

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

POSTAL RATE AND FEE CHANGES, 2006

Docket No. R2006-1

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS BERNSTEIN  
TO INTERROGATORIES OF GCA (GCA/USPS-T8-1 - 7)  
(July 24, 2006)

The United States Postal Service hereby provides the response of witness Bernstein to the following interrogatories of GCA, filed on July 10, 2006: GCA/USPS-T8-1 – 7. With respect to Question 3, which requests provision of a large set of hard-copy materials, in accordance with Rule 27, arrangements to inspect that material at Postal Headquarters can be made by contacting undersigned counsel.

Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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July 24, 2006

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**GCA/USPS-T8-1**

Your testimony (USPS-T-8 at 4) states that “the purpose of [the] testimony is not to provide specific estimates of historical or future electronic diversion, but to provide a narrative that accompanies the testimony of Mr. Thress.”

- a. Table 10 of witness Thress’ testimony (USPS T-7) forecasts that the marginal number of pieces of First Class Mail electronically diverted in 2006 will be 4,342,924, but in 2007, 2008, and 2009 the annual figure will drop below the level of historical diversion in 2005 (4,130,686 diverted pieces) and decrease to 3,747,472 diverted pieces in 2009. Explain in full, how, if at all, your testimony supports Mr. Thress’ forecast that fewer pieces of First Class Mail will be electronically diverted in years 2007, 2008, and 2009 than in year 2005.
- b. Exclusive of Mr. Thress’ forecast, state whether you believe that fewer pieces of First Class Mail will be electronically diverted in years 2007, 2008, and 2009 than in year 2005. Provide the basis of your answer in full.
- c. Exclusive of Mr. Thress’ forecast (and econometric calculations) identify what information (specifically and by type) you would find it appropriate to consider for business forecast purposes to address the issue of whether fewer pieces of First Class Mail will be electronically diverted in years 2007, 2008, and 2009 than in year 2005 and to otherwise estimate the level of electronic diversion of FCLM in 2007, 2008, and 2009. Provide the basis of your answer in full.

**RESPONSE:**

a. My testimony documents the growth in several technological alternatives to the mail and links this growth to the recent decline in First-Class Mail volumes. It does not make forecasts of future mail volumes or future levels of electronic diversion.

Nonetheless, the evidence presented supports the view that electronic diversion will continue into the future.

This assessment is consistent with the forecasts presented by witness Thress, who also forecasts continued electronic diversion into the future. My testimony does not make an assertion regarding the pace of electronic diversion. The “marginal” diversion as you refer to it, or the “incremental” diversion as I refer to it in my R2001-1 testimony, may increase, decrease, or stay the same.

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Consider the following simple example. Suppose in prior Year 1, 85 percent of bills are paid by mail and 15 percent are paid electronically. I will ignore bills paid in-person in this example. Suppose in current Year 2, the electronic share rises to 25 percent and the mail share falls to 75 percent. Suppose, finally, in future Year 3, the electronic share rises to 34 percent and the mail share falls to 66 percent.

From Year 1 to Year 2 to Year 3, there has been an increase in the use of electronic bill payment, as the share has risen from 15 percent to 25 percent to 34 percent. There has been a corresponding decline in the share of payments by mail, falling from 85 percent to 75 percent to 66 percent.

But, note, the incremental diversion of mail in the future (9 percent of total payments due to an increase in the electronic share from 25 percent to 34 percent) is less than the incremental diversion of mail in the past (10 percent of total payments due to an increase in the electronic share from 15 percent to 25 percent).

This analysis is consistent with the argument presented in my testimony that the use of electronic alternatives to the mail will increase, consistent with the argument that there will be additional electronic diversion of mail, and consistent with the estimated levels of historical and future electronic diversion presented in the testimony of Mr. Thress.

b. My belief is that over the next few years, the pace of electronic diversion is likely to remain as it has over the past few years. The pace of electronic diversion is best measured as a percentage of mail volume diverted from one year to the next. Therefore, a constant percentage diversion could result in a decline in the number of pieces diverted, simply because as volume declines, there is less and less mail remaining to be diverted. This is the case with single-piece letters, as shown in the table below.

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The table presents historical and R2006-1 after-rates forecasted volumes of First-Class single-piece and workshare letters. It also shows the estimated incremental diversion of single-piece and workshare letters, both historically and in the forecast period, taken from Mr. Thress's Table 10. Incremental diversion is measured as the percentage of the prior year's volume lost due to diversion in a given year. For example, First-Class single-piece volume in 2002 was 49,253.266 million pieces, which can be viewed as the starting volume for 2003. During 2003, it is estimated by Mr. Thress that 2,788.306 million pieces were diverted, equal to 5.66 percent of the starting volume.

My table shows that the pace of electronic diversion over the recent past is similar to the pace projected for the near future, as I would expect it to be. In the case of single-piece letters, historical diversion has averaged 6.04 percent of volume while projected diversion averages 6.36 percent of volume. Thus, the percentage of remaining single-piece letter volume diverted in the future is greater than in the recent past, even while the absolute volume of incremental diversion declines due to the continued decline in single-piece volume.

