

UNITED STATES OF AMERICA  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

*Before:*

Chairman Blair,  
Vice Chairman Acton,  
and Commissioners  
Goldway and Hammond

Rate and Service Changes to Implement  
Functionally Equivalent Negotiated Service  
Agreement With The Bradford Group

Docket No. MC2007-4

OPINION AND RECOMMENDED DECISION



Washington, DC 20268-0001  
April 18, 2008

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## I. INTRODUCTION AND SUMMARY

The Postal Regulatory Commission finds that the proposed Negotiated Service Agreement with The Bradford Group (NSA or Agreement) meets the requirements of the Postal Reorganization Act (PRA), that the Agreement is in the best interest of the Postal Service and the mailing community, and that the financial analysis supports approval of the Agreement.

This decision was made difficult by the Postal Service's improper unit cost calculations, failure to exercise appropriate due diligence under the circumstances, and the Postal Service's continued accedence to admittedly unreliable volume estimates provided by the NSA partner. Application of the Commission's analysis introduced in Docket No. MC2004-3 (Docket No. MC2004-3 Analysis), however, shows that while the Postal Service may suffer financial harm from the flats portion of the Agreement, this is outweighed by the more substantial gains likely to accrue from the letter portion of the Agreement. Given this potential overall increase in contribution and the Agreement's contractual protective mechanisms, the Commission finds that the Agreement supports a favorable recommendation under the circumstances.

This Opinion also discusses several ways for the Postal Service to improve its analysis of potential NSA arrangements with future NSA partners.

## II. PROCEDURAL HISTORY

On August 3, 2007, the United States Postal Service filed a formal request with the Postal Regulatory Commission seeking a recommended decision approving a mail classification and related rates predicated on a Negotiated Service Agreement with The Bradford Group (Bradford).<sup>1</sup> The Negotiated Service Agreement was proffered as functionally equivalent to the Bookspan Negotiated Service Agreement recommended by the Commission<sup>2</sup> and approved by the Governors.<sup>3</sup>

The Postal Service identified Bradford, along with itself, as parties to the Agreement. Thus, Bradford has been considered a co-proponent, procedurally and substantively, of the Postal Service's Request during the Commission's review.

The Request, which includes six attachments,<sup>4</sup> was filed pursuant to chapter 36 of the PRA, 39 U.S.C. § 3601 *et seq.*<sup>5</sup> In support of the Request, the Postal Service filed Direct Testimony of Broderick A. Parr on Behalf of the United States Postal

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<sup>1</sup> Request of the United States Postal Service for a Recommended Decision on Classifications and Rates to Implement a Functionally Equivalent Negotiated Service Agreement with Bradford Group, August 3, 2007 (Request).

<sup>2</sup> Opinion and Recommended Decision, Docket No. MC2005-3, May 10, 2006 (Bookspan Opinion).

<sup>3</sup> Notice of the United States Postal Service of Decision of the Governors, June 1, 2006 (Governors' Decision).

<sup>4</sup> Attachments A and B to the Request contain proposed changes to the Domestic Mail Classification Schedule and associated rate schedules; Attachment C is a certification required by Commission rule 193(i) specifying that the cost statements and supporting data submitted by the Postal Service, which purport to reflect the books of the Postal Service, accurately set forth the results shown by such books; Attachment D is an index of testimony and exhibits; Attachment E is a compliance statement addressing satisfaction of various filing requirements; and Attachment F is a copy of the Negotiated Service Agreement.

<sup>5</sup> The procedures of the former Postal Rate Commission apply to this request under 39 U.S.C. § 3622(f) as established by the Postal Accountability and Enhancement Act, Pub. L. No. 109-435, 120 Stat. 3198 (2006) (PAEA). Section 3622(f) specifies, for the mail categories which are the subject of this Request, that: "[p]roceedings initiated to consider a request for a recommended decision filed by the Postal Service during that 1-year [transition] period shall be completed in accordance with subchapter II of chapter 36 of this title and implementing regulations, as in effect before the date of enactment of this section."

Service, August 3, 2007 (USPS-T-1) and library reference USPS-LR-L-1, MC2004-3 Opinion and Further Recommended Decision Analysis for The Bradford Group NSA. Bradford separately filed direct testimonies of Steve Gustafson (BG-T-1) and Wendy Ring (BG-T-2) both on behalf of Bradford, August 3, 2007. The Request also relies on record evidence entered in the baseline docket, Docket No. MC2005-3. The Postal Service's Compliance Statement, Request Attachment E, identifies the baseline docket material on which it proposes to rely.

