakening economic conditions
11 would be something that would cause us to think about that.
12 We haven't been asked in the same way that Mr. Tolley hasn't
13 been asked, but I think it's something that should be
14 thought of very seriously.

15 COMMISSIONER GOLDWAY: Finally, just to touch on
16 an issue that I raised in an aside. In economic modeling,
17 is there a way in which you can not only do cross price
18 elasticity with products that are competitive, as you seem
19 to have done, but to evaluate the relative service of those
20 products? Because one of my concerns for several years has
21 been problems with the service of priority mail. And it's
22 not just a question of its price in comparison to its
23 competitors, but its service reliability in comparison to
24 its competitors.

25 Is there a way that economists factor in that

1 relationship of competition when they estimate elasticity,
2 volume growth, et cetera?

3 THE WITNESS: Yes, people do that.

4 COMMISSIONER GOLDWAY: Do you do it in your
5 models?

6 THE WITNESS: We haven't, no.

7 COMMISSIONER GOLDWAY: Thank you.

8 THE WITNESS: You're welcome.

9 COMMISSIONER OMAS: Mr. Covington?

10 COMMISSIONER COVINGTON: Thank you, Mr. Chairman.

11 Earlier, Dr. Musgrave, I asked you if you had any
12 sense of what the Postal Service's share of total business-
13 to-business and business-to-residential volume was as it
14 relates to a two to three day market, and you said that you
15 didn't know that. As a matter of fact there were quite a
16 few questions you didn't know that Commissioner Goldway
17 asked you.

18 I was wondering, in light of the fact that I think
19 your role as far as providing testimony or developing
20 testimony before the Postal Service was that you were
21 basically looking at volume forecasts for specifically
22 priority mail and express mail, correct?

23 THE WITNESS: Yes.

24 COMMISSIONER COVINGTON: In response to an
25 interrogatory, Dr. Musgrave, I'd like to refer you to your

1 response to UPS/USPS-T9-8. If you can find the hard copy of
2 that.

3 What it is is that you were asked -- That's
4 UPS/USPS-T9-8..

5 (Pause)

6 THE WITNESS: I'm there.

7 COMMISSIONER COVINGTON: Okay.

8 It says provide for base year 2000, number one,
9 the volume of priority mail that was sent by residential
10 customers and number two, separately, the volume that was
11 sent by business. If this information is not available,
12 provide the Postal Service's best estimate of such volume.

13 I understand 8. What is the correct answer to
14 8(b)?

15 You have the estimate for GFY2000 is 107.2 million
16 pieces?

17 THE WITNESS: Yes.

18 COMMISSIONER COVINGTON: Would that be one
19 billion?

20 THE WITNESS: Yes.

21 COMMISSIONER COVINGTON: Just wanted to clarify
22 that in my mind. Thanks a lot, Doctor.

23 COMMISSIONER OMAS: Mr. McKeever?

24 MR. MCKEEVER: Thank you Commissioner Omas.

25

1 CROSS-EXAMINATION

2 BY MR. McKEEVER:

3 Q How are you?

4 A I'm happy to see you again.

5 Q In response to some questions from Commissioner
6 Goldway you referred to the change in the break point
7 between first class mail and priority mail, do you remember
8 that?

9 A Yes.

10 Q The result of that change in break point would be
11 to take volume away from priority mail and put it into first
12 class mail instead, is that correct?

13 A Yes.

14 Q So if you were to ignore that change in break
15 point and take that volume and leave it in priority mail,
16 the priority mail volume would be greater, is that correct?

17 A I think so, yes.

18 Q There were also some questions about priority
19 mail's cross price elasticity with parcel post. Do you
20 recall that?

21 A Yes.

22 Q I think you indicated that that is increasing that
23 elasticity?

24 A I think it's decreasing.

25 Q Decreasing. What does that --

1 COMMISSIONER GOLDWAY: The parcel post has
2 increased.

3 THE WITNESS: From the last case to now, yes. It
4 was .05 in the previous case and .096 in the current.

5 BY MR. McKEEVER:

6 Q So the absolute value has increased.

7 A Right.

8 Q Okay. Does that indicate to you that parcel post
9 is a closer substitute for priority mail than it was before?

10 A No. I know that there are people here that like
11 to use those elasticity measures as a measure of
12 competition, and I understand why people want to do that.

13 What I always want to point out is that
14 competition can be very much more diversified than what only
15 happens in price.

16 It's true that when elasticity goes up, the more
17 price sensitive. I'm more than happy to say that. But when
18 we start using words like more competitive and words like
19 that, competition is so broad and so intense I don't like to
20 use those terms.

21 Q But you are willing to say that there is more
22 price sensitivity than there was before.

23 A Oh, yes.

24 Q And am I clear that we were talking about parcel
25 post and priority mail?

1 A Yes.

2 Q In that sense you're viewing those two as
3 competitive products.

4 A Alternative, sure.

5 Q Okay. There were also a question or two, there
6 was also a question or two from Commissioner Goldway
7 indicating there was a certain rate increase proposed for
8 priority mail and a lower rate increase proposed for parcel
9 select. Do you recall that?

10 A I remember her saying that.

11 Q Do you know whether in fact certain parcel select
12 prices are actually proposed by the Postal Service to
13 decrease in this case?

14 A No.

15 Q You don't know that?

16 A No.

17 MR. McKEEVER: That's all I have, Mr.
18 Commissioner. Thank you.

19 COMMISSIONER OMAS: Thank you, Mr. McKeever.
20 Mr. Koetting?

21 MR. KOETTING: If we could just have another
22 couple of minutes please, Mr. Chairman?

23 COMMISSIONER OMAS: Great.

24 You know, at this point why don't we take about a
25 ten minute break and come back at 11:15. Thank you.

1 (Recess taken)

2 COMMISSIONER OMAS: Mr. Koetting?

3 MR. KOETTING: The Postal Service has no Redirect,
4 Mr. Chairman.

5 COMMISSIONER OMAS: Thank you.

6 Mr. Musgrave, that completes your testimony here
7 today. We appreciate your appearance and your contributions
8 to our record.

9 Thank you again, and you are now excused.

10 THE WITNESS: Thank you.

11 (Witness excused)

12 COMMISSIONER OMAS: Mr. Koetting, would you please
13 introduce your next witness for today?

14 MR. KOETTING: Thank you, Mr. Chairman. The
15 Postal Service calls as its next witness Peter Bernstein.

16 COMMISSIONER OMAS: Mr. Bernstein, would you raise
17 your right hand?

18 Whereupon,

19 PETER BERNSTEIN

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

22 COMMISSIONER OMAS: Thank you. Be seated.

23 DIRECT EXAMINATION

24 BY MR. KOETTING:

25 Q Could you please state your full name for the

1 record?

