

OFFICIAL TRANSCRIPT OF PROCEEDINGS BEFORE THE POSTAL RATE COMMISSION

In the Matter of:)
)
RATE AND SERVICE CHANGES)
TO IMPLEMENT BASELINE) Docket No. MC2006-3
NEGOTIATED SERVICE)
AGREEMENT WITH)
WASHINGTON MUTUAL BANK)

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C O N T E N T S

WITNESSES APPEARING:
PETER BERNSTEIN

<u>WITNESSES:</u>	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>	<u>VOIR DIRE</u>
Peter Bernstein	369	--	401	--	--
By Mr. Costich	--	386	--	--	--

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E X H I B I T S

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P R O C E E D I N G S

(9:35 a.m.)

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2
3 CHAIRMAN OMAS: Good morning. Today we are
4 holding hearings to receive rebuttal testimony in
5 Docket No. MC2006-3, the Postal Service request for an
6 opinion and recommended decision on a proposed
7 baseline negotiated service agreement with Washington
8 Mutual Bank.

9 One witness is scheduled to appear today.
10 He is Peter Bernstein.

11 Before we begin, does anyone have any
12 procedural matter to discuss?

13 (No response.)

14 CHAIRMAN OMAS: Counsel?

15 MR. HESELTON: Yes, Mr. Chairman. Frank
16 Heselton appearing on behalf of the Postal Service.

17 CHAIRMAN OMAS: Would you please identify
18 your witness, please?

19 MR. HESELTON: Mr. Bernstein, would you
20 identify yourself for the record, please?

21 MR. BERNSTEIN: Yes. My name is Peter
22 Bernstein, and I am vice president of RCS Economic and
23 Financial Consulting in Chicago.

24 CHAIRMAN OMAS: Will you stand please, Mr.
25 Bernstein, and raise your right hand?

1 Whereupon,

2 PETER BERNSTEIN

3 having been duly sworn, was called as a
4 witness and was examined and testified as follows:

5 CHAIRMAN **OMAS**: Please be seated. Proceed.

6 DIRECT EXAMINATION

7 (The document referred to was
8 marked for identification as
9 Exhibit No. USPS-RT-1.)

10 BY MR. HESELTON:

11 Q Mr. Bernstein, earlier I handed you two
12 copies of a document entitled Rebuttal Testimony of
13 Peter Bernstein on Behalf of the United States Postal
14 Service and identified therein as USPS-RT-1.

15 Have you had a chance to examine these
16 documents?

17 A Yes, I have.

18 Q And was this testimony prepared by you or
19 under your direction and control?

20 A Yes, it was.

21 Q Do you have any changes or corrections to
22 make at this point?

23 A I do have two changes to make. The first is
24 on page 29 at line 21. "WBM" should be changed to
25 "WMB".

1 The second change is at page 37 beginning at
2 line 12, the sentence beginning, "In order to
3 receive..." That complete sentence should be removed
4 and replaced with the following sentence:

5 "A key feature of this proposed NSA is the
6 requirement that WMB send at least 90 percent (or a
7 minimum of 500 million pieces) of its marketing mail
8 as first class mail."

9 Q And with these changes if you were to
10 testify today your testimony would be the same?

11 A Yes.

12 MR. HESELTON: Mr. Chairman, I ask that the
13 rebuttal testimony of Peter Bernstein on behalf of the
14 United States Postal Service identified therein as
15 USPS-RT-1 be admitted as evidence at this time.

16 CHAIRMAN OMAS: Is there any objection?

17 (No response.)

18 CHAIRMAN OMAS: Hearing none, Mr. Heselton,
19 would you please provide two copies of the corrected
20 surrebuttal testimony of Peter Bernstein to the
21 reporter?

22 That testimony is received into evidence.
23 However, consistent with Commission practice it will
24 not be transcribed.

25 //

1 (The document referred to,
2 previously identified as
3 Exhibit No. USPS-RT-1, was
4 received in evidence.)

5 CHAIRMAN OMAS: There is no written cross-
6 examination of rebuttal witnesses, but the Postal
7 Service has provided written responses to Presiding
8 Officer's Information Request No. 3. These questions
9 were intended to clarify rebuttal testimony.

10 Mr. Heselton, I want to thank you for that
11 prompt response.

12 Witness Bernstein, you provided answers to
13 Questions 1, 2, 3 (a) and 5 (b). Do those answers
14 remain accurate to the best of your belief?

15 THE WITNESS: Yes, they do.

16 CHAIRMAN OMAS: I am now handing the
17 reporter two copies of the response to the Presiding
18 Officer's Information Request 3.

19 The response is admitted into evidence and
20 is to be transcribed into the record.

21 //

22 //

23 //

24 //

25 //

1 (The document referred to was
2 marked for identification as
3 Exhibit No. POIR No. 3,
4 Questions 1, 2, 3(a), 4 and
5 5(b), and was received in
6 evidence.)

