

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

POSTAL RATE AND FEE CHANGES, 2006

Docket No. R2006-1

RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS KIEFER
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.,
(VP/USPS-T36-12(a), (c), (d), 13 -18, 20))

The United States Postal Service hereby files the responses of witness Kiefer to above-listed interrogatories, filed on July 7, 2006. Interrogatory part 12(b) has been redirected to the Postal Service and Interrogatory 19 has been redirected to witness Berkeley, Each interrogatory is stated verbatim and are followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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VP/USPS-T36-12. Please refer to the discussion in your testimony concerning flats that will use the proposed NFM rate in Regular Standard, including page 5, beginning on line 13, page 15, beginning on line 17, and the section beginning on page 21, line 17.

- a. Is it possible to trace the origins of the pieces paying the proposed NFM rates and state what proportion of them came from one or another current rate category, such as one portion coming from automation flats and another portion coming from non-automation flats? If so, please provide the proportions.
- b. In view of your statement on page 5, line 13, that the "definitions of flats will be changed," please outline the requirements for a flat to use the proposed rates for the new non-automation flats category.
- c. Please explain the extent to which the proposed non-automation flats category will be, in effect, a category of machinable flats.
- d. In line with the new definition of flats, which may be a category of machinable flats (see part c), please identify the costs in your testimony or in library references providing costs that apply to the new non-automation flats category, including a discussion of how well the costs apply.

RESPONSE:

- a. Please see my worksheet WP-STDREG-9. I used these proportions to obtain my estimated volumes for NFM pieces from the forecasts of current nonletter rate categories.
- b. Redirected to the Postal Service.
- c. While the Postal Service expects that most of the pieces that will remain nonautomation flats will be machinable, there may be some that meet the nonautomation flats criteria but remain nonmachinable. I do not know what share of total nonautomation flats will be machinable or nonmachinable.
- d. The costs associated with nonautomation flats can be found in my Inputs worksheet in cells D125, D126, D127, D128 and D153. The costs in these cells are estimated unit costs for existing nonautomation flats. According to the redefinition matrix in my workpaper WP-STDREG-9, more than 89 percent of currently categorized nonautomation flats will continue to be categorized as nonautomation flats. How many of that 89 percent are machinable, I do not know. I do not know

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what impact, if any, the recategorization of the remaining 11 percent might have on the estimated unit costs for nonautomation flats.

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VP/USPS-T36-13. Please refer to your workbook WP-STDECR.xls in USPS-LR-L-36, tab 'Inputs,' cell D55.

- a. Please confirm that the source of the volume in the formula in subject cell is, essentially, ADVO-LR-1, Docket No. R2005-1, and that its entire basis for it is commercial volume. If you do not confirm, please describe the basis for the figure you use.
- b. Please provide the justification for applying the ratio in cell D55 to Nonprofit ECR volumes.

RESPONSE:

- a. I received the estimated number of DALs from witness Kelley (USPS-T-30).
Witness Kelley informs me that he derived the estimate of 4.6 billion DALs using ADVO-LR-1, Docket No. R2005-1 as a starting point. He also informs me that the 4.6 billion figure was his estimate for the base year, rather than the test year as I had formerly understood it. Applying this estimate to the base year Saturation nonletter volumes yields a DAL usage fraction of 41.42 percent, slightly higher than the 40.16 percent figure I used in my revenue calculations. The impact of using the higher estimate on Standard Mail revenues would not be substantial.
- b. The estimate I received from witness Kelley did not specify what proportion of the DALs was used with commercial volumes and what proportion was used with nonprofit volumes. At the time I received the estimate I thought it reasonable to prorate these DALs between the commercial and nonprofit subclasses based on applicable volumes. Even if one were to assign 100 percent of the DAL count (and the consequent surcharge revenue) to the commercial subclass, the nonprofit to commercial average revenue ratio would not change substantially.

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VP/USPS-T36-14. Please refer to your workbook WP-STDREG-R0621-POIR5-Q3-Resp.xls in USPS-LRL- 148, part of the Postal Service's response to Question 3 of POIR No. 5, and to cell D115 of tab 'Inputs.'