2 A Yes, it's Peter Daniel Bernstein.

3 Q Mr. Bernstein, I've handed you a copy of a
4 document entitled Direct Testimony of Peter Bernstein on
5 behalf of the United States Postal Service which has been
6 designated as USPS-T-10.

7 (The document referred to was
8 marked for identification as
9 USPS-T-10.)

10 Q Are you familiar with that document?

11 A Yes, I am.

12 Q Was it prepared by you or under your supervision?

13 A Yes, it was.

14 Q Does the copy I have handed you contain the
15 revised pages that were submitted on December 10th?

16 A Yes, it does.

17 Q Do you have any additional changes to make this
18 morning?

19 A Yes, I do have one revision.

20 On page 65 of my testimony, line 22, the second
21 efficient should actually be inefficient.

22 Q Could you please read the sentence as it now
23 appears in your revised testimony?

24 A Yes. "Postal prices that are below the
25 incremental cost of a less efficient private firm are not

1 economically inefficient, although it is recognized that
2 this remains a contentious issue."

3 Q Is that change reflected in the copy of the
4 testimony that I've handed you?

5 A Yes, it is.

6 Q And do you have any further changes to make?

7 A No, I don't.

8 Q With those revisions if you were to testify orally
9 today would this be your testimony?

10 A Yes, it would.

11 Q And was it your intention also to sponsor the
12 Category II Library References contained in your Table of
13 Contents?

14 A Yes.

15 Q And those are USPS-LR-J133, Projection of Future
16 Values of Internet Variables; and J134, Bernstein Pricing
17 Models. Correct?

18 A Correct.

19 MR. KOETTING: Mr. Chairman, I'm handing the
20 Reporter two copies of the Direct testimony of Peter
21 Bernstein on behalf of the United States Postal Service,
22 USPS-T-10, and I request that the testimony along with the
23 associated library references be admitted into evidence.

24 COMMISSIONER OMAS: Without objection, I will
25 direct counsel to provide the Reporter with two copies of

1 the corrected Direct testimony of Peter Bernstein. That
2 testimony is received into evidence. As is our practice, it
3 will not be transcribed.

4 (The document previously
5 identified as USPS-T-10 was
6 received in evidence.)

7 COMMISSIONER OMAS: Mr. Bernstein, have you had an
8 opportunity to examine the packet of designated written
9 Cross-Examination that was made available to you in the
10 hearing room this morning?

11 THE WITNESS: Yes, I have.

12 COMMISSIONER OMAS: If the questions contained in
13 that packet were posed to you orally today would your
14 answers be the same as those previously provided in writing?

15 THE WITNESS: Yes, they would.

16 I want to just add that we have included my entire
17 response to GCA interrogatory number 16. Originally it was
18 missing the second, or the last part of it.

19 COMMISSIONER OMAS: Are there any corrections or
20 additions you would like to make to your answers?

21 THE WITNESS: No.

22 COMMISSIONER OMAS: Counsel, would you please
23 provide two copies of the corrected designated written
24 Cross-Examination of Witness Bernstein to the Reporter?
25 That material is received into evidence and it is to be

1 transcribed into the record.

2 (The document identified as
3 USPS-T-10/Cross-Examination
4 received in the record.)

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001


Postal Rate and Fee Changes

Docket No. R2001-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF UNITED STATES POSTAL SERVICE
WITNESS PETER BERNSTEIN
(USPS-T-10)

<u>Party</u>	<u>Interrogatories</u>
Advo, Inc.	NAA/USPS-T10-7
Direct Marketing Association, Inc.	DMA/USPS-T10-1-3 GCA/USPS-T10-4 NAA/USPS-T10-2-3, 5-6, 9
Greeting Card Association	GCA/USPS-T10-1-7, 9, 11, 14-21
Mail Order Association of America	DMA/USPS-T10-1-3 NAA/USPS-T10-3, 6, 9
Newspaper Association of America	GCA/USPS-T10-1-3, 6 NAA/USPS-T10-3-10
United States Postal Service	DMA/USPS-T10-1

Respectfully submitted,



Steven W. Williams
Acting Secretary

INTERROGATORY RESPONSES OF
UNITED STATES POSTAL SERVICE
WITNESS PETER BERNSTEIN (T-10)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory

DMA/USPS-T10-1
DMA/USPS-T10-2
DMA/USPS-T10-3
GCA/USPS-T10-1
GCA/USPS-T10-2
GCA/USPS-T10-3
GCA/USPS-T10-4
GCA/USPS-T10-5
GCA/USPS-T10-6
GCA/USPS-T10-7
GCA/USPS-T10-9
GCA/USPS-T10-11
GCA/USPS-T10-14
GCA/USPS-T10-15
GCA/USPS-T10-16
GCA/USPS-T10-17
GCA/USPS-T10-18
GCA/USPS-T10-19
GCA/USPS-T10-20
GCA/USPS-T10-21
NAA/USPS-T10-2
NAA/USPS-T10-3
NAA/USPS-T10-4
NAA/USPS-T10-5
NAA/USPS-T10-6
NAA/USPS-T10-7
NAA/USPS-T10-8
NAA/USPS-T10-9
NAA/USPS-T10-10

Designating Parties

DMA, MOAA, USPS
DMA, MOAA
DMA, MOAA
GCA, NAA
GCA, NAA
GCA, NAA
DMA, GCA
GCA
GCA, NAA
GCA
GCA
GCA
GCA
GCA
GCA
GCA
GCA
GCA
DMA
DMA, MOAA, NAA
NAA
DMA, NAA
DMA, MOAA, NAA
Advo, NAA
NAA
DMA, MOAA, NAA
NAA

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF DMA

DMA/USPS-T10-1. Please refer to Table 16 on page 81 of your testimony.

- (a) Please provide the "system-wide" mark-up that corresponds to the "R2000-1 Mark-ups (Adjusted)" shown in Table 16.
- (b) Please provide a Table similar to Table 16, with an additional column showing the "Mark-up Index" for each Mail Product shown in the Table.

RESPONSE:

- a. As shown on the attached sheet, the corresponding system-wide markup is 65.6 percent. Note that this corresponds to mark-ups over volume variable cost, whereas the mark-ups (and system-wide mark-up) presented in the PRC opinion are mark-ups over attributable cost.
- b. Please see the attached sheet.