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RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS
BERNSTEIN (USPS-RT-1) TO PRESIDING OFFICER'S INFORMATION
REQUEST NO. 3, QUESTION 1

1. Please refer to USPS-RT-1 (revised October 23, 2006), pages 31-32. Witness Bernstein presents two illustrative **examples** of estimated changes in Washington Mutual's First-class Mail volume in response to the proposed discounts. The first example uses overall (or average) workshare elasticities, while the second **uses** elasticities estimated based on assumptions about the price-sensitivity of First-class advertising mailers in general, and Washington Mutual Bank specifically.
 - a. The first example forecasts a volume increase of 7.2 percent. To estimate the number of additional pieces using this figure, would it be most appropriate to apply the 7.2 percent to Washington Mutual Bank's total First-class Mail volume, First-class advertising volume, or some other volume? Please explain the rationale for your response.
 - b. The second example forecasts a volume increase of 41.9 percent. To estimate the number of additional pieces using this figure, would it be most appropriate to apply the 41.9 percent to Washington Mutual Bank's total First-Class Mail volume, First-class advertising volume, or some other volume? Please explain the rationale for your response.

RESPONSE:

(a) The 7.2 percent increase could be **applied** to WMB's total First-Class Mail workshare letter volume if: a) the composition of WMB's mailings were the same as that of the typical First-class Mail workshare letter mailer, and b) WMB's responsiveness to changes in prices (its price elasticity) were the same as estimated by witness Thress (in Docket No. R2006-1) for all First-class Mail workshare letter mailers. I do not believe these conditions hold. WMB makes greater use of First-class Mail workshare advertising mail than the typical First-Class Mail workshare **letter** mailer, relative to its volume of non-advertising First-Class Mail workshare mail and relative to its volume of Standard Mail. Therefore, its mail composition is different from that of the typical First-class **Mail** workshare advertising mailer. Moreover, because of WMB's greater use of First-class Mail workshare advertising mail, it is likely that its total volume of First-class Mail

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS
BERNSTEIN (USPS-RT-1) TO PRESIDING OFFICER'S INFORMATION
REQUEST NO. 3, QUESTION 1

workshare letters will be more sensitive to changes in the price-difference with Standard Mail than is estimated for all First-class Mail workshare mail, which is predominantly non-advertising mail

(b) The 41.9 percent figure should be applied to WMB's First-class Mail workshare advertising volume. The figure was calculated based on reasonable own-price and price-difference elasticities for WME's First-class Mail workshare advertising mail, not for total volumes or for other volumes.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS
BERNSTEIN (USPS-RT-1) TO PRESIDING OFFICER'S INFORMATION
REQUEST NO. 3, QUESTION 2

2. On page 21, lines 17-18 **USPS-RT-1** (revised October 23, 2006), witness Bernstein **states** that "...the 1.115 percent increase must be almost entirely reflected in changes in advertising volume...".
- a. Please confirm that the **price-difference** elasticity of First-class Workshared letters estimated by witness Thress in his Docket No. R2006-1 testimony would **be** based in part on any changes in operational mail brought about by changes in the difference between the price of First-class Workshared letters and the price of Standard Regular letters, even if this change operated through the change in accounts of banking institutions brought about by response to the change in price **of** First-class Workshared letters.
 - b. If confirmed, please discuss how this **might** affect witness Bernstein's analysis.
 - c. If not confirmed, please explain the reasons for not confirming.

RESPONSE:

(a) - (c) The hypothetical suggests that when the price-difference between First-class Mail workshare letter mail and Standard Regular mail decreases, there is an increase in First-class Mail workshare advertising mail volume, which in turn generates more accounts, which itself in turn generates more First-class Mail non-advertising workshare mail volume such as account statements. If this hypothetical truly explains mailer behavior, then its effect would be reflected in the historical volume data and captured in the price-difference elasticity estimated by witness Thress. I believe however that this effect is likely to be extremely minor. First, it is not clear that there will be much of a change in the total number of accounts resulting from the greater use of First-class Mail workshare solicitations because there may also be a coinciding decrease in the use of Standard Mail solicitations. To the extent that First-class Mail solicitations are more likely to generate a new account (the so-called "lift"), there might be an increase in the number of accounts. That, however, depends on **the** exact

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS
BERNSTEIN (USPS-RT-1) TO PRESIDING OFFICER'S INFORMATION
REQUEST NO. 3, QUESTION 2

operating strategy of the mailer as to whether it seeks a given number of accounts, a given volume of mail, a given cost of mailings, or some other operating criteria. Moreover, given the generally low response rate associated with credit card solicitations (on the order of 0.4 percent) the overall increase in accounts, if it were to occur at all, would be small as would the overall number of new account mailings.

To illustrate, assume in response to a decrease in the price of First-class Mail workshare letters, a company sends 100 million more First-class Mail solicitations. Given a response rate of 0.4 percent, this would generate 400,000 more accounts and about 5 million more pieces of First-class Mail operations mail over a twelve-month period. The overall increase in operational mailings then is just 5 percent of the total represented by the original increase in total First-class Mail solicitation mailings. Moreover, if the 100 million piece increase in First-class Mail solicitations resulted in a similar decrease in Standard Mail mailings, then the overall increase in accounts would be quite a bit less. Assuming a 20 percent lift, one would have expected that 100 million Standard Mail mailings would have generated 333,000 additional accounts, $(400,000/1.2 = 333,333)$. thereby implying that the net increase in accounts would be only 66,667 and the total increase in operational mailings would be on the order of 1 million pieces. As such, the overall impact on First-class Mail operations volume is an even smaller percentage of the original 100 million pieces.

