

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

RATE AND SERVICE CHANGES TO IMPLEMENT
BASELINE NEGOTIATED SERVICE AGREEMENT
WITH BOOKSPAN

Docket No. MC2005-3

RESPONSE OF UNITED STATES POSTAL SERVICE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 2

The United States Postal Service hereby provides the responses of its witnesses to Presiding Officer's Information Request (POIR) No. 2, issued on August 24, 2005. Witness Plunkett is responding to question 1.a., 1.b (excluding the last sentence which Bookspan answers), 1.c. (excluding the last sentence which Bookspan answers), 1.d. (excluding the first sentence which Bookspan answers), 1.e.ii., and 3. Witness Yorgey is responding to questions 2 and 4. Bookspan is also providing the answer to 1.e.i.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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1. Please refer to Request of the United States Postal Service for a Recommended Decision on Classifications and Rates to Implement a Baseline Negotiated Service Agreement with Bookspan, Attachment A (proposed Domestic Mail Classification Schedule language). Section 620.11 states in part: "Eligible Standard Mail under this section is defined as letter shaped pieces sent by Bookspan for the purposes of soliciting book club membership of persons who are not current subscribers to the book club or clubs Bookspan is promoting in the mailing or to book club members whose membership is expiring."

Also, please refer to Request of the United States Postal Service for a Recommended Decision on Classifications and Rates to Implement a Baseline Negotiated Service Agreement with Bookspan, Attachment F (Negotiated Service Agreement Between the United States Postal Service and Bookspan). Section I.A. states in part: "In the last three government fiscal years, Bookspan mailed an average of 87 million Standard Mail letters to consumers who were not the subscribers to the book club or clubs Bookspan was promoting in the mailing and to book club members whose membership was expiring. For the purposes of this agreement, the term 'Bookspan Letter Mail Solicitations' shall mean Standard Mail solicitation letters sent by Bookspan, by entities in which Bookspan holds controlling shares, and by their vendors on their behalf."

Finally, please refer to Response of Bookspan to Presiding Officer's Information Request No. 1, August 10, 2005, Response 4(c) states in part: "Finally, and perhaps most importantly, the volumes set forth below include letter mail sent by Bookspan to existing members and, therefore, ineligible for the NSA."

The three sources cited above appear inconsistent in describing what types of Bookspan's Standard Mail letters are eligible for mailing under the terms and conditions of the Negotiated Service Agreement. For example, the response to POIR No. 1 part 4(c) infers that "existing" members of a Bookspan book club are not eligible to receive mailings under the terms and conditions of the Negotiated Service Agreement. The DMCS language appears to describe mailings to existing customers. The contract does not place a restriction on mailing to existing customers. As another example, the contract appears to limit mailing to "solicitations" type mailings. However, it is not clear whether a mailing "to book club members whose membership is expiring," as written in the proposed DMCS language, must be a solicitations type mailing.

- a. If there is a conflict between the requirements appearing in the Domestic Mail Classification Schedule language (Request, Attachment A) and the requirements appearing in the Negotiated Service Agreement contract (Request, Attachment F), how is the conflict resolved? Does the Domestic Mail Classification Schedule language take precedence? Please explain.
- b. Please describe the characteristics of Bookspan's Standard Mail that is eligible for mailing under the terms and conditions of the Negotiated Service Agreement. Is eligible Standard Mail limited to "solicitations" mail? Please describe the

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characteristics of Bookspan's Standard Mail that is not eligible for mailing under the terms and conditions of the Negotiated Service Agreement.

c. Please confirm that "book club members whose membership is expiring" are existing members of a Bookspan book club. If this is a correct interpretation, will such existing members be eligible to receive Standard Mail under the terms of the Negotiated Service Agreement? At what point in time is the status of a member of a Bookspan book club changed from an "existing member" to an existing member "whose membership is expiring?"

d. Please confirm that Bookspan uses Standard Mail for solicitations to more than one book club. If this is a correct assumption, please indicate whether existing members of one book club may receive Bookspan solicitations for a second (unrelated) book club under the terms of the Negotiated Service Agreement.

e. Witness Posch states that: "A current member receives 16 to 19 Standard Mail letters per year offering the cycle's Featured Selection as well as other club selections and offerings." Bookspan-T-1 at 4.