For workshare letters, the values are 3.00 percent and 2.92 percent, and for total First-Class Mail (also including First-Class cards), the values are 4.33 percent and 4.26 percent. The small decline in the percent of total First-Class Mail incrementally diverted is due to the decrease in single-piece volume relative to workshare volume.

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**First-Class Single Piece Letters**

	Prior Year's Volume	Current Year Diversion	% of Volume Diverted
2003	49,253.266	2,788.306	5.66%
2004	46,557.786	2,958.496	6.35%
2005	45,161.746	2,757.899	6.11%
Average			<b>6.04%</b>
2006	43,375.988	2,779.970	6.41%
2007	41,410.402	2,568.699	6.20%
2008	39,104.641	2,466.870	6.31%
2009	37,206.438	2,423.321	6.51%
Average			<b>6.36%</b>

**First-Class Workshare Letters**

	Prior Year's Volume	Current Year Diversion	% of Volume Diverted
2003	47,658.076	1,811.965	3.80%
2004	47,287.971	1,141.289	2.41%
2005	47,333.818	1,323.722	2.80%
Average			<b>3.00%</b>
2006	49,065.552	1,492.332	3.04%
2007	48,748.410	1,495.231	3.07%
2008	48,376.760	1,410.574	2.92%
2009	48,427.200	1,276.957	2.64%
Average			<b>2.92%</b>

**Total First-Class Mail**

	Prior Year's Volume	Current Year Diversion	% of Volume Diverted
2003	102,378.632	4,672.842	4.56%
2004	99,058.856	4,181.693	4.22%
2005	97,926.396	4,130.686	4.22%
Average			<b>4.33%</b>
2006	98,070.956	4,342.924	4.43%
2007	95,815.357	4,110.310	4.29%
2008	93,156.413	3,919.518	4.21%
2009	91,291.090	3,747.473	4.10%
Average			<b>4.26%</b>

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c. One approach would be to estimate the growth in the use of various technological alternatives to the mail and combine those estimates with estimates of the impact of the use of each technology on the diversion of First-Class Mail. For example, one could hypothesize a certain volume loss corresponding to a projected increase in the level of e-mail.

The drawback of this approach is that the results can be extremely sensitive to the assumed diversion ratio, and for many technologies the plausible range of diversion ratios is quite large. Furthermore, there is the difficulty of aggregation, given the fact that growth in the use of some technologies affects not only the volume of mail but also the use of other technologies. For example, online bill payments clearly replace some mailed bill payments, but they may also replace payments made by other methods, such as in-person or by telephone. Another problem with this approach is that because First-Class Mail is affected by myriad technological changes, a slowing in the growth rate of the use of some technologies can be easily offset by an acceleration of the growth rate in other technologies.

A second approach would be to decompose First-Class Mail into individual mail segments and make a segment-by-segment projection of diversion. Total projected diversion would be the sum of projected diversion of each mail type, which could then be compared with historical estimates of diversion to determine whether the projected number of pieces diverted is rising, falling, or remaining the same.

For example, an important mail segment is household bill payments. The share of bills paid by mail could be projected into the future, based on analysis of historical shares as well as projections of key drivers of bill payment activity such as the number of households with Internet access, the number of broadband households, the number of online banking households, changes in the perceived advantages of different payment methods in terms of cost, convenience, reliability and security. From that, one

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could make a forecast of the future diversion of household bill payments and compare the forecast with recent historical diversion.

That approach could then be repeated for each important segment of First-Class Mail, e.g., correspondence, bills and statements sent to households, advertising, non-household to non-household mail, etc. A forecast of total diversion would equal the sum of the forecasts of diversion of each mail segment.

Of course, to know whether this forecast represents an increase or a decrease in diversion would require an estimate of historical diversion. To do that, one could look at historical volumes of each mail segment, recognizing that one would have to take account of other factors which drive historical volumes such as postal rates and economic conditions.

Or, one could account for the impacts of postal rates, economic conditions, and electronic diversion by constructing an econometric model of mail volumes, including variables that reflect the impacts of these and other variables, and use the coefficients obtained from that econometric equation to calculate estimates of historical diversion and to make forecasts of future diversion. This is the approach taken by Mr. Thress and it is superior to any other approach I have encountered.

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**GCA/USPS-T8-2**

Your testimony (USPS-T-8 at 27) states that “the use of technological alternatives to the mail will continue to increase in the future.” Reconcile this statement with Mr. Thress’ forecast that fewer pieces of First Class Mail will be electronically diverted in years 2007, 2008, and 2009 than in year 2005. Provide the basis of your answer in full.