Therefore, it appears that the direct increase in First-class Mail workshare advertising mail volume represents 95 to 100 percent of the pricedifference

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS
BERNSTEIN (USPS-RT-1) TO PRESIDING OFFICER'S INFORMATION
REQUEST NO. 3, QUESTION 2

elasticity effect estimated by witness Thress. As such, this impact is minor and does not affect the statement that "the 1.115 percent increase must be almost entirely reflected in changes in advertising volume."

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS
BERNSTEIN (USPS-RT-1) TO PRESIDING OFFICER'S INFORMATION
REQUEST NO. 3, QUESTION 3, subpart (a)

3. Pages 33 through 39 of witness Bernstein's testimony (USPS-RT-1, revised October 23, 2006) argues that the contractual requirement for Washington Mutual Bank to send 90 percent of its credit card solicitation mail, or a minimum of 500 million pieces as First-Class Mail is a non-price factor affecting volume. The contractual requirement is referred to as the "Solicitation Mail Volume Guarantee" and appears in the contract at section II.J.
- a. Should the severity of the penalty for non-compliance associated with the Solicitation Mail Volume Guarantee be considered when analyzing this contract provision as a non-price factor affecting volume? Please include a discussion of how a hypothetical mailer might react to a penalty the mailer views as severe versus how a hypothetical mailer might react to a penalty a mailer considers relatively minor.
 - b. Please confirm that at the Year 1 projected total mail volume of 713 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), and the Year 1 projected operational mail volume of 120 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), Washington Mutual Bank must send a minimum of 84.4 percent (500 million pieces) of its solicitation mail as First-class Mail in order to comply with the Solicitation Mail Volume Guarantee (rounded up to the next higher tenth of one percent). If not confirmed, please explain and show all calculations.

$$500 \text{ million (Solicitation Mail Volume Guarantee)} / (713 \text{ million (total mail volume)} - 120 \text{ million (operational mail volume)}) = 84.4 \text{ percent}$$
 - c. Please confirm that at the Year 2 projected total mail volume of 750 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), and the Year 2 projected operational mail volume of 125 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), Washington Mutual Bank must send a minimum of 80 percent (500 million pieces) of its solicitation mail as First-class Mail in order to comply with the Solicitation Mail Volume Guarantee. If not confirmed, please explain and show all calculations.

$$500 \text{ million (Solicitation Mail Volume Guarantee)} / (750 \text{ million (total mail volume)} - 125 \text{ million (operational mail volume)}) = 80 \text{ percent}$$
 - d. Please confirm that at the Year 3 projected total mail volume of 785 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), and the Year 3 projected operational mail volume of 130 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), Washington Mutual Bank must send a minimum of 76.4 percent (500 million pieces) of its solicitation mail as First-class Mail in order to comply with the Solicitation Mail Volume Guarantee

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS
BERNSTEIN (USPS-RT-1) TO PRESIDING OFFICERS INFORMATION
REQUEST NO. 3, QUESTION 3, subpart (a)

(rounded up to the next higher tenth of one percent). If not confirmed, please explain and show all calculations.

$$\frac{500 \text{ million (Solicitation Mail Volume Guarantee)} - 130 \text{ million (operational mail volume)}}{785 \text{ million (total mail volume)}} = 76.4 \text{ percent}$$

RESPONSE:

(a) Yes, the severity of the penalty should be considered when analyzing the impact on mail volume resulting from the above provisions of the contract. The more severe the penalty, the more the mailer will be disposed to comply with contract provisions. For example, suppose absent the penalty, a mailer would have sent 495 million pieces. With a penalty set at \$250,000, the mailer could avoid a cost of \$250,000 by sending 5 million more pieces, which might be a sufficiently large incentive to induce the mailer to increase volume to the 500 million piece requirement. If the penalty were only \$25,000, the incentive might not be large enough to induce the mailer to increase its mailings by 5 million more pieces than otherwise planned.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS
 AYUB (USPS-T-I) TO PRESIDING OFFICER'S INFORMATION
 REQUEST NO. 3, QUESTION 3, subparts (b)-(d)

3. Pages 33 through 39 of witness Bemstein's testimony (USPS-RT-1, revised October 23, 2006) argues that the contractual requirement for Washington Mutual Bank to send 90 percent of its credit card solicitation mail, or a minimum of 500 million pieces as First-class Mail is a non-price factor affecting volume. The contractual requirement is referred to as the "Solicitation Mail Volume Guarantee" and appears in the contract at section II.J.
- a. Should the severity of the penalty for non-compliance associated with the Solicitation Mail Volume Guarantee be considered when analyzing this contract provision as a non-price factor affecting volume? Please include a discussion of how a hypothetical mailer might react to a penalty the mailer views as severe versus how a hypothetical mailer might react to a penalty a mailer considers relatively minor.
 - b. Please confirm that at the Year 1 projected total mail volume of 713 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), and the Year 1 projected operational mail volume of 120 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), Washington Mutual Bank must send a minimum of 84.4 percent (500 million pieces) of its solicitation mail as First-class Mail in order to comply with the Solicitation Mail Volume Guarantee (rounded up to the next higher tenth of one percent). If not confirmed, please explain and show all calculations.