- i. Under what circumstances do these mailings solicit "book club membership of persons who are not current subscribers to the book club or clubs Bookspan is promoting in the mailing?"
- ii. Under what circumstances are these mailings eligible for mailing under the terms of the Negotiated Service Agreement?

RESPONSE:

a. There is no conflict between the requirements in the contract and the DMCS language. First, it is not clear why a reader would infer that the answer to POIR 1, question 4(c) was a comment on the terms of the contract. Rather, it was a response to a Commission request for Bookspan's historical Standard Mail volumes in 2001 and 2002. In no way did witness Epp "[imply] that 'existing' members of a Bookspan book club are not eligible to receive mailings under the terms and conditions of the Negotiated Service Agreement." Rather, he provided a caveat for the very purpose of

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differentiating the volumes he presented in response to the Commission's question from those subject to the NSA.

Second, the DMCS language limits all discounts to Standard Mail solicitation letters. A mailing "to book club members whose membership is expiring" would not be eligible unless it is composed of Standard Mail letters soliciting book club membership. Any lack of clarity that might be perceived in that regard could be removed by changing "to book club members whose membership is expiring" to "of book club members whose membership is expiring." The Postal Service would have no objection if the Commission recommended the change of "to" to "of" in its recommended decision.

b. Eligible mail must be sent Standard Mail. It must be letter shaped. It must solicit membership in a book club from among non-subscribers of that particular book club or from members whose membership in that club is expiring. In the latter regard, it must be a solicitation letter comparable to those sent to nonmembers.

c. Although the second question was worded in terms of recipients' "eligibility" to receive mail, the real import is whether such mail is counted in the volumes and potentially eligible for discounts under the NSA. If that is what the next question meant to address—Will Standard Mail solicitation letters sent to existing members whose membership is expiring be counted and eligible?—the answer is yes.

Bookspan will provide an answer to the question of at what point in the membership cycle they solicit renewals. Presumably, Bookspan judges what the appropriate timing is to maximizing renewals. Since maximization of renewals benefits the Postal Service as well, the Postal Service did not see the need for the agreement to

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have defined or restricted the timing of renewal solicitations, which may or may not be the implication of the question.

d. Bookspan's answer will address the use of solicitation mailings for various book clubs, but it is the Postal Service's understanding that it uses them for more than one book club. Otherwise, the issue of cross-solicitation would not have come up and would not be specifically mentioned in the agreement. In that regard, we come to the answer to the final question in this part, which we interpret to mean: "Are Standard Mail solicitation letters sent to members of one book club to join another second (unrelated) book club eligible for be counted and potentially receive discounts under the terms of this agreement?" The answer to that question is yes.

e. ii. Under no circumstances are the periodic club mailings offering the cycle's Featured Selection as well as other club selections and offerings eligible to be counted and possibly receive discounts under the agreement, even if they contain solicitations to renew membership in that club or to join other clubs. The purpose of the agreement is to generate *additional* solicitation volumes.

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2. Please refer to the Request, Attachment F, Section II.F. (page 4) (Bookspan NSA) which sets forth the Merger and Acquisition provisions of the Bookspan NSA. In relevant part, the Bookspan NSA, Section F states: “[i]f the merger or acquisition results in a material increase as described herein, the Standard Mail volume blocks will be adjusted to add the volume of Standard Mail sent by the acquired entity during the 12 months preceding the merger or acquisition.” In light of this language, and the rest of the agreement: if a merger or acquisition results in a material increase as defined in Section F of the Bookspan NSA and volume blocks are adjusted to add the volume of Standard Mail sent by the acquired entity, will there be a corresponding adjustment to the volume commitment levels? If so, please quantify that adjustment. If not, please explain why not.