**RESPONSE:**

As stated in my response to your interrogatory 1a, an increase in the use of technological alternatives implies further electronic diversion. It does not require that the number of pieces diverted in a future year (incremental diversion) be greater than the number of pieces diverted in an earlier year. Incremental diversion could decline because the growth rate of the use of technological alternatives has slowed, as shown in my earlier example concerning bill payment activity. Or, as is the case with single-piece letters shown in the table accompanying my response to your interrogatory 1b, the number of pieces diverted in a future year could be less than the number diverted in an earlier year simply because of the decline in volume which leaves few pieces remaining to be diverted.

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**GCA/USPS-T8-3**

Your testimony (USPS-T-8 at 50) states that “the use of electronic alternatives to paying bills by mail found in the Diary Study are corroborated by a variety of other sources, some of which were mentioned in my R2005-1 testimony at pages 24 to 34.” Please identify all of the sources of which you are aware that corroborate this phenomenon and provide copies of the supporting materials in your possession.

**RESPONSE:**

I am informed that an opportunity to inspect those materials at Postal Headquarters can be arranged through my postal counsel at 202/268-2992.

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**GCA/USPS-T8-4**

Your testimony (USPS-T-8 at 57) states that “online bill presentment [is] a development that would affect the volume of bills sent through the mail.” State your opinion as to whether you expect the volume of online bill presentment to grow in the next few years (i.e., 2006-2009). Provide the basis of your answer in full.

**RESPONSE:**

I expect online bill presentment to continue to grow over the next few years. This increase in online bill presentment will lead to further diversion of bills and statements sent through the mail, though the eventual volume of bill and statement mail is dependent on other factors in addition to the level of online bill presentment.

Evidence supporting the view that online bill presentment will increase is found in the Household Diary. The share of bills presented electronically increased from 1 percent in 2002 to 7 percent in 2005. Furthermore, as households continue to make greater use of online bill payment, it seems reasonable that some of these households will opt for online bill presentment so that the bill receipt and payment operation moves entirely online. Finally, I believe that as consumer interest in receiving bills online increases, more billers will begin offering online bill presentment to their customers.

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**GCA/USPS-T8-5**

Your testimony (USPS-T-8 at 60) states that “online bill payment ... could be the key driver of the future shares of bills paid by mail.” Reconcile this statement with Mr. Thress’ forecast that fewer pieces of First Class Mail will be electronically diverted in years 2007, 2008, and 2009 than in year 2005. Provide the basis of your answer in full.

**RESPONSE:**

I see nothing that needs to be “reconciled.” Growth in online bill payment will reduce payments by mail. Whether the mail payment reduction occurs at a faster, slower, or similar rate depends on whether the growth in online bill payment occurs at a faster, slower, or similar rate, also taking account of the growth in other forms of electronic payments.

Moreover, the diversion of household bill payments is only one aspect of the diversion of First-Class Mail presented in Mr. Thress’s testimony.

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**GCA/USPS-T8-6**

Your testimony (USPS-T-8 at 60) states that “online bill payment ... could be the key driver of the future shares of bills paid by mail.” State your opinion as to what you believe will be the key driver of the volume of FCLM electronically diverted in the next few years (i.e., 2006-2009). Provide the basis of your answer in full.

**RESPONSE:**

I do not believe there is a single key driver of the diversion of First-Class Mail because First-Class Mail consists of many different types of mail, each of which may be affected by different drivers of diversion. For example, online bill payment is likely to be the key driver of diversion of household bill payments. Broadband access may be the key driver of the diversion of bill and statement mail to households. E-mail advertising may be the key driver of the diversion of First-Class advertising mail. Services such as E-Vite may be the key driver of the diversion of First-Class invitations. Changing views toward the acceptability of e-mail might be the key driver the diversion of various other kinds of personal mail. The ability of businesses to coordinate their invoice, billing, and payment operations may be the key driver of the diversion of certain types of business-to-business First-Class Mail.

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**GCA/USPS-T8-7**

State whether you have ever communicated to anyone as to whether, and to what Extent, FCLM volumes will be impacted by electronic diversion, including, but not limited to, the time period of the next few years (i.e., 2006-2009). Identify all such communications, state to whom they were made, and provide the substance of the communication.

**RESPONSE:**

Much of my work at RCF involves analysis of electronic diversion.

Communications regarding the impact of diversion on mail volumes occur almost on a daily basis. Your interrogatory appears to seek a daily record of my work over a period of several years, a request I view as impractical. The thrust of what I have been communicating is what has been presented as my direct testimony in this case, as well as in my testimonies in R2005-1 and R2001-1.

In addition to these testimonies, I have worked on the creation of pessimistic and optimistic diversion scenarios, based on different assumptions about the growth in the use of the many drivers of electronic diversion. The purpose of these scenarios is to identify a wide range of risks and opportunities facing the Postal Service, beyond those presented in the most likely, baseline scenario. The results of this work can be found on page 8 of the Postal Service's September 2005 "Strategic Transformation Plan: 2006 – 2010," available on the Postal Service's web site, [www.USPS.com](http://www.USPS.com).

## CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with Section 12 of the Rules of Practice and Procedure.

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