$$500 \text{ million (Solicitation Mail Volume Guarantee)} / (713 \text{ million (total mail volume)} - 120 \text{ million (operational mail volume)}) = 84.4 \text{ percent}$$
 - c. Please confirm that at the Year 2 projected total mail volume of 750 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), and the Year 2 projected operational mail volume of 125 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), Washington Mutual Bank must send a minimum of 80 percent (500 million pieces) of its solicitation mail as First-class Mail in order to comply with the Solicitation Mail Volume Guarantee. If not confirmed, please explain and show all calculations.

$$500 \text{ million (Solicitation Mail Volume Guarantee)} / (750 \text{ million (total mail volume)} - 125 \text{ million (operational mail volume)}) = 80 \text{ percent}$$
 - d. Please confirm that at the Year 3 projected total mail volume of 785 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), and the Year 3 projected operational mail volume of 130 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), Washington Mutual Bank must send a minimum of 76.4 percent (500 million pieces) of its solicitation mail as First-class Mail in order to comply with the Solicitation Mail Volume Guarantee (rounded up to the next higher tenth of one percent). If not confirmed, please explain and show all calculations.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS
AYUB (USPS-T-1) TO PRESIDING OFFICER'S INFORMATION
REQUEST NO. 3, QUESTION 3, subparts (b)-(d)

500 million (Solicitation Mail Volume Guarantee) / (785
million (total mail volume) - 130 million (operational mail
volume)) = **76.4** percent

RESPONSE:

(b) - (d) Confirmed.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS
AYUB (USPS-T-I) TO PRESIDING OFFICER'S INFORMATION
REQUEST NO. 3, QUESTION 4

- 4. Assume the Year 1 projected total mail volume of 713 million pieces (see WMB-T-I at 9, Table 4, revised June 8, 2006). and the Year 1 projected operational mail volume of 120 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), and assume that Washington Mutual Bank fails to comply with the Solicitation Mail Volume Guarantee by only mailing 499 million pieces of solicitations mail by First-class Mail, thus failing to send one million pieces of First-class Mail that otherwise would have allowed compliance. All other solicitations are mailed by Standard Mail. Given these assumptions, what is the dollar value of discounts provided to Washington Mutual Bank at this point? What is the penalty in dollars that Washington Mutual Bank is liable to pay the Postal Service at this point? Please show all calculations.

RESPONSE:

Assuming that WMB's total mail volume is 713 million pieces, and assuming that 619 million pieces of that total are First-class Mail (120 + 499 million), we can assume that 94 million pieces of mail would be Standard Mail (713 - 619 million). If

Assumed Total Mail Volume (First-Class Mail and Standard Mail)		713 million
First-class Mail Operations Volume	120 million	
First-class Mail Marketing Volume	499 million	
Total First-Class Mail Volume		619 million
Assumed Standard Mail volume		94 million

this were the case, WMB would be in violation of the contractual requirement identified in the "Solicitation Mail Volume Guarantee" which appears in the contract at section II.J. Given the assumptions above, WMB would not have mailed 500 million pieces via First-class Mail and the ratio of WMB's First-class Mail to its total solicitation mail volume would be only be 84 percent (499 / (499 + 94)). As a consequence, **WMB** would be subject to a penalty of \$250,000.

Moreover, the agreement provides Postal Service with the ability to terminate the agreement at any time. The Postal Service will monitor WMB's

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS
AYUB (USPS-T-1) TO PRESIDING OFFICER'S INFORMATION
 REQUEST NO. 3, QUESTION 4

volume trends on a quarterly basis (see Agreement, Section IV, part F). If the volume trends indicated that WMB would not satisfy the Solicitation Mail Volume Guarantee, the Postal Service would be able to terminate the agreement before the end of the year.

For a discussion of the likely impact of the penalty on WMB's mailing behavior given the assumptions above, please refer to witness Bernstein's answer to question 3, subpart (a)

Additionally, given the assumptions described above WMB would receive incentives on the 129 million pieces above the threshold (619 Total First-class Mail Volume – 490 Threshold). Under that scenario, WMB would have to increase its total postage spending by \$12.2 million (net of incentives) to receive the \$5.9 million incentives.

490,000,000	505,000,000	\$ 0.035	15,000,000	\$525,000	\$1,578,000
505,000,000	520,000,000	\$ 0.040	15,000,000	\$600,000	\$1,503,000
520,000,000	560,000,000	\$ 0.045	40,000,000	\$1,800,000	\$3,808,000
560,000,000	710,000,000	\$ 0.050	59,000,000	\$2,950,000	\$5,321,800
Total			129,000,000	\$5,875,000	\$12,210,800

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS
AYUB (**USPS-T-1**) TO PRESIDING OFFICER'S INFORMATION
REQUEST NO. 3, QUESTION 5. subpart (a)

5. Page 37 of witness Bernstein's testimony (USPS-RT-1. revised October 23, 2006) states that "[i]n order to receive the discount, WMB would have to send at least 90 percent of its marketing mail as First-class Mail."
- a. Do all parties to the contract agree that Washington Mutual Bank will not receive any discounts if it does not send at least 90 percent of its marketing mail as First-class Mail?
 - b. Does the terminology "or a minimum of 590 million credit card solicitations" affect the accuracy of witness Bernstein's statement or change the response to question a. **above**?