**TABLE ACCOMPANYING POSTAL SERVICE WITNESS BERNSTEIN
RESPONSE TO DMA/USPS-T10-1**

a. System-wide R2000-1 Mark-up Using PRC Recommended Rates and USPS Estimated TY Volume Variable Cost Per Piece

	PRC R2000-1 Test Year Recommended Price	USPS R2000-1 Test Year Volume Variable Cost per Piece	PRC R2000-1 Test Year After-Rates Volumes	Revenues = PRC Price x Test Year Volume	Volume Variable Costs with PRC Volumes, USPS Cost per Piece
First-Class LFIPPs	\$ 0.3570	\$ 0.1867	100,149,186	35,749,253	18,697,853
First-Class Cards	\$ 0.1851	\$ 0.1319	5,577,450	1,032,498	735,666
Priority Mail	\$ 4.4589	\$ 2.6053	1,243,245	5,543,505	3,239,026
Express Mail	\$ 14.5411	\$ 6.4717	72,819	1,058,871	471,263
Periodicals In-County	\$ 0.0939	\$ 0.1000	880,587	82,714	88,059
Out of County	\$ 0.2419	\$ 0.2480	9,488,154	2,294,995	2,353,062
Standard Regular	\$ 0.2020	\$ 0.1521	52,464,672	10,596,328	7,977,596
Standard ECR	\$ 0.1517	\$ 0.0794	35,750,714	5,422,913	2,837,310
Standard Parcel Post	\$ 3.2362	\$ 2.8789	367,601	1,189,645	1,058,287
Standard BPM	\$ 1.0561	\$ 0.9503	530,951	560,716	504,563
Standard Media	\$ 1.6541	\$ 1.7610	231,479	382,890	407,632
Registered	\$ 8.7820	\$ 8.2071	10,966	96,304	89,999
Insured	\$ 2.1706	\$ 2.1218	44,783	97,204	95,021
Certified	\$ 1.9000	\$ 1.6118	279,926	531,859	451,185
COD	\$ 5.6383	\$ 4.6919	3,544	19,982	16,628
Money Orders	\$ 1.1177	\$ 0.7318	239,753	267,971	175,451
			207,335,830	64,927,647	39,198,601

System-Wide Mark-Up

65.6%

b. R2000-1 Mark-Up Index Corresponding to Data in Table 16 of USPS-T-10

	R2000-1 Mark-Ups (Adjusted)	Mark-Up Index
First-Class LFIPPs	91.2%	1.389
First-Class Cards	40.3%	0.614
Priority Mail	71.1%	1.083
Express Mail	124.7%	1.900
Periodicals In-County	1.3%	0.020
Out of County	1.3%	0.020
Standard Regular	32.8%	0.500
Standard ECR	91.1%	1.388
Standard Parcel Post	12.4%	0.189
Standard BPM	11.1%	0.169
Standard Media	0.3%	0.005
Registered	7.0%	0.107
Insured	2.3%	0.035
Certified	17.9%	0.273
COD	20.2%	0.308
Money Orders	52.7%	0.803

System-Wide
(From part a.)

65.6%

1.000

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF DMA

DMA/USPS-T10-2. Please refer to Table 17 on pages 83 and 84 of your testimony.

- (a) Please confirm that Table 17 shows calculations of "After-Rates Prices" in this proceeding based on (1) the R2000-1 Mark-ups (Adjusted), and (2) mark-ups determined using Ramsey pricing principles (constrained as described in your testimony). If you cannot confirm, please explain in detail.
- (b) Please confirm that, at a price based on the R2000-1 Mark-ups (Adjusted), the volume of First-Class Letters would be estimated to be approximately 97.9 billion pieces that would produce revenues of approximately \$38.3 billion. If you cannot confirm, please explain in detail.
- (c) Please confirm that, at a price based on the R2000-1 Mark-ups (Adjusted), the volume of Standard mail would be estimated to be approximately 96.3 billion pieces that would produce revenues of approximately \$18.2 billion. If you cannot confirm, please explain in detail.
- (d) Please confirm that, at a price based on Ramsey principles, the volume of First-Class Letters would be estimated to be approximately 96.9 billion pieces that would produce revenues of approximately \$40.0 billion. If you cannot confirm, please explain in detail.
- (e) Please confirm that, at a price based on Ramsey principles, the volume of Standard mail would be estimated to be approximately 104.0 billion pieces that would produce revenues of approximately \$16.6 billion. If you cannot confirm, please explain in detail.
- (f) Please confirm that, at a price based on Ramsey principles, the volumes of First-Class Letters and Standard mail combined would be estimated to be approximately 6.7 billion pieces greater, producing revenues greater by approximately \$100,000,000, as compared with prices based on the R2000-1 Mark-ups (Adjusted). If you cannot confirm, please explain in detail.

RESPONSE:

a. through f. Confirmed

**RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF DMA**

DMA/USPS-T10-3. On page 78 of your testimony you discuss judgmental constraints on Ramsey prices. You say, "A second type of constraint imposed on the Ramsey prices is a limit on the mark-up of products with particularly low price elasticities."

(a) Please confirm that First-Class Letters have lower test year own-price elasticity than do Standard Regular or Standard ECR. If you cannot confirm, please explain in detail.

(b) Were any of the prices for First-Class Letters or Standard Regular or Standard ECR shown in your Table 17 the subject of any constraints? If so, please explain in detail and state what such prices would have been in the absence of such constraints.

RESPONSE:

- a. Confirmed
- b. No.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-1. Please refer to your testimony at pages 7 through 10. Is it a fair reading of your testimony that the effect of e-mail on use of the postal system is evolving as is the recognition of that effect? If you do not agree that it is, please explain why.

RESPONSE:

Yes.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-2. Please refer to page 17 of your testimony. Do you agree that the restraints on the adoption and use of the Internet include restraints associated with cultural and social factors? If you do not agree, please explain why?

RESPONSE:

Yes.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-3. Please refer to page 17 of your testimony. Do you agree that the restraints on the adoption and use of the Internet are such that the number of Internet users and the nature and extent of their uses have evolved and will continue to evolve with time? If you do not agree, please explain why?

RESPONSE:

Yes.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-4. Please refer to page 20 of your testimony. Have you prepared any table corresponding to Table 4 for the subject of personal correspondence of a non-commercial nature? If you have, please provide it together with an explanation of how the table was developed?