The Postal Service submitted a request for the establishment of settlement procedures.<sup>6</sup> The Commission granted the request and made its facilities available for conducting a settlement conference.<sup>7</sup> A settlement conference convened on August 28, 2007, where the participants came to agreement on a desired discovery period, but expressed a general belief that settlement of this case would be unlikely. Tr. 1/4-8.

A prehearing conference was held on August 28, 2007, immediately after the settlement conference, to identify issues in this docket and to solicit information necessary to establish a procedural schedule. The Commission subsequently issued an initial procedural schedule and ruled on a Postal Service proposal to limit issues.<sup>8</sup> September 28, 2007 was set as the deadline for participants to file statements as to whether a hearing would be necessary, whether they intend to file testimony, or whether they intend to conduct oral cross-examination of the co-proponents' witnesses. That order also held that the instant docket was not functionally equivalent to the Bookspan NSA, Docket No. MC2005-3. Instead, this docket would proceed under rule 195, the rule applicable to baseline NSAs.

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<sup>6</sup> Request of the United States Postal Service for Establishment of Settlement Procedures, August 17, 2007.

<sup>7</sup> Order Granting Postal Service Motion to Establish Settlement Procedures, August 20, 2007.

<sup>8</sup> PRC Order No. 32, Order Regarding Limitation of Issues and Establishing Procedural Schedule, September 7, 2007.

The Commission issued a Commission Information Request to clarify certain aspects of the record.<sup>9</sup>

The Commission also issued several procedural orders related to Bradford and the Postal Service's concerns relating to the release of data under protective conditions.<sup>10</sup> Ultimately, much of the information subject to those orders was made publicly available.<sup>11</sup> The Commission recognizes and appreciates the efforts and willingness of Bradford and the Postal Service to provide the Commission with as much information as possible, and its willingness to expeditiously work with the participants to allow the Commission to promptly disclose as much information as possible into the public record. Many difficult procedural issues relating to information placed under seal were avoided due to the participants' cooperation. As a result, the Commission will be able to provide recommendations based on solid data and evidence without compromising its "strong public policy favoring open and transparent Commission recommendations."<sup>12</sup>

The Office of the Consumer Advocate (OCA) filed a contingent request for hearing pending receipt of clarifying information through follow-up interrogatories.<sup>13</sup> No other participant filed a request for a hearing.

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<sup>9</sup> Commission Information Request No. 1, September 14, 2007.

<sup>10</sup> Order No. 34, Order Granting Motion of The Bradford Group for Protective Order Regarding the Response of Witness Gustafson to Interrogatory of the Office of the Consumer Advocate (OCA/BG-T1-1), September 10, 2007; Order No. 38, Order Denying Joint Motion of United States Postal Service and The Bradford Group for Protective Conditions for Material Responsive to Interrogatories of the Office of the Consumer Advocate (OCA/USPS-T1-19(c), 20, 21(c), (f), (i) and 22), October 9, 2007; Order No. 41, Order Granting Joint Motion of The Bradford Group and the United States Postal Service for an Extension of Time to Respond to Commission Order No. 38, October 19, 2007; Order No. 44, Order on Joint Motion of The Bradford Group and the United States Postal Service for Protective Conditions in Response to Commission Order No. 38 (OCA/USPS-T1-19(c), 20, 21(c), 21(f), 21(i) and 22); November 9, 2007.

<sup>11</sup> See Joint Motion of The Bradford Group and United States Postal Service to Withdraw Motion for Protective Conditions in Response to Commission Order No. 44 (OCA/USPS-T1-19(c), 20, 21(c), 21(f), 21(l), and 22), November 16, 2007.

<sup>12</sup> P.O. Ruling MC2005-3/5, September 9, 2005, at 3.

<sup>13</sup> Office of the Consumer Advocate Contingent Request for Hearing, September 28, 2007.

Upon receipt of those follow-up interrogatories, OCA filed a motion to establish a procedural schedule and stated that it did not seek a hearing.<sup>14</sup> The Commission granted the motion, did not hold a hearing in this case, and set the final procedural deadlines.<sup>15</sup> The record was closed on January 11, 2008. *Id.*

Initial briefs were filed on January 16, 2007, by Bradford, the Postal Service, the American Catalog Mailers Association (ACMA), and the OCA.<sup>16</sup> Reply briefs were filed on January 30, 2007, by Bradford, the Postal Service, and the ACMA.<sup>17</sup>

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<sup>14</sup> Office of the Consumer Advocate Motion to Establish Procedural Schedule, December 20, 2007.

<sup>15</sup> Order No. 51, Order Establishing Procedural Schedule, December 21, 2007.

<sup>16</sup> Initial Brief of The Bradford Group (Bradford Brief); Initial Brief of the United States Postal Service (Postal Service Brief); Initial Brief of the American Catalog Mailers Association (ACMA Brief); and Initial Brief of the Office of the Consumer Advocate (OCA Brief), all filed on January 16, 2008.