- a. Please confirm that the source of the cost in cell D115 is cell G44 on tab 'CRA ADJ UNIT COSTS' in workbook STD REG FLATS.xls in USPS-LR-L-43. If you do not confirm, please provide the correct source and describe the characteristics of the cost, e.g., whether it is a workshare-related cost.
- b. Please explain whether the cost in cell D115 is a workshare-related cost of the kind usually used to help set automation discounts.
- c. Please explain whether the cost in cell G20 of tab 'PRESORT LEVELS HELD CONSTANT' in the same USPS-LR-L-43 workbook is a workshare-related unit cost that would be appropriate for calculating passthroughs for automation flats.

RESPONSE:

- a. Confirmed.
- b. The referenced cost is a total mail processing unit cost, which is a sum of proportional unit cost (sometimes referred to as modeled worksharing related cost) and fixed unit cost (sometimes referred to as non-worksharing related cost) for nonautomation Mixed ADC flats. It is the same as the total mail processing unit cost for nonautomation Mixed ADC flats shown on page 75 of USPS-LR-L-43 (tab: PRESORT LEVELS HELD CONSTANT) that is used to help set automation discounts.
- c. The referenced cost is a total mail processing unit cost, which is a sum of proportional unit cost (sometimes referred to as modeled worksharing related cost) and fixed unit cost (sometimes referred to as non-worksharing related cost) for automation Mixed ADC flats having the same mail characteristics as nonautomation flats. It is used, in conjunction with the corresponding costs for nonautomation flats, to help set automation discounts. Therefore it is appropriate to use it in calculating the passthrough of cost differences between automation and nonautomation flats.

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VP/USPS-T36-15. Please refer to your workbook WP-STDREG-R0621-POIR5-Q3-Resp.xls in USPS-LRL- 148, part of the Postal Service response to Question 3 of POIR No. 5, and to cell D125 of tab 'Inputs.'

- a. Please confirm that the source of the cost in cell D125 is cell G36 on tab 'CRA ADJ UNIT COSTS' in workbook STD REG FLATS.xls in USPS-LR-L-43, and that this cost (1) is a total cost and not a workshare-related cost, and (2) is a weighted average of costs for machinable and non-machinable pieces. If you do not confirm, please state a different source and describe the characteristics of the cost, e.g., whether it is a workshare-related cost and whether it is a weighted average of machinable and non-machinable pieces.
- b. If you confirm part a, please explain (1) the applicability of a total cost instead of a workshare-related cost to calculating the passthrough between nonautomation flats and automation flats, and (2) whether a corresponding workshare-related cost is available.
- c. If you agree that the cost in cell D125 is a weighted average of costs for machinable and non-machinable flats, please explain whether a similar cost is available for machinable flats, which would correspond to the machinable flats category in the Regular rates you propose.

RESPONSE:

- a. It can be confirmed that the referenced cost is a total mail processing unit cost and therefore it is the sum of both proportional unit cost (sometimes referred to as modeled worksharing related cost) and fixed unit cost (sometimes referred to as non-worksharing related cost) for nonautomation Mixed ADC flats. It is therefore not identical to modeled worksharing related cost. It is a total unit cost for all pieces, both machinable and nonmachinable. As I understand it, it was not developed from separate unit costs for both machinable and nonmachinable pieces, so in that strict sense it is not a weighted average unit cost, although as a total unit cost it should be equivalent to a weighted average unit cost.
- b. (1) Given that the non-worksharing related unit cost (i.e. fixed unit cost) component of the total cost is the same for both automation and nonautomation flats (as can be readily seen in USPS-LR-L-43), the differences between the total costs is identical to the difference between the worksharing related unit cost components (i.e. proportional unit cost components). Hence using total unit costs gives the

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same result as using proportional unit cost (i.e. worksharing related unit cost) differences for calculating passthroughs of cost differences.

(2) Please see my response to part (a).

- c. Please see my response to part (a). It is my understanding that separate costs are not available for machinable and nonmachinable flats.

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VP/USPS-T36-16. Please refer to your workbook WP-STDREG-R0621-POIR5-Q3-Resp.xls in USPS-LRL- 148, part of the Postal Service response to Question 3 of POIR No. 5, and to cell D108 of tab 'Inputs.'