RESPONSE:

(a) If Washington Mutual mails less than 500 million First-class Mail marketing pieces then it is required by the NSA to send at least 90 percent of its marketing mail as First-class Mail. If it fails to meet this requirement, the contract may be terminated. The 500 million piece minimum requirement is also a non-price requirement in the same manner as the 90 percent requirement

RESPONSE ~~OF~~ UNITED STATES POSTAL SERVICE WITNESS
BERNSTEIN (USPS-RT-1) ~~TO~~ PRESIDING OFFICERS INFORMATION
REQUEST NO. 3, QUESTION 5, subpart (b)

5. Page 37 of witness Bernstein's testimony (USPS-RT-1, revised October 23, 2006) states that "[i]n order to receive the discount. WMB would have to send at least 90 percent of its marketing mail as First-class Mail."
- a. Do all parties to the contract agree that Washington Mutual Bank will not receive any discounts if it does not send at least 90 percent of its marketing mail as First-class Mail?
 - b. Does the terminology "or a minimum of 500 million credit card solicitations" affect the accuracy of witness Bernstein's statement or change the response to question a. above?

RESPONSE:

(b) The statement quoted above is a ~~shorter~~ version of my statement on page 33 which reads, "A key feature of this proposed NSA is the requirement that WMB send at least 90 percent (or a minimum of 500 million pieces) of its marketing mail as First-class Mail." The statement of page 37 refers only to the 90 percent requirement because that is the focus of that section of my testimony. I acknowledge that WMB could receive discounts under the **NSA** if it mailed a minimum of 500 million credit card solicitations. Importantly, the existence of the 500 million piece minimum requirement does not change the conclusions from my analysis of the 90 percent requirement. Either of these requirements represents a non-price factor affecting the after-rates volume of First-class Mail workshare letters sent by WMB. Therefore, my conclusion that WMB's after-rates volume cannot necessarily be estimated by looking solely at price-elasticities remains true.

1 CHAIRMAN OMAS: Mr. Heselton, will you
2 please provide a declaration for Witness Ayub
3 verifying the accuracy of his responses to Question
4 3(b) through (d), 4 and 5(a)?

5 MR. HESELTON: I would be happy to, Mr.
6 Chairman.

7 CHAIRMAN OMAS: Thank you.

8 This now brings us to oral cross-
9 examination. One participant has requested oral
10 cross-examination, the Office of Consumer Advocate

11 Mr. Costich?

12 MR. COSTICH: Thank you, Mr. Chairman.

13 CROSS-EXAMINATION

14 BY MR. COSTICH:

15 Q Good morning, Mr. Bernstein.

16 A Good morning. Bernstein actually.

17 Q I listened to your counsel and not to you.
18 Sorry.

19 A That's okay.

20 Q First I'd like to discuss in general terms
21 the notion of exogenous factors. Would you agree that
22 these are nonprice factors that affect volumes?

23 A I don't think that's actually a definition
24 of exogenous factors, but I think what you're
25 referring to within this case that may be correct,

1 yes.

2 Q Can we agree that there are a host of
3 exogenous factors that affect Washington Mutual's mail
4 volume?

5 A Yes.

6 Q Can we agree that the values of exogenous
7 factors are parameters of a demand curve?

8 A As I understand your question, yes. A
9 demand curve generally shows a relation between
10 quantity and price given values of other factors. I
11 think that's what you're referring to when you say
12 exogenous factors.

13 Q Yes. Can we agree that a change in the
14 value of an exogenous factor will shift the demand
15 curve?

16 A If it's a factor that affects demand.

17 Q If it's in the demand function will that
18 happen?

19 A And if there's not some sort of offsetting
20 change by another factor, yes.

21 Q Ceteris paribus?

22 A Yes, if you wish.

23 Q And can we agree that the values of
24 exogenous factors are embedded in the estimates of
25 Washington Mutual's before and after rates volume

1 estimates?

2 A I believe so, yes

3 Q And can we agree that for a particular year
4 of the NSA, the values of exogenous factors are the
5 same for the before and after rates estimates?

6 A They should be in the sense that the only
7 difference between the before and after rates is the
8 effect of the new rates.

9 Q Could you turn to your Figure 5 on page 45?

10 A Table 5?

11 Q Excuse me. Yes. First, there seems to be
12 some conflict between the first caption at lines 13
13 and 14 and then the caption that's down just above the
14 numbers

15 A You're correct. You're very much correct.
16 Thank you. That should be Before Rates Volume Known,
17 After Rates Volume Unknown. Thank you.

18 Q I think that's Table 4.

19 A Yes. I apparently just --

20 Q I mean I think this one is --

21 A I'm sorry. You're right again. The caption
22 above the table is correct. The caption under the
23 heading above those price measures is incorrect. It
24 should say on line 14 After Rates Volume Is Known, But
25 Before Rates Volume Is Uncertain.