RESPONSE:

Data for personal correspondence corresponding to the data presented in my Table 4 are not available from the Household Diary study or any source of which I am aware. Furthermore, the share of personal correspondence sent electronically (by E-mail, for example) is not in my opinion a particularly relevant number. Unlike an electronic bill payment, which generally substitutes one-for-one for a mailed payment, an electronic correspondence does not necessarily displace one mailed correspondence.

Nonetheless, personal correspondence mail has declined during the recent period in which Internet access grew substantially. Data from the Household Diary Study show that Household-to-Household mail volume declined from 1995 through 2000. Though this decline is consistent with a longer-term trend away from mailed correspondence, it is also likely to be driven by increased use of new communication alternatives.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-5. Please refer to page 20 of your testimony. In the preparation of your testimony, did you review any studies of the effects of Internet usage upon the use of mails to exchange greetings or other personal non-commercial uses? If you did, please identify those studies and explain your usage of them.

RESPONSE:

I reviewed a number of studies discussing the impact of Internet usage on the use of mail for personal correspondence. Among them were a December, 2000 report by the Pew Internet and American Life Project, "The Holidays Online: E-mails and E-Greetings Outpace E-Commerce." Among the findings of this report are that more than 51 million people sent e-mails to relatives and friends to discuss the holidays and more than 30 million people sent E-greetings. Other information was obtained from

Nielsen/Net_Ratings which periodically releases information regarding use of the internet. Nielsen found that in October, for example, AmericanGreetings.com was the 12th most popular website with more than 21 million unique visitors in that month. PC Data Online reported that more than 10 million people visited greeting card sites on last Valentine's day.

A June 2001 Gallup Poll survey, "Almost All E-Mail Users Say Internet, E-Mail Have Made Lives Better," found that sending E-mail was the most common online activity and that two-thirds of E-mail users say they have reduced their use of the U.S. Mail with one in five saying that they now use the mail "a great deal less."

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

- GCA/USPS-T10-6. Please refer to your testimony at page 30, lines 17 to 20. Please provide your understanding, if any, of how Internet access fees are structured for household users.

RESPONSE:

As I noted in my testimony, there are a variety of fee structures for Internet access. Fees vary by method of connection to the Internet. The most common methods of connections are dial-up modem, cable modem, and through a DSL. Second, for any given method of connection, fees may vary by the number of hours of Internet access.

Dial-up modems typically cost from \$10 to \$25 per month. There are few "free" Internet service providers still in business, and the most famous, NetZero, now charges a monthly fee of \$9.95 for access of more than 40 hours a month. America Online currently charges \$23.95 for unlimited access, but has lower priced plans for households that make only limited use of the Internet. Broadband access, through a cable modem or DSL, typically costs between \$40 and \$60 per month for unlimited usage. In addition to monthly access fees, some plans have one-time charges (often referred to as "activation charges") which may be waived or reduced depending on changing market conditions.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-7. Please refer to page 69 of your testimony.

- a. Does your statement regarding the nature of the single-piece and workshare price elasticities (page 69, lines 7-9) assume that any single-piece letter may migrate to workshare? If your answer is negative, please explain.
- b. If it were the case that no single-piece letter could migrate to workshare, would the price elasticity of single-piece letters then be an "own-price elasticit[y]" in the usual sense? If your answer is negative, please explain.

RESPONSE:

- a. My statement regarding the nature of the single-piece and workshare price elasticities is not based on an assumption, but rather on an observation that when only the single-piece price is increased, the workshare discount is also raised. Therefore, the volume impact on single-piece is a mix of the impacts of the higher price and higher discount. A further observation is that higher discounts cause some (though not necessarily "any") single-piece letters to migrate to workshare.
- b. If there were no migration between single-piece and workshare letters, then the discount elasticity would be zero and the own-price elasticity of single-piece letters would be an own-price elasticity in the usual sense of showing the impact of a change in own-price only. However, the magnitude of this "usual" own-price elasticity may not be the same as the magnitude of the own-price elasticity that results when the discount elasticity is not zero, as was found by witness Thress.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-9 On page 56 of your testimony you discuss diversion from telephone price declines as part of the other factors you estimated for the past five years. Would not the major impact from this telephone factor have been in the first ten years following telecom deregulation in the early 1980s?

RESPONSE:

To the extent that telephone deregulation had any negative impact on First-Class single-piece letter mail volume, it seems likely that the major effect would have been in the years soon after telecom deregulation. Please see GCA/USPS-T10-8 for more discussion of the relation between single-piece letter volume and telephone prices. My testimony discussed the general downward trend in single-piece letter volume due to a variety of factors and concluded at page 56, lines 18-20, "[T]his decline is probably largely complete, but is part of the historical trend in single-piece letter volume that is measured in the econometric equation."

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

CA/USPS-T10-11

- a. Please confirm that your view of the impact of "technological diversion" on the Postal Service is that, on balance, it will have a negative impact.
- b. Please confirm that this is not an estimate based on economy-wide efficiency or welfare considerations, just the narrow consideration of the Postal Service's own welfare.
- c. Please confirm that the "technological diversion" on which your testimony focuses is a very good example of what the late economist Joseph Schumpeter meant by process of "creative destruction".
- d. In Schumpeter's view, please confirm that on balance for the economy as a whole, technological processes of "creative destruction" are viewed as a positive, and indeed, necessary occurrence for economic progress?

RESPONSE:

- a. Confirmed.
- b. Diversion has a negative impact both on the Postal Service and users of the Postal Service.
- c. My testimony does not address the theories of Joseph Schumpeter. The technological changes affecting the Postal Service may reflect his idea of "creative destruction."
- d. Again, my testimony does not address the work of Joseph Schumpeter. However, I would agree that the wide range of technological changes discussed in my testimony have had an overall positive impact on the economy.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-14 Is the main point of your testimony to argue that Ramsey pricing is warranted because of technological diversion?

RESPONSE:

No.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-15 With respect to your Table 6, what percentage of total households served by the Postal Service, under your universal delivery mandate, with hard copy delivery services would be included in your May, 2005 estimate of 168.9 million active Internet users? Between today and that date, does this represent a movement toward your universal delivery address totals?

RESPONSE:

I do not quite understand your question and I do not believe I have any data that would be responsive. Active Internet users is measured in terms of individuals, not households. I can say that growth in the number of users is projected to exceed growth in total population, and that therefore the percentage of households with Internet access is expected to increase.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-16

- a. With respect to your argument on pricing and demand inelasticities on page 66, lines 1-10, please confirm that the own price demand elasticity for Standard A Regular mail is less than one in absolute value.
- b. Please confirm that such a numerical elasticity in a. renders the service a price inelastic one, not a price elastic one.
- c. Please confirm the textbook proposition that for price inelastic goods, raising the price results in greater revenue even factoring in the volume loss from the price increase.
- d. Why would substitutes for FCM letter mail such as you discuss affect elasticities "not much" while substitutes for advertising mail are alleged to explain the less inelastic own price elasticity found for those subclasses than those traditionally found for FCM letters?