<sup>17</sup> Reply Brief of The Bradford Group (Bradford Reply Brief); Reply Brief of the United States Postal Service (Postal Service Reply Brief); and Reply Brief of American Catalog Mailers Association (ACMA Reply Brief), all filed on January 30, 2008.

### III. SUMMARY OF PROPOSAL

#### A. Witness Gustafson's Testimony (BG-T-1)

Witness Gustafson is the Director of Marketing Services for The Bradford Group. He describes Bradford as the recognized leader in new product development and sales of collectibles ranging from plates and dolls, music boxes, jewelry, figurines and ornaments, to architectural villages, electric trains, and diecast cars.

Witness Gustafson asserts that Bradford has millions of clients, and the vast majority of correspondence between Bradford and its customers takes place through the Postal Service. Typically, its customers prefer to order and pay for products through the mail rather than online or over the phone.

To reach potential and current customers, witness Gustafson explains, Bradford generates significant volumes of solicitations, Business Reply Mail, and First-Class Mail using external response mailing lists, external media placements, and its own internal lists of former and existing customers. He notes that each solicitation letter and media placement contributes to the Postal Service's mailstream — whether or not it produces an addition to Bradford's customer base. However, witness Gustafson states, when Bradford successfully markets a product, there is a significant multiplier effect inherent in Bradford's business model. Each successful solicitation generates approximately 67 mailpieces, including a significant number of parcels where the Postal Service is Bradford's carrier of choice. Of these parcels, witness Gustafson notes, a significant majority weigh less than one pound, and nearly 100 percent of these parcels are sent through the Postal Service.

Witness Gustafson explains how a successful solicitation contributes to the mailstream over the course of one year (the multiplier effect):

- A customer receives a Bradford Standard Mail solicitation, the vast majority of which are for a series or subscription plan.
- The customer responds to the offer and places an order by Business Reply Mail or First-Class Mail.
- Bradford sends either (1) a parcel via the Postal Service, or (2) a First-Class solicitation requesting payment.
- The customer's reply to either the parcel or First-Class solicitation is sent via First-Class Mail.
- In many cases, the solicitation requesting payment asks for an installment payment. In this situation, an installment payment will possibly trigger Bradford to send a parcel by the Postal Service, or if no payment is promptly received, subsequent efforts (up to five) will be made via First-Class Mail to obtain payment.
- Even if a customer does not pay, he or she may be re-marketed to at a later date by a Standard Mail letter or flat.
- If the installment payment system is chosen, continued First-Class solicitations would typically follow as well as continuity product shipments through the Postal Service.
- A current customer could receive up to 40 Standard Mail letter or flat solicitations per year offering other products.
- Those 40 Standard Mail solicitations could result in additional product orders generating additional parcels sent by the Postal Service as well as First-Class Mail communications.
- If a customer refuses a product or wishes to return a product, the return is typically done through Bulk Parcel Return Service paid for by Bradford.
- Each subsequent product shipment as part of a series or subscription plan is typically made through the Postal Service as a parcel; each subsequent order would trigger additional First-Class Mail correspondence for product payment or installment payment. Responses would be returned via First-Class Mail.

- If an item is on backorder, Bradford notifies its customers by postcard.
- If the delay in shipment will be longer than 30 days, Bradford provides a Business Reply Mail return postcard for the customer to mail in order to ask Bradford to keep the order open or request a refund.
- Customers send First-Class Mail correspondence to Bradford related to their accounts.
- Bradford sometimes sends customers correspondence by First-Class Mail requesting additional information on their account.
- If customers fall behind on payments, Bradford sends First-Class Mail seeking collections of past due accounts.

Witness Gustafson comments that Bradford intends to maintain its current level of use of the Postal Service as described above. He notes that just as an increase in Standard Mail solicitations as a result of a rate incentive will increase Bradford's multiplier mail, the decline in mail solicitations explained by witness Ring related to the before-rates forecasts would result in a decline in the multiplier effect.

Witness Gustafson also explains that each entity in The Bradford Group provides a carefully screened list of customers, which is highly desirable to other marketers and fund-raisers — and many further mailings to those who positively respond to the offer. Thus, witness Gustafson believes the benefits of the multiplier effect extends well beyond Bradford's mail volumes.

A lower postage rate, according to witness Gustafson, means that Bradford can test and expand its use of its mailing lists in promotions that would not otherwise meet Bradford's criteria at current costs. He believes that the more lists that are tested, the more the business is expected to grow to the benefit of Bradford and the Postal Service.