- a. Please confirm that the cost figure in cell D108 is a weighted average of the cost of machinable and non-machinable letters, at the mixed AADC level. If you do not confirm, please provide a specific source for this cost and outline its characteristics.
- b. Acknowledging your response to part a, please explain, one part at a time, with particularity, the applicability of the cost in cell D108 to:
 - (i) the cost used in cell X7 of tab 'Presort Tree' for machinable letters;
 - (ii) the cost used in cell V9 of tab 'Presort Tree' for machinable letters at the mixed AADC level;
 - (iii) the cost used in cell R9 of tab 'Presort Tree' for non-machinable letters at the mixed AADC level;
 - (iv) the cost used in cell P7 of tab 'Presort Tree' for non-machinable letters;
 - (v) the cost in cell D34 of tab 'Proposed Rates' for machinable letters at the mixed AADC level; and
 - (vi) the cost in cell D39 of tab 'Proposed Rates' for non-machinable letters at the mixed AADC level.

RESPONSE:

- a. Confirmed.
- b. (i) The cell D108 figure was used in cell X7 since it was also used to make the comparison between the Mixed AADC nonautomation machinable letters and AADC nonautomation machinable letters. The latter used the cost figure in cell D111 which was also not disaggregated by machinability. In that case I chose to maintain consistency within the branch of the tree rather than across the separate branches of the tree. (See my response to POIR5, Question 3(a).) While I could also have used two different figures for Mixed AADC nonautomation machinable letters, I chose to use the same cost data for both within and across branch comparisons. I recognize that other analysts may make different choices in this matter.
 - (ii) Please see my response to subpart (i). I chose to use the data in D108 to maintain consistency within the nonautomation machinable letters branch of the tree. I recognize that other analysts may make different choices in this matter.

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(iii) Please see my responses to subparts (i) and (ii). I chose to use the figure in D108 in the comparison shown in cell R9 to maintain consistency with the nonmachinable letters branch of the tree. I recognize that other analysts may make different choices in this matter.

(iv) Please see my responses to subparts (i) and (iii). I chose to use the cell D108 figure to make the comparison between the Mixed ADC nonmachinable letters and Mixed ADC nonautomation flats to maintain consistency between the cost data used in the nonmachinable letters branch of the tree and across the separate branches of the tree. I recognize that other analysts may make different choices in this matter.

(v) The comparison in question used the figure in Inputs cells D108 and D111. As described in response to subpart (i), both of these cost data were consistent with each other since they both reflected weighted average costs. I used these figures as guides in developing my proposed pricing for nonautomation letters, specifically the presort price differential between Mixed AADC and AADC letters. I also used these same data as a guide in developing the presort component of the price differential between Mixed ADC and ADC presorted nonmachinable letters. In this way the pricing for both sets of letters used a consistent reference point for the presort differences proposed in the proposed rates.

(vi) Please see my responses to subpart (v). As discussed in that response, I used data in Inputs cells D108 and D111 together because they were consistent with each other in that they were both weighted average figures. Additional costs due specifically to nonmachinability were also used to guide the development of the prices for nonmachinable letters including the price differentials between Mixed ADC nonmachinable letters and ADC nonmachinable letters.

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VP/USPS-T36-17. Please refer to your workbook WP-STDREG-R0621-POIR5-Q3-Resp.xls in USPS-LRL- 148, part of the Postal Service's response to Question 3 of POIR No. 5, and to cell D115 of tab 'Inputs.'

- a. Please confirm that the cost figure in cell D115 is not a workshare-related cost. If you do not confirm, please provide a specific source for this cost and outline its characteristics.
- b. Acknowledging your answer to part a, please explain, one part at a time, with particularity, the applicability of the cost in cell D115 to:
 - (i) the cost used in cell P28 of tab 'Presort Tree' for automation flats at the mixed ADC level; and
 - (ii) the cost in cell D54 of tab 'Proposed Rates' for automation flats at the mixed ADC level.
- c. Would you agree that any concerns about the use of the cost in cell D115 would also apply to the costs in cells D116 through D118 of tab 'Inputs'? Please explain if you do not agree.