RESPONSE:

- a. Confirmed.
- b. Confirmed.
- c. Confirmed.
- d. Standard Regular is more elastic than First-Class letter mail. There may be a number of different reasons why it is more elastic. One likely reason is that the presence of competing advertising media makes Standard Regular volume more sensitive to rate changes. This can occur because advertisers often make decisions based on a direct comparison of the cost effectiveness of different media. Increases in Standard Regular rates make direct mail relatively less cost effective and could be expected to induce advertisers to shift advertising dollars to another media.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

In contrast, it seems reasonable that the decision to use First-Class letters or an electronic alternative is less based on the price of First-Class letters. Instead, the decision may have to do with the technological capabilities of a user, including such things as their ownership of home computer, access to the Internet, and their individual comfort with using computers and the Internet as alternatives to the mail. Increases in First-Class letter rates are unlikely to cause people to buy a computer, obtain Internet access, or become more comfortable with using technological alternatives to the mail. Therefore, it appears that *technological diversion is not strongly related to the price of First-Class letters*, and would not be expected to have a meaningful impact on the letter own-price elasticity.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-17 With reference to your discussion on page 68, lines 20-22, please cite all factors that would lead current own price elasticity of FCM letters to be less than what it was in the last case, given the fact it is greater for FCM single piece letters.

RESPONSE:

I would argue that the price elasticity of First-Class letters is essentially the same as it was in the last case, in that whatever difference that exists is well within the range of statistical variation. More simply, the overall elasticity is the same because while the estimated own-price elasticity of single-piece letters has increased, the estimated own-price elasticity of workshare letters decreased. Moreover, the share of First-Class letter mail that is workshared is increasing, giving relatively more weight to this lower elasticity in the calculation of an elasticity for total First-Class letters.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-18 Please refer to page 35 in your testimony and your LR-J-133, Excel file, "Forecasts of Internet Variables.xls," in your worksheet "USER FORECASTS"

- a. Please confirm that the formula you have given on this page of your testimony is correctly specified.
- b. If your answer to a. is negative, please provide the correct formula.
- c. If your answer to a. is affirmative, explain why the formula used in your Excel file under the column titled "Fitted" differs from the one in your text and how you would reconcile the two.

RESPONSE:

a through c. The formula on page 35 is missing one term. A corrected page will be submitted.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-19 Please refer to your LR-J-133, Excel file, *Forecasts of Internet Variables.xls*, worksheet "USER FORECASTS."

- a. Please describe in detail, what initial values you used for the model coefficients (m , p , q , d), what constraints (if any) you imposed on these coefficients in the solver, and how did you run the solver to obtain the final parameter estimate.
- b. If you did not impose any constraints on the coefficients, please explain, why using your final parameter estimates as initial values without any constraints yields completely different parameter estimates.

RESPONSE:

a and b. The parameter estimates were constrained to be non-negative. No initial values were selected. However, it may be the case that the final estimation of the Bass curve parameters is dependent on results from earlier estimations so that small differences in parameter estimates can result from following a different estimation process.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-20 Please refer to your LR-J-133, Excel file, "Forecasts of Internet Variables.xls," worksheet "USER FORECASTS."

- a. Please confirm that the minimum ESS you have obtained equals 60.521993.
- b. Please confirm that by using the following parameter estimates $m=274.6$, $p=0.008398$, $q=0.002309$, and $d=0.418733$ in your model the ESS would equal 60.458634.
- c. If your answer to both a. and b. are affirmative, then m , the ceiling on the active users or as you define it "the maximum size of the market or ceiling value" equals 274.6 rather than your estimate of 306.7. Please explain how this affects your reviewing of the statistical results on line 17, page 37 of your testimony.
- d. If your answer to b. is affirmative, explain how these parameter estimates affect your results in the other sections.

RESPONSE:

- a. Confirmed.
- b. Confirmed.
- c. It has no effect.
- d. The impact is immaterial. Using the parameter estimates suggested in your interrogatory leads to projections of future users that are essentially the same as those presented in my testimony. For example, my testimony projects that in May of 2003, active Internet users will total 139.27 million. Using the above parameters would yield a forecast for May of 2003 of 138.89 million, a difference of less than three-tenths of one percent.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-21 Please refer to your LR-J-133, Excel file, "Forecasts of Internet Variables.xls," worksheet "\$ per USER FORECASTS" and Table 7 on page 39 of your testimony USPS-T-10.

- a. Please confirm that adjusted R-squared is 0.938 rather than 0.983 as you have reported in your Table 7.
- b. Please confirm that the values you have reported in Table 7 of your testimony for intercept are not from the regression summary output you have provided in your Excel file (where you must have used time trend input of 1 to 25) rather from an unreported regression output where you have used time trend 0 to 24.
- c. Please confirm that if you had used a quadratic model where the square of the time trend was also included in the model you would have obtained a better fit.
- d. If your answer to c. is affirmative please describe how this would have affected your forecasts of dollar per user spending on ISP (Table 8 and Table 9 page 40 and 42 of your testimony) and ultimately Dr. Tolley's volume forecasts.

RESPONSE:

- a. Confirmed, "0.983" should read "0.938."
- b. Confirmed, understanding that a linear model with a time trend running from 0 to 24 yields exactly the same forecasts as a linear model with a time trend running from 1 to 25.
- c. Not confirmed. While I found that a quadratic model (one with a time-squared term) yielded a higher adjusted r-squared, it had other properties which made it inferior to the model I presented in my testimony. First, in the quadratic model, the t-statistic on the linear term drops to 1.7, below the level generally used as a measure of statistical significance. Second, the quadratic model generates

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

forecasts which I consider to be unreasonable. For example, the quadratic model gives a forecast of \$86.01 per month per active Internet user in April of 2005. This is more than twice the \$40.46 monthly expense projected for this month using the linear model. Actual monthly expenses were measured at \$18.61 in April of 2001 so that the quadratic model would project a 360 percent increase over a four-year period, a result that I consider to be unreasonable.

- d. As I stated in c, I chose not to use the forecasts from the quadratic model because they were unreasonable. I expect that Dr. Tolley would be equally averse to using an unreasonable projection of an input variable in his volume forecasts.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA

NAA/USPS-T10-2. Does growth in the number of households have a positive effect on the volume of mail?