RESPONSE:

There is no adjustment level to the volume commitments in the event of a merger.

There are already clauses in the agreement that protect the Postal Service from the increase in volume due to mergers. These provision include a cap on the total amount of pieces that may be discounted, a 30-day termination clause, and restriction on the content of mailings eligible for the discount.

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3. In Attachment 1 to the response to POIR No. 1, witness Yorgey presents the results of the Postal Service's estimates of Bookspan's before rates volumes using monthly, quarterly, and yearly trend analysis. Also, the response to POIR No. 1 question 1(c) states that the Postal Service's analysis "does not indicate that any particular portion of Bookspan's mail is likely to exhibit demand characteristics that differ fundamentally from those of the subclass to which it belongs."

a. Please confirm that Table 1 below shows the financial impact of the proposed NSA on the Postal Service as estimated by USPS-T-2, Appendix A, with the following modifications (presented in Attachment A):

- Before rates volumes are set equal to the results of the Postal Service's yearly trend forecast (response to POIR No. 1, Attachment 1, page 1 of 3), adjusted downward for the response to the R2005-1 proposed rate increase.
- Bookspan's after rates volumes are estimated using the elasticities of Standard Regular and ECR, weighted by Bookspan's FY 2004 "new member solicitation" letter volumes.
- All increased volume in response to the discounts is assumed to be new volume (*i.e.*, not at the expense of reduced flats volume).

Table 1.

| | FY2006 | FY2007 | FY2008 | Total |
|--|-------------------|--------------------|-------------------|-------------------|
| (1) Contribution from new Standard letter mail | \$ 340,830 | \$ 345,453 | \$ 348,492 | 1,034,776 |
| (2) Contribution from Standard non-letter mail converted to Standard letter mail | \$ - | \$ - | \$ - | - |
| (3) Total New Contribution | \$ 340,830 | \$ 345,453 | \$ 348,492 | 1,034,776 |
| (4) Total Discount Exposure | \$ 156,833 | \$ 288,380 | \$ 139,927 | 585,140 |
| (5) Total Incremental Discounts | \$ 66,458 | \$ 69,665 | \$ 72,873 | 208,996 |
| (6) Total USPS Value | \$ 117,539 | \$ (12,592) | \$ 135,693 | \$ 240,640 |

b. Please confirm that Table 2 below presents the financial impact of the proposed NSA on the Postal Service as estimated by USPS-T-2, Appendix A, modified as described in subpart (a) above, except using the results of the Postal Service's quarterly trend forecast (response to POIR No. 1, Attachment 1, page 2 of 3). The calculations are presented in Attachment B.

Table 2.

| | FY2006 | FY2007 | FY2008 | Total |
|--|-------------------|---------------------|-----------------|---------------------|
| (1) Contribution from new Standard letter mail | \$ 366,336 | \$ 573,668 | \$ 594,089 | 1,534,093 |
| (2) Contribution from Standard non-letter mail converted to Standard letter mail | \$ - | \$ - | \$ - | - |
| (3) Total New Contribution | \$ 366,336 | \$ 573,668 | \$ 594,089 | 1,534,093 |
| (4) Total Discount Exposure | \$ 298,781 | \$ 501,953 | \$ 423,823 | 1,224,558 |
| (5) Total Incremental Discounts | \$ 71,431 | \$ 173,532 | \$ 168,256 | 413,219 |
| (6) Total USPS Value | \$ (3,877) | \$ (101,817) | \$ 2,010 | \$ (103,684) |

c. Please confirm that Table 3 below presents the financial impact of the proposed NSA on the Postal Service as estimated by USPS-T-2, Appendix A, modified as described in subpart (a) above, except using the results of the Postal Service's monthly trend forecast (response to POIR No. 1, Attachment 1, page 3 of 3). The calculations are presented in Attachment C.