RESPONSE:

- a. Please see my responses to VP/USPS-T36-14(a) and (b). Since it includes both a worksharing related unit cost and a non-worksharing related unit cost it is not identically a worksharing related cost.
- b.
 - (i) The cost in cell D115 is used in cell P28 of the Presort Tree worksheet, along with the cost in cell D116 (from the Inputs sheet), to establish differences in mail processing unit costs between Mixed ADC automation flats and ADC automation flats. The difference between the figures in D115 and D116 shows the difference in unit mail processing costs between these two presort levels and is appropriate to use to show how much of the cost difference is reflected in the proposed rate differential (i.e. the passthrough) which is the figure reported in cell P28.
 - (ii) The cost in cell D115 is used in cell D54 of the Proposed Rates worksheet, along with the cost in cell D116 (from the Inputs sheet), to establish differences in mail processing unit costs between Mixed ADC automation flats and ADC automation flats. The difference between the figures in D115 and D116 is appropriate to use to help establish the proposed rate differential between these two presort levels.

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- c. My view is that any "concerns" about the use of the cost in D115 in cells P28 of the Presort Tree worksheet and D54 of the Proposed Rates worksheet due to these costs having a fixed (i.e. non-worksharing related) component are unfounded. That view also applies to similar uses of the costs in cells D116 through D118 of the Inputs worksheet.

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VP/USPS-T36-18. Please refer to your response to Question 3 of POIR No. 5, and the included workbook WP-STDREG-R0621-POIR-Q3-Resp.xls in USPS-LR-L-148. All cell references in this question beginning with D will be to tab 'Inputs' and all other cell references will be to tab 'Presort Tree,' unless otherwise specified.

- a. In the presort tree you provided, you did not show a comparison between machinable letters and machinable flats (which seems to be an appropriate name for your category of "Nonautomation Flats"). Please explain whether you believe the relationship between machinable letters and machinable flats to be a key relationship, each allowing corresponding automation categories to be a step further removed, as such removal would be suggested by notions of worksharing.
- b. Drawing on the costs you show in cell P7 for machinable flats, do you agree that the cost of machinable flats is 32.934 cents (calculated by adding the costs in cell D125 and in cell D153)? If you do not agree, please present an improved cost estimate for machinable flats.
- c. Do you agree that the cost of machinable letters equals cell D151 (3.596 cents) plus cell D109 (5.546 cents), which sums to 9.142 cents? If you do not agree, please present an improved cost estimate for machinable letters.
- d. Using the figures in parts b and c, or others you supply, do you agree that the cost of machinable flats is 23.792 cents more than the cost of machinable letters, but that the rate you propose for machinable flats is only 13.9 cents more than the rate for machinable letters, indicating a passthrough of 58.4 percent? If you do not agree, please present improved costs and a corrected passthrough.
- e. Do you agree that rates set in this way imply a substantially higher per-piece contribution from letters than from flats, calculated in the same way as the contributions in the testimony of Postal Service witness Michelle K. Yorgey (USPS-T-2) as developed on pages 2 through 6 of Appendix A, in Docket No. MC2005-3? If you do not agree, please present your own quantitative analysis of the relative contributions of machinable letters and flats as they would exist under the rates you propose.
- f. In terms of economics and fairness and any other ratesetting principles you wish to suggest, please discuss the advocacy of requiring substantially larger perpiece contributions from letters than from flats.

RESPONSE:

- a. In developing presort trees in response to the Commission's request in POIR5, I used a slightly modified version of one of the two tree structures proposed by the Commission. I assume that either or both of the models proposed by the Commission contained all of the relationships the Commission believed to be key relationships. Neither of the proposed models identified the nonautomation flat-nonautomation machinable letter relationships as key relationships. In my

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response to POIR5, question 3(a), I stated my opinion that the key relationships were those within each branch of the tree, rather than those that go across the branches.

- b. Please see my response to VP/USPS-T36-12(d), in particular my assertion that I do not know the proportion of machinable flats in the nonautomation flats category after recategorization. I can confirm that the total mail processing and delivery costs I used in developing rates for origin-entered Mixed ADC nonautomation flats was 32.934 cents, calculated by adding the mail processing and delivery costs in D125 and D153, respectively.
- c. I can confirm that the total mail processing plus delivery cost of an origin-entered Mixed AADC nonautomation machinable letter is 9.142 cents, as shown in cell D7 of my workpaper WP-STDREG-26, obtained by adding the mail processing and delivery costs in Inputs cells D109 and D151, respectively.
- d. Please see my response to VP/USPS-T36-12(d), in particular my assertion that I do not know the proportion of machinable flats in the nonautomation flats category after recategorization. I can confirm that the mail processing and delivery cost total for an origin entered Mixed ADC nonautomation flat is 23.792 cents higher than the mail processing plus delivery cost total for an origin entered Mixed AADC machinable nonautomation letter. I can confirm that the price I propose for origin entered Mixed ADC nonautomation flats is 13.9 cents higher than the price I propose for origin entered Mixed AADC nonautomation machinable letters. I can confirm that the rates I propose result in a passthrough of 58.4 percent of the cost difference between the two pieces in question.
- e. I have reviewed the pages of witness Yorgey's testimony cited in the question and I do not see any calculations of per-piece contributions.