1 Q Thank you. Now, in this table you have an
2 after rates volume of 700, and you describe that as a
3 known value, right?

4 A In this illustration, yes.

5 Q If the 700 is a known value, why would a cap
6 be set at 550?

7 A I don't think it would be. I think it is
8 showing the case where when I say it's a known value
9 I'm sort of saying let us assume for the purpose of
10 this illustration that it were a known value.

11 Another way to think about that is known,
12 but known by who. It may be known by Washington
13 Mutual. It may not be known by other people, those
14 who are constructing this NSA or proposing some kind
15 of volume cap.

16 Q I'd like to alter your illustration just a
17 little and assume that everyone knows the volume is
18 going to be 700.

19 A Uh-huh.

20 Q In which case I think if there's going to be
21 a cap it's going to be 700. Would you agree?

22 A Well, if everybody knows with certainty that
23 the volume is 700 I don't even see why you would
24 bother having a cap. It would seem to be a given in
25 that case.

1 Q Well, when you say that the 700 is known is
2 this a volume that results solely from the discount,
3 or does it also include known changes in all possible
4 exogenous factors?

5 A No. The difference between the second
6 column and the third column, the Volume Before Rates
7 and the Volume After Rates, is the impact of the NSA
8 itself and so that is the only driver of that
9 difference in volume.

10 Q If that's the case then wouldn't it make
11 sense to have a cap of 700 to protect against possible
12 shifts in the demand curve that would lead to an after
13 rates volume greater than 700?

14 A Possibly. Not necessarily. You say
15 possible shifts. A shift can be greater or they can
16 be lower. If they're greater there's a certain --
17 without a cap if the volume is greater than that
18 there's a certain benefit from that.

19 I don't see why you necessarily would want
20 to limit that upside benefit if let us say some, as
21 you might suggest, exogenous factor drove volume to
22 750 million. That's 50 million more pieces on which
23 the Postal Service would earn revenues greater than
24 cost and generate more contribution, which would then
25 be beneficial to the Postal Service and then to other

1 customers to the extent that it raises their total
2 contribution from this mailer.

3 I don't see why you would want to prevent
4 yourself from getting more. If the volume is less the
5 cap of 700 is immaterial since you don't reach it, so
6 I don't see why that necessarily argues that you
7 should have a volume cap of 700.

8 Q Well, that's a cap on the volume eligible
9 for discounts, right?

10 A Correct.

11 Q It's not a cap that says a mailer can't mail
12 more than 700 million.

13 A Let me see if I understand your hypothesis.
14 There might be some exogenous factor that drives
15 volume higher independent of the discount. Is that
16 your argument?

17 Q Yes. Exactly.

18 A I see there then your point would be that
19 you would get that 50 million or whatever the number
20 might be anyhow.

21 Q Exactly.

22 A Well, I can see your argument there in that
23 regard.

24 Q Essentially there would be leakage, correct?

25 A Yes. However -- okay. I'll accept that.

1 Q In this illustration isn't the real
2 difficulty in setting the threshold?

3 A No. I'm not sure that the real difficulty
4 is setting the threshold, but that is one of the
5 difficulties involved in NSAs in general.

6 Q Well, in this illustration the range of
7 possible before rates volumes is from 450 to 700,
8 correct?

9 A Correct.

10 Q Setting the threshold at 450 leaves the
11 Postal Service open to leakage, correct?

12 A Correct, to the extent; that the before rates
13 volume might be greater than 450.

14 Q Would you agree that in this illustration
15 the only party to the NSA who actually risks a loss is
16 the Postal Service?

17 A Well, give me a second there. That may be
18 true, the other party being Washington Mutual. Yes, I
19 think that's true.

20 Q Now could you look at Table 4 on page 43?
21 Now we have the reverse situation in terms of what's
22 known and what isn't?

23 A Correct.

24 Q And here again the known volume is simply
25 the volume resulting from the NSA and does not include

1 any exogenous factors?

2 A The known volume here is the before rates
3 volume, which is the volume in the absence of the NSA

4 Q Thank you. In spite of calling the before
5 rates volume known, the possibility exists that an
6 exogenous factor might push that volume up during the
7 period of the NSA?

8 A Up or down? Well, then that's not
9 technically what the definition of the before rates
10 volume is.

11 If you're saying that the before rates
12 volume could be some number other than 450 then that
13 would be true. Before rates volume is the volume that
14 would occur in the absence of the NSA given whatever
15 other drivers of volume exist.

16 Q It's a forecast, right?

17 A Yes, I suppose we could say that.

18 Q And I guess what is being assumed here is
19 that it's an extremely accurate forecast given the
20 values of other exogenous factors? Would that be
21 right?

22 A It's taken as a given, yes.

23 Q But it does assume certain values for
24 exogenous factors?

25 A Implicitly.

1 Q If an exogenous factor were to cause a
2 demand curve to shift to the right, that would be true
3 for both the before and after rates volumes, correct?