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Table 3.

| | FY2006 | FY2007 | FY2008 | Total |
|--|--------------------|---------------------|---------------------|---------------------|
| (1) Contribution from new Standard letter mail | \$ 385,194 | \$ 629,038 | \$ 674,509 | 1,688,741 |
| (2) Contribution from Standard non-letter mail converted to Standard letter mail | \$ - | \$ - | \$ - | - |
| (3) Total New Contribution | \$ 385,194 | \$ 629,038 | \$ 674,509 | 1,688,741 |
| (4) Total Discount Exposure | \$ 403,734 | \$ 820,655 | \$ 885,710 | 2,110,100 |
| (5) Total Incremental Discounts | \$ 75,108 | \$ 190,281 | \$ 211,569 | 476,959 |
| (6) Total USPS Value | \$ (93,648) | \$ (381,899) | \$ (422,770) | \$ (898,317) |

- d. Please confirm that the financial impact of the proposed NSA on the Postal Service as estimated by USPS-T-2, Appendix A, modified as described in subpart (a) above, except using the before rates volume forecasts originally included in the Postal Service's analysis (USPS-T-2, Appendix A, page 2), would include no discounts being paid, no increase in volume, and therefore no impact on the Postal Service's finances. If not, please provide the calculations showing the impact on the Postal Service's finances under these assumptions.

RESPONSE:

- a.-d. Confirmed that the indicated adjustments and calculations yield the results displayed above. However, it should be noted that Mr. Thress' elasticity estimates do not take into account cross-price effects between letters and non-letters for either Standard Regular or Standard Regular ECR. For a mailer such as Bookspan, who sends both letters and flats for similar purposes (in this case, to recruit new book club members), changes in the relative prices of letters and flats would be expected to engender shifts in the relative amounts of each type of mail used. Indeed, witness Epp's (Bookspan-T-2) testimony indicates that relative cost plays an important role in determining the distribution of resources and, therefore, the mix of media (including mail) used. By specifically excluding this effect, the calculations above underestimate the true value of the NSA to both Bookspan and the Postal Service.

Additionally, the calculations above imply a highly restrictive interpretation of the average price elasticity calculated for Standard Regular and Standard Regular ECR mail by Mr. Thress. As stated by witness Plunkett in response to interrogatory

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OCA/USPS-T1-16d, it is quite possible that the price elasticity of Bookspan's new-member marketing mail deviates from the averages of the Standard Mail subclasses, even substantially, without that demand being fundamentally different from those subclasses as a whole. Bookspan's new-member marketing mail is a very small portion of total Standard Regular Mail (approximately $\frac{1}{3}$ of one percent in FY 2004). As such, particular characteristics of Bookspan's mail cannot be taken to represent the Standard Regular Mail subclasses as a whole, and the average characteristics of the Standard Regular Mail subclasses cannot be expected necessarily to well represent Bookspan's mail.

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4. In the response to POIR No. 1, question 1(a)(i) and (ii), witness Yorgey indicates that the results of the trend analysis provided in that response represent "initial forecast ranges." The response goes on to state that later efforts "refined the analysis using different volume assumptions to make alternative forecasts."
- a. Do the results provided in response to POIR No. 1 represent the Postal Service's best independent estimates of Bookspan's before rates volumes?
- b. If not, please provide the Postal Service's best independent estimates of Bookspan's before rates volumes, including supporting documents and electronic workpapers (e.g., Excel spreadsheets). Please include a presentation of the calculation of any adjustments to the inputs or outputs and explain the rationale for any such adjustments

RESPONSE:

As I indicated in my response to POIR No. 1, question 1.a., I developed "forecast ranges," but did not develop a specific point forecast. The best available point forecast, as described previously, are the forecasts provided by Bookspan in the current filing. Based on the ranges I developed, it is probable that the Bookspan estimate is the best available forecast based on the existing data.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

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