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- f. I can only answer this question as a hypothetical since, as I have discussed previously (in response to VP/USPS-T36-5(g)) "I do not know whether pieced-together numbers like these can lead to appropriate measures of contribution comparable to the contribution measures developed using CRA data at the subclass level." The Postal Service has maintained in the past and continues to maintain that the appropriate focus is on rates, not per-piece contributions. Mailers pay rates, not contributions. The rates I am advocating for nonautomation machinable letters and nonautomation flats, to take the two specific categories that are the subject of this interrogatory, are fair and reasonable, regardless of whether one can demonstrate that the unit contribution of these letters are higher than the flats or not. One need only look at my worksheet WP-STDREG-27 to appreciate the reasonableness of the rates I am advocating. The maximum rate increase I am proposing for a nonautomation machinable Regular subclass letter is 3.5 percent. This is less than one-third the subclass average increase, measured at constant volume. In contrast, the minimum rate increase I have proposed for minimum per piece-rated nonautomation flats is 9.2 percent. It is clear from examining the rate changes in WP-STDREG-27 that my proposed pricing will increase the rate differential between letters and flats and narrow any "contribution gap" that might exist, when compared to equal percentage rate increases. The Postal Service is not oblivious to the cost differentials implied by part (d) of this question and, while I am not willing to concede that these numbers can be used to accurately infer total unit contributions at the most detailed rate category level, I believe that my pricing proposals fairly respond to the cost differences, thereby balancing interests of sending appropriate economic price signals with the goals of reasonable price changes.

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VP/USPS-T36-19. Please refer to your response to VP/USPS-T36-10(c), in which you provide AR fees at TYBR volumes for Commercial Regular of \$63,654, Nonprofit Regular of \$29,866, Commercial ECR of \$33,971, and Nonprofit ECR of \$6,479, all in thousands. In your original workpapers, you provided TYBR fees of, in the same order, \$70,173, \$33,547, \$36,363, and \$6,135. The AR fees referenced above, then, are 7.6 percent, 5.6 percent, 10.8 percent, and 5.6 percent higher than your original TYBR fees, respectively. Please explain whether this means that each category of Standard mail is realizing a different percentage increase in fee levels. If they are, please explain what accounts for these differences.

RESPONSE:

Redirected to witness Berkeley (USPS-T-39).

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VP/USPS-T36-20. This question seeks to clarify aspects of your response to VP/USPS-T36-10(b), in which you discuss how you handled heavy letters in ECR.

- a. Please confirm whether the following statements properly summarize the path you took. If you do not confirm, please explain.
 - (i) Heavy letters must be automation compatible, so basic (non-automation) letters cannot be heavy letters.
 - (ii) Automation basic letters, which are restricted to certain destinations, can be heavy letters, because of their automation compatibility.
 - (iii) Most automation basic letters weigh from 0 to 3.3 ounces, but a few weigh from 3.3 to 3.5 ounces.
 - (iv) You assumed that the automation basic letters weighing from 0 to 3.3 ounces would migrate to 5-digit Regular but that the automation basic letters weighing from 3.3 to 3.5 ounces would stay in ECR.
 - (v) For the automation basic heavy letters that stay in ECR, you show them in your spreadsheets on the same line with basic (non-automation) letters.
- b. Are the cost adjustments for the shift of automation basic letters to 5-digit Regular consistent with the path you took? If not, please explain why not.

RESPONSE:

- a. I can confirm that the statements (i) to (v) are true statements, although I am not sure that they describe the "path" of thinking I followed. As I stated in the response to VP/USPS-T36-10(b), my approach was one of analytical simplicity, since the volume projections for the 0.0 to 3.3 ounce Automation Basic letters were made as a distinct group, separate from the projections for the 3.3 to 3.5 ounce automation Basic heavy letters, which were forecast as part of Basic nonletters.
- b. Yes.

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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