4 A Correct.

5 Q So I would ask you to assume that in fact
6 there is an exogenous shift causing volumes to
7 increase by 50.

8 A I can assume that.

9 Q Now, if there is no cap the volume of mail
10 receiving discounts would increase by 50, correct?

11 A In that case, yes. You're saying that if
12 the before rates volume is 500 and the threshold is
13 450?

14 Q Yes.

15 A Yes.

16 Q And without a cap the mail receiving
17 discounts would increase by 50, correct?

18 A That is correct.

19 Q And again, this increase in volume would
20 have occurred whether there was an NSA or not,
21 correct?

22 A By your assumptions, yes.

23 Q So is it correct that both of your tables, 4
24 and 5, are implicitly assuming no change in any
25 exogenous factors?

1 A No change. It's not already incorporated in
2 the volumes there.

3 Q Well, isn't that kind of a change what a
4 volume cap is supposed to protect against?

5 A It may be.

6 Q Could you turn to Figure 1 on page 37? Now,
7 you've already made a change to your testimony on this
8 page.

9 A Uh-huh.

10 Q And I'm assuming that's as a result of the
11 **POIR?**

12 A Yes, it is.

13 Q Is it correct that once WMB mails 500
14 million first class worksharc solicitation pieces it's
15 free of any constraint?

16 A I believe so, yes. I'm sorry. First class
17 solicitation pieces?

18 Q Right.

19 A Yes.

20 Q And the year one forecast for WMB is 593
21 million? Is that correct?

22 A Yes, I believe so.

23 Q So when you get out Eo that level of volume
24 the only factor affecting that volume is the level of
25 the discount?

1 A At that point, yes.

2 Q Could you turn to page 15, the bottom
3 paragraph?

4 A Uh-huh.

5 Q At lines 18 and 19 you say that the reduced
6 price for first class workshared letters causes first
7 class volume to go up. Is that right?

8 A I don't say it exactly like that, but
9 that's --

10 Q Is that what you mean?

11 A -- what I'm saying, yes.

12 Q And then at lines 21 and 22 you say that the
13 increased use of first class workshare causes a
14 reduction in standard. Is that a correct paraphrase?

15 A Yes.

16 Q Is that a one-for-one reduction?

17 A It does not have to be.

18 Q I would ask you to assume that the ratio is
19 actually one to 1.2.

20 A One piece of first class and 1.2 pieces of
21 standard?

22 Q Right.

23 A Okay. I can assume that.

24 Q Would it be correct to say that every new
25 piece of first **class** workshare generated by the NSA

1 would mean a sacrifice of 1.2 pieces of standard?

2 A Given your one to 1.2 assumption, yes, it
3 would mean that.

4 Q And would it also be correct to say that the
5 contribution gained on a piece of first class
6 workshare comes at the cost of the contribution from
7 1.2 standard pieces?

8 A Again given your assumption, yes.

9 Q **And** a financial analysis of the NSA should
10 take that into account?

11 A Well, that's an assumption that you're
12 making, and I guess it's subject to how you view that
13 assumption. It could be a factor.

14 MR. COSTICH: Thank you. I have no
15 questions, Mr. Chairman. In fact I do have.

16 CHAIRMAN OMAS: Proceed.

17 BY MR. COSTICH:

18 Q If we could go back to the 593 million
19 forecast?

20 A Okay.

21 Q That was a forecast for FY 2006, correct?

22 A I believe so, yes.

23 Q And FY '06 is over, correct?

24 A Yes, it is.

25 Q Do you happen to know what Washington

1 Mutual's actual volumes were for fiscal year '06?

2 A No, not for the full year. No, I don't.

3 MR. COSTICH: Mr. Chairman, could I ask that
4 the Postal Service or WMB provide **WMB's** volumes, both
5 marketing and customer, for fiscal year **2006**?

6 CHAIRMAN OMAS: Is that possible?

7 MR. HESELTON: **Yes**, Mr. Chairman. The
8 Postal Service will obtain those figures and supply
9 them to the Commission.

10 CHAIRMAN OMAS: Thank you. Could we get
11 that in seven days, please?

12 MR. HESELTON: We will take that as a target
13 that we will use our best efforts to meet, Mr.
14 Chairman.

15 CHAIRMAN OMAS: Thank you.

16 MR. COSTICH: Can we be explicit that we're
17 asking for the customer first class volume, the
18 solicitation first class volume and any standard
19 solicitation volume?

20 MR. HESELTON: If available for those
21 breakdowns, we will supply them.

22 CHAIRMAN OMAS: Thank you, Mr. Heselton.
23 Is there anything else, Mr. Costich?

24 MR. COSTICH: No. Thank you.

25 CHAIRMAN OMAS: Thank you.

1 Is there any other cross-examination for
2 Witness Bernstein?

3 (No response.)

4 CHAIRMAN OMAS: Mr. Bernstein, I need some
5 clarification. I would like to be sure that I
6 understand the penalty provisions you discuss in your
7 answer to Question 5(a) of the POIR.

8 If you don't know the answer just say so,
9 but am I correct that the penalty for not meeting the
10 500 million piece requirement is optional; that is,
11 the Postal Service may waive the penalty if it
12 chooses?