RESPONSE:

Yes.

**RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

NAA/USPS-T10-3. Please refer to page 43, lines 9-10 of your testimony, where you state the truism that "advertising dollars spent on the Internet are advertising dollars that cannot be spent on other media, direct mail included." Do you believe the growth in Internet advertising has caused less direct mail advertising than would have occurred in the absence of Internet advertising, or has the Internet advertising consisted of new advertising that would not have been made otherwise?

RESPONSE:

I believe that growth in Internet advertising has caused less direct mail advertising than would have occurred in the absence of Internet advertising. This view is corroborated by the econometric work of Thomas Thress which shows a significant negative relation between increases in Internet advertising and Standard mail volume. Please see Section II.D of his testimony (USPS-T-8) for a discussion of the econometric impacts on Standard mail.

Some Internet advertising may be new advertising. According to data presented in LR-I-134, total advertising expenditures grew more rapidly from 1995 to 2000 (the period during which Internet advertising emerged) than from 1990 to 1995. However, given the stronger overall economy in the latter period, combined with two elections and two Olympics, it is reasonable that the growth in total advertising expenditures would have occurred independent of the development of Internet advertising.

**RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

NAA/USPS-TO-4. Please refer to page 46, Table 11. Would advertising expenditures on a newspaper's website be included as "Newspapers" or as "Internet"?

RESPONSE:

My understanding is that the PWC/IAB measure of Internet advertising includes advertising expenditures on a newspaper's website as "Internet."

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA

NAA/USPS-T10-5. Please refer to page 46, Table 11. Would advertising expenditures contained in a newspaper Total Market Coverage program mailed to non-subscribers of the newspaper be contained in "direct mail" or "newspapers" in this table?

RESPONSE:

My understanding is that if the advertising is mailed, it is considered direct mail advertising.

**RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

NAA/USPS-T10-6. Please refer to page 47, lines 1 to 9 of your testimony. Is it your testimony that newspapers did not lose any "advertising share" to Internet advertising? Please explain.

RESPONSE:

My testimony does not focus on the impact of the Internet on newspaper advertising. Newspapers may have lost some advertising share to the Internet. Looking at the data presented in LR-I-134, I observe that while the newspaper advertising has declined since the advent of Internet advertising in 1995, this decline has been occurring for many years. In contrast, the decline in direct mail advertising share since 1995 follows a 15-year period during which the direct mail share increased.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA

NAA/USPS-T10-7. Please refer to page 50, lines 16 to 20. Do you agree or disagree with Mr. Blodgett's prediction that Internet advertising revenues will decline in 2001? Please explain your answer.

RESPONSE:

As explained in my testimony, my projections of future Internet advertising revenues fall between the projections of the more optimistic analysts and the more pessimistic analysts, such as Mr. Blodgett. I note that there is considerable uncertainty about the short-term prospects for Internet advertising. Nonetheless, all analysts, including Mr. Blodgett, predict that over a longer period of time, Internet advertising will increase.

**RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

NAA/USPS-T10-8. Please refer to page 62, lines 13-16 of your testimony. Do you agree that Internet advertising is capable of being highly targeted to an individual's particular interests? If so, please discuss whether you believe Internet advertising is at least as capable of being targeted as Standard Regular mail.

RESPONSE:

There is a wide variety of Internet advertising, some of which appears well-suited for targeting to an individual's interests, some that is not. An example of an Internet ad that is targeted to an individual's interests would be an E-mail message from a computer store to a previous buyer of a computer game. On the other hand, a banner ad presented at the Yahoo home page would probably be less targeted.

I do not know whether Internet advertising is as capable of being targeted as Standard Regular mail.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA

NAA/USPS-T10-9. Please refer to page 62, lines 13 to 16 of your testimony:

- a. Do you agree that Standard Enhanced Carrier Route mail is targeted on the basis of geography?
- b. Do you believe that Internet advertising can be targeted geographically to the same degree as Standard ECR mail?
- c. Do you believe that Standard Regular mail is as suited for geographic targeting as is Standard ECR mail?

RESPONSE:

- a. Geography is one basis for targeting ECR mail.
- b. I think that geographic targeting is less important for Internet advertising than for Standard ECR mail.
- c. I believe that since ECR mail provides a lower rate for mailers who can attain the required level of carrier-route density, it is better suited for geographic targeting than Standard Regular mail.

**RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF NAA**

NAA/USPS-T10-10. Please refer to page 64, lines 20-22 of your testimony, where you state that Standard Regular non-carrier route mail "has grown, in part at the expense of ECR mail, due to improvements in database marketing which have allowed advertisers to target customers more effectively." Please state specifically what types of ECR mail have migrated to Standard Regular mail as a consequence of improvements in database marketing.

RESPONSE:

Please see Dr. Tolley's testimony (USPS-T-7), page 102, line 4 to page 106, line 2 and page 114, lines 6 to 23.

1 COMMISSIONER OMAS: Is there any additional Cross-
2 Examination for Witness Bernstein?

3 Mr. Ackerly?

4 CROSS-EXAMINATION

5 BY MR. ACKERLY:

6 Q Mr. Bernstein, I believe that the packet did not
7 include your answer which we received late, the ABANAPM-T-
8 10-5. I am handing you two copies of your answer to this
9 question and ask if this question were asked you today would
10 your answer be the same?

11 A Yes, it would.

12 MR. ACKERLY: I'm handing two copies to the
13 Reporter and ask that the document in question be
14 transcribed into the record and admitted into evidence.

15 COMMISSIONER OMAS: Without objection.

16 (Answer ABANAPM-T-10-5 was
17 received in evidence.)

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RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES FROM ABA & NAPM

ABA&NAPM/USPS-T10-5 Referencing your Table 11, on page 47, lines 3 and 4, you argue that much of the Internet-induced diversion of advertising has come from direct mail.

- a. Please confirm that your table since 1995, as much ad diversion to the Internet has come from newspapers as from direct mail.
- b. Please confirm that even more diversion from broadcast TV has been induced by the Internet than for direct mail since 1995, using the method of looking at your table 11 to judge such.