13 THE WITNESS: Chairman, I was not the one
14 who answered 5(a). I answered 5(b), so perhaps I'm
15 not the best one to answer your question there.

16 CHAIRMAN OMAS: Well, is there someone from
17 the Postal Service that could get that answer to me?
18 I would be most appreciative.

19 MR. HESELTON: We will undertake to provide
20 that answer, Mr. Chairman.

21 CHAIRMAN OMAS: Thank you.

22 Also I have one other question, and
23 obviously I don't know that that was 5(b). I'm sure
24 it's still 5(a). Also, am I correct that Washington
25 Mutual will earn discounts for volumes above 450

1 million pieces which may in part offset that penalty?

2 THE WITNESS: Again, first of all, I believe
3 the threshold is 490 million.

4 CHAIRMAN OMAS: Okay. Well, 490 million.

5 THE WITNESS: Again, I think you are
6 correct, but I am not the one who answered 5(a) so I
7 probably should not be taken as the authority there.

8 CHAIRMAN OMAS: Okay. Can we get that?

9 MR. HESELTON: The Postal Service would be
10 happy to provide you with the answer to that question
11 also, Chairman Omas.

12 CHAIRMAN OMAS: I would appreciate that very
13 much. It's been a little sort of murky. We can't
14 fully understand it.

15 Thank you very much. We appreciate your
16 cooperation.

17 MR. HESELTON: Thank you.

18 CHAIRMAN OMAS: Are there any other
19 questions from the bench?

20 (No response.)

21 CHAIRMAN OMAS: There doesn't seem to be
22 any.

23 Are there any follow-up questions, Mr.
24 Costich?

25 (No response.)

1 CHAIRMAN OMAS: Mr. Heselton, would you like
2 some time with your witness?

3 MR. HESELTON: Yes, Mr. Chairman. If we
4 could take a break of about 10 minutes, we'd
5 appreciate it.

6 CHAIRMAN OMAS: Very good. Ten minutes.
7 We'll be back here at 10:15.

8 (Whereupon, a short recess was taken.)

9 CHAIRMAN OMAS: Mr. Heselton?

10 REDIRECT EXAMINATION

11 BY MR. HESELTON:

12 Q Mr. Bernstein, during the course of the
13 cross-examination you were asked a number of questions
14 with regard to exogenous factors and the impact of
15 these factors on the demand curves involved here in
16 the analysis.

17 Those questions, many of them were premised
18 on an assumption of an increase in volumes resulting
19 from the impact of those exogenous factors. Do you
20 have anything additional to add to the discussion?

21 A Yes. I think that the element of exogenous
22 factors is that they could conceivably cause an
23 increase or a decrease in volumes, and to the extent
24 that they would cause a decrease in volumes then you
25 have a different dynamic going on.

1 Part of the dynamic is that the NSA, by
2 granting discounts, would encourage the mailer to
3 increase their volume to offset whatever those
4 negative exogenous factors might be.

5 Q Okay. Also during the course of discussion
6 of exogenous factors those factors were mentioned with
7 regard to the range of volumes beginning at 450
8 million and up to volumes of 700 million.

9 30 you have any additional thoughts with
10 regard to that range?

11 A Well, a number of things. You know, these
12 were hypothetical numbers. I would suspect that a
13 before rates volume of 700, which I put for
14 illustration, would seem to be rather unlikely.

15 There's not a uniformity to the range there
16 given the history of volumes. I would say that that
17 is more an illustration of an extreme case, so that's
18 one consideration.

19 A second consideration is that there
20 certainly is uncertainty about the before rates volume
21 and the after rates volume, and therefore another
22 thing that needs to be considered is the difference or
23 the percentage difference between the two in that
24 these exogenous factors, positive or negative, are
25 going to affect both in some way and so what

1 ultimately in many ways determines the value of the
2 NSA is the difference between those, the increase in
3 volume that is generated by the discounts.

4 Considering the hypothetical presented
5 earlier, if the before rates volume is for some reason
6 higher the after rates volume is higher, but what's
7 important is the difference between those two, and the
8 larger that difference the greater additional volume
9 is generated by the NSA, and to the extent that there
10 might be some leakage if the before rates volume is
11 higher the greater that additional volume, the more
12 offset and additional contribution.

13 To the extent that the exogenous factors
14 cause volume to decrease, again the greater is the
15 recovery of volumes through the effect of the discount
16 so I guess the concluding point then is that we need
17 to think about the difference between the two in
18 response to the NSA.

19 MR. HESELTON: Mr. Chairman, that completes
20 the Postal Service's redirect.

21 CHAIRMAN OMAS: Thank you, Mr. Heselton.

22 Thank you, Mr. Bernstein. That completes
23 your testimony here today. We appreciate your
24 contribution and your appearance. You are now
25 excused.

1 THE WITNESS: Thank you.

2 (Witness excused.)

3 CHAIRMAN OMAS: Ladies and gentlemen, this
4 concludes today's hearing, and we are now adjourned.
5 Have a great day.

6 (Whereupon, at 10:23 a.m. the hearing in the
7 above-entitled matter was concluded.)

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DOCKET NO.: MC2006-3
CASE TITLE: Washington Mutual Bank USA
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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: 11/9/06



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