RESPONSE:

a and b. I can confirm neither supposition. First, I have not analyzed the impact of the Internet on newspaper or broadcast TV advertising. Second, declines in the shares of these advertising media are not necessarily reflective of diversion to the Internet. As I discussed in my testimony, both newspapers and broadcast TV have been experiencing declining advertising shares for many years, and the decline clearly begins well before the introduction of Internet advertising. In contrast, direct mail advertising share grew steadily from 1980 to 1995, before starting a decline at the same time that Internet advertising began. Furthermore, the econometric analysis of Thomas Thress (USPS-T-8) shows that increases in Internet advertising have a statistically significant negative impact on the volumes of Standard Regular and Standard ECR mail.

1 BY MR. ACKERLY:

2 Q Mr. Bernstein, am I correct from what you said a
3 moment ago that your answers to all four parts of
4 interrogatory 16 by GCA are in the packet that has just gone
5 into the --

6 A Yes, that is correct.

7 MR. ACKERLY: Thank you. That's all I have.

8 COMMISSIONER OMAS: Thank you, Mr. Ackerly.

9 By the way, Mr. Ackerly was with the Direct
10 Marketing Association.

11 MR. STOVER: David Stover, Greeting Card
12 Association.

13 I have a packet of GCA interrogatories and
14 responses which was filed on the 12th, and I will hand the
15 witness a copy and ask him if his answers would be the same
16 if he were asked orally today.

17 Please note that the cover sheet inadvertently
18 includes number eight, which was redirected to Witness
19 Thress.

20 (Pause)

21 THE WITNESS: Yes.

22 MR. STOVER: I will give the Reporter two copies
23 and ask that they be transcribed and entered.

24 COMMISSIONER OMAS: Without objection.

25 //

(The document identified as
USPS-T-10/Interrogatories were
received in evidence.)

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

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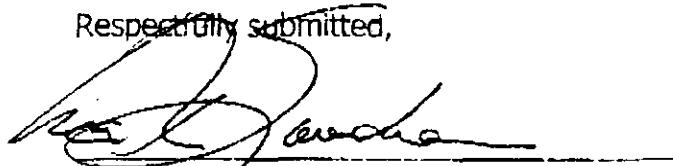
Postal Rate and Fee Changes, 2001

Docket No. R2001-1

**FURTHER DESIGNATIONS OF WRITTEN CROSS-EXAMINATION OF
USPS WITNESS BERNSTEIN (USPS-T-10) BY
GREETING CARD ASSOCIATION
(GCA/USPS-T10)
(December 12, 2001)**

Greeting Card Association (GCA) hereby designates the following interrogatories to and responses by USPS Bernstein as written cross-examination: GCA/USPS-T10-8, 12, 13, 15, 17, 18, 22 and 23. Two copies of this cross-examination have been filed at the Docket Room of the Commission. This designation is being filed two days late due to the Postal Service's filing of the responses at 5:24 p.m. on December 10, 2001 and the inability to consult with GCA's expert witness.

Respectfully submitted,


Alan R. Swendiman

Counsel for
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RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-12.

- a. Please confirm that in Schumpeter's theory, the process of creative destruction almost always involves the creation of new organizations to grow and manage the new technology due to the inability or unwillingness of the older institutions to do so.
- b. Please confirm that in the context of your discussion of diversion due to the Internet, relatively new firms like AOL are leading the process of "creative destruction".
- c. Has the Postal Service contemplated alliances with companies like AOL for universal electronic delivery of letter mail as, for example, it has consummated with FedEx in a different arena of new competition?

RESPONSE:

- a. My testimony does not address the theories of Joseph Schumpeter.
- b. Maybe.
- c. I don't know.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-13 Are you implying by your testimony that "technological diversion is responsible for there being two rate increases (January and July) and another rate case filing to further raise rates, all in 2001?

RESPONSE:

The second rate increase in 2001 is due to the Postal Rate Commission's decision to reduce the Postal Service's revenue request. Beyond that, I believe that volume losses due to technological diversion are one of the important reasons why the Postal Service is filing the R2001-1 rate case soon after implementing the R2000-1 rates.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-15 With respect to your Table 6, what percentage of total households served by the Postal Service, under your universal delivery mandate, with hard copy delivery services would be included in your May, 2005 estimate of 168.9 million active Internet users? Between today and that date, does this represent a movement toward your universal delivery address totals?

RESPONSE:

I do not quite understand your question and I do not believe I have any data that would be responsive. Active Internet users is measured in terms of individuals, not households. I can say that growth in the number of users is projected to exceed growth in total population, and that therefore the percentage of households with Internet access is expected to increase.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-17 With reference to your discussion on page 68, lines 20-22, please cite all factors that would lead current own price elasticity of FCM letters to be less than what it was in the last case, given the fact it is greater for FCM single piece letters.

RESPONSE:

I would argue that the price elasticity of First-Class letters is essentially the same as it was in the last case, in that whatever difference that exists is well within the range of statistical variation. More simply, the overall elasticity is the same because while the estimated own-price elasticity of single-piece letters has increased, the estimated own-price elasticity of workshare letters decreased. Moreover, the share of First-Class letter mail that is workshared is increasing, giving relatively more weight to this lower elasticity in the calculation of an elasticity for total First-Class letters.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-18 Please refer to page 35 in your testimony and your LR-J-133, Excel file, "Forecasts of Internet Variables.xls," in your worksheet "USER FORECASTS"

- a. Please confirm that the formula you have given on this page of your testimony is correctly specified.
- b. If your answer to a. is negative, please provide the correct formula.
- c. If your answer to a. is affirmative, explain why the formula used in your Excel file under the column titled "Fitted" differs from the one in your text and how you would reconcile the two.

RESPONSE:

a through c. The formula on page 35 is missing one term. A corrected page will be submitted.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-22 Please refer to your testimony USPS-T-10 page 48. You state, "Total advertising expenditures are projected to grow by 1.5% from 2000 to 2001 and then increase at the same rate as personal consumption expenditure." In your LR-J-133, Excel file, "Forecasts of Internet Variables.xls," worksheet "advertising" you provide the following figures for the personal consumption expenditure growth rate: 5.29%, 5.47%, 5.30% and 5.59% for the years 2002, 2003, 2004, and 2005, respectively.

- a. Please provide the source for the personal consumption expenditure growth rate.
- b. Given the current projection of deeper than expected recession, do you confirm that these projected personal consumption expenditure growth rates are highly unlikely?
- c. If you answer to b. is affirmative, then provide a more realistic projections available (if any) which has incorporated the recent events and other recent economic concerns as well as your revised projected Internet advertising expenditures based on these new growth rates. Furthermore, explain how this will affect the First-Class mail diversion to Internet and ultimately Tolley's volume forecasts. In other words, how it affects "the magnitude of the impact of ISP expenditure on single-piece letter volume" (USPS-T-10, page 53) and Table 2 of Dr. Tolley you have provided on page 54 of your testimony.
- d. If your answer to b. is affirmative, please explain whether it is reasonable to state on page 57 of your testimony that "Between the Base Year and the Test year, ISP expenditures are projected to increase from \$20.4 billion to \$48.3 billion. This increase is projected to reduce single-piece volume by about 7.8% over a period of slightly more than two years."
- e. If your answer to b. is negative, please elaborate in detail why these projected personal consumption expenditure growth rates would still entail and thus would not have any impact on the magnitude of the diversion of First-Class mail to Internet as you and Dr. Tolley have projected.

RESPONSE:

- a. The personal consumption expenditure projections used in my analysis come from DRI/WEFA and are the same as the projections used by Dr. Tolley in his volume forecasts. The data are found in LR-J-124, file M02QTR.XLS. Nominal consumption expenditures can be calculated by taking the monthly values of real

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

consumption expenditures (C96C) and multiplying them by the implicit consumption deflator for that month.

- b. Whether the projections are "highly unlikely," or merely "unlikely", we are in the midst of a recession which was not assumed to occur when these projections were made. Please see Dr. Tolley's response to NAA/USPS-T7-13 for a broader discussion of this issue. With respect to my testimony, the projected 1.5 percent increase in total advertising expenditures in 2001 represents a decline in real (inflation-adjusted) expenditures, consistent with the current recession. How much less advertising expenditures grow than I projected depends on the depth of the current recession and the strength of the ensuing recovery. There are indications that advertising expenditures are declining substantially. For example, on November 28th, the Wall Street Journal reported that during the 2001 fall advertising season, newspaper, magazine, television, and radio advertising spending were each between 9.6 and 15.0 percent less than a year earlier. [Decline in Ad Revenue Worsens, Suggesting No Quick Turnaround, Wall Street Journal, November 28th]. Bob Coen of McCann-Erickson estimates that total advertising will decline 4.1 percent for all of 2001 and grow only 2.4 percent for 2002. [Bob Coen's Insider's Report, McCann-Erickson WorldGroup, December 2001].
- c. Please see Dr. Tolley's response to NAA/USPS-T7-13. Note also that as a point of record, ISP consumption expenditure projections are not based on projections of personal consumption expenditures.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

- d. Your interrogatory raises several issues, each of which will be addressed in turn. First, will the current recession cause ISP consumption expenditures to be less than originally projected? Indeed, this is a real possibility. Even though the projections of ISP consumption are not based on projections of total consumption, it seems reasonable that a recession could cause a slowdown in the growth of ISP consumption. A second issue is how would lower growth in ISP consumption would effect the estimate of diversion and ultimately the volume forecasts of Dr. Tolley. Taken by itself, a decline in ISP consumption would imply less diversion, but this decline cannot be taken by itself. Any change in ISP consumption due to a recession represents only one impact of a deteriorating economic environment. A recession will adversely affect mail volume in more direct ways than through its impact on diversion. In other words, there may be less diversion because there will be less mail to be diverted.

Beyond the impact of the recession on mail diversion, there is another important recent development -- the mailing of anthrax. This event is likely to cause more mail diversion to electronic alternatives. Whether this diversion is reflected in increases in ISP consumption expenditures is unclear, but it seems just as likely that the combined impacts of a recession and the mailing of anthrax will lead to more, as opposed to less, diversion of First-Class letter mail than originally forecast.

- e. Please see my answer to d.

RESPONSE OF POSTAL SERVICE WITNESS BERNSTEIN
TO INTERROGATORIES OF GCA

GCA/USPS-T10-23. Please refer to pages 65-67 of your testimony USPS-T-10.

- a. Please confirm that in your discussion of technological diversion postal pricing, whether you are assuming that the technological diversion has no impact on the USPS costs.
- b. If your answer to a. is affirmative, then isn't it reasonable for the USPS to cut back on some services to reduce costs rather than employing very large increases in rates in order to break-even?
- c. If your answer to a. is negative, explain in detail in which direction the technological diversion affects the USPS costs and the alternatives that USPS may pursue to break-even other than "...rate cases occurring either more frequently, with greater increases, or both." (USPS-T-10, page 66).

RESPONSE:

- a. I am not assuming that technological diversion has no impact on USPS costs.
- b. Not applicable.
- c. Taken by itself, technological diversion would be expected to increase average cost per mail piece because the reduction in volume causes the Postal Service's non-volume variable costs to be spread out over fewer pieces of mail.

Alternatives to large or frequent rate increases could include efforts to reduce labor or capital costs or efforts to increase volumes through changes in marketing or pricing strategy.

1 COMMISSIONER OMAS: This brings us to the oral
2 Cross-Examination of Mr. Bernstein. Several parties have
3 requested oral Cross-Examination. Direct Marketing
4 Association, Greeting Cards of America, and United Parcel
5 Service.

6 Mr. Ackerly? Direct Marketing Association.

7 MR. ACKERLY: We have no oral Cross-Examination at
8 this time.

9 COMMISSIONER OMAS: Thank you, Mr. Ackerly.
10 Greeting Card Association, Mr. Stover?

11 MR. STOVER: We likewise have no oral Cross at
12 this time.

13 COMMISSIONER OMAS: Thank you, sir.

14 Mr. McKeever?

15 MR. MCKEEVER: Mr. Commissioner, we're going to
16 make it unanimous. We have no Cross-Examination either.

17 COMMISSIONER OMAS: Thank you, Mr. McKeever.

18 Well, Mr. Bernstein, that completes your presence
19 here today. Excuse me, I sort of have to laugh. I never
20 expected all three.

21 That completes your presence here today and your
22 testimony. We appreciate your appearance and your
23 contribution to the record.

24 Thank you. You're excused.

25 THE WITNESS: Thank you.

1 (Witness excused)

2 COMMISSIONER OMAS: Well, this includes today's
3 hearing. We will reconvene again tomorrow morning at 9:30
4 a.m. where we will receive testimony from Postal Service
5 witnesses Shaw, Pafford, Hunter, Harahush and Xie.

6 I thank you for your presence and we'll see you in
7 the morning.

8 Thank you.

9 (The hearing was concluded at 11:26 a.m.)

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REPORTER'S CERTIFICATE

DOCKET NO.: R2001-1
CASE TITLE: In Re: POSTAL RATE AND FEE CHANGES
HEARING DATE: December 13, 2001
LOCATION: Washington, DC

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 Rate Commission.

Date: December 13, 2001


Michael Pecknay

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