Witness Gustafson identifies Bradford's historic volumes on the following table:

**Table III-A-1**  
**The Bradford Group's Historic Solicitation Volumes**

	<b>FY 2003</b>	<b>FY 2004</b>	<b>FY 2005</b>	<b>FY 2006</b>
Standard Letters	155,157,000	177,621,000	189,047,000	169,496,000
Standard Flats	44,228,000	50,685,000	52,561,000	56,940,000
<b>Total</b>	199,385,000	228,306,000	241,608,000	226,436,000

The table above shows that there was a decline of more than 20 million pieces in Standard Mail solicitation volume corresponding with the postal rate increases in FY 2006. He notes that the growth in Standard Mail flats in FY 2006 as shown on the table was primarily a result of vastly improved cost structures (printing and paper costs) for one of Bradford's major catalog lines. This allowed the company to mail about 8 million more copies of that catalog in FY 2006.

Witness Gustafson explains that Bradford pays strong attention to address quality, and there was no opportunity for the Postal Service to impose cost saving-related obligations as a condition of this NSA. He notes that Bradford's external vender, Experian, applies state-of-the-art list processing tools to achieve the maximum possible deliverability results, and that they perform address hygiene on "active" customer files on a monthly basis and inactive customer files every three months.

**B. Witness Ring's Testimony (BG-T-2)**

Bradford Group witness Ring is the Vice President of Customer Promotions for The Bradford Group. She provides some background on Bradford, describes Bradford's approach to marketing and mailing, and discusses Bradford's volume forecasts.

Witness Ring states that Bradford's primary mission is to provide the public with fine collectibles and other products promoted to customers through direct mail solicitations, catalogs, and advertising in magazines and the internet. She explains that most products are shipped to clients through the Postal Service. She notes that

Bradford's competition is from specialty gift shops, department stores, online shopping sites, and large discount chains. She considers the collectibles' industry to be a mature industry with an overall rate of growth that is relatively flat or declining. Despite this, she believes that Bradford's continued success is due to its innovation and product development expertise, its understanding of and ability to respond to its customers' preferences, and its success in managing operational costs and achieving economies of scale. According to witness Ring, Bradford customers value the following three essential characteristics of Bradford: convenience of at-home delivery, innovative products, and a 365-day guarantee offered for most products.

She states that since Bradford uses the mail both to serve existing customers and to reach new customers, postage costs are a major factor influencing Bradford's business. Other factors that affect the ability of Bradford to grow its business are: (1) the state of the economy; (2) Bradford's success in creating and offering collectibles and other innovative products; (3) the cost, price, and value of its products; and (4) the cost of printing and paper.

Witness Ring explains that Bradford spends a significant amount of financial and other resources up front to acquire new customers with the hope that the customer will buy not only one collectible, but additional collectibles or products. In general, these additional purchases provide the positive return on Bradford's investment.

She notes that Bradford grows its customer base almost exclusively through direct marketing and uses a significant amount of direct mail, primarily Standard Mail letters and flats. However, she points out that Bradford also uses print advertising in magazines such as *Ladies' Home Journal* or *Good Housekeeping* and markets through newspaper inserts, enclosures in third-party mailings, and through the internet. How Bradford divides its funds between these media varies depending on price and relative effectiveness. She explains that on average, the cost to reach one consumer is much lower in print advertising. However, Bradford's ability to target customers with a common set of characteristics is generally better through the mail. It is for this reason

that witness Ring believes that even though direct mail is more costly on average, it is frequently more effective in terms of response than print advertising.

Witness Ring explains that direct mail is primarily responsible for Bradford's profit generation. She notes that Bradford's marketing plan is developed through a complex and iterative process using annual growth, revenue, cost, and profitability goals set by senior management. This information is then combined with various business metrics such as historic revenues, costs, profitability, active customer figures, how many products an average customer will purchase, and the duration of a typical active customer to develop an overall marketing budget to enable Bradford to meet the owner's goals.

Additionally, witness Ring points out that Bradford is constantly designing new marketing campaigns for each product or product series, and the media managers and their teams — print, mail, and internet — are responsible for the campaigns specific to their particular medium. Bradford plans thousands of campaigns each year, but determining which campaigns actually get executed requires a complex, multi-factor decisional analysis that evaluates each campaign by applying a common set of business metrics, such as expected cost per mailing, response rate, and average revenue contribution. These metrics are used to determine the expected profitability of each campaign. Next, the campaigns are ranked, and those high enough in rank to meet Bradford's internal profitability thresholds are executed. Witness Ring notes that even small differences between campaigns such as cost of postage or paper can change the ranking of a campaign and ultimately whether it is executed. She points out that postage typically constitutes a significant percentage of the costs of Bradford's direct mail campaigns (roughly half of the cost per thousand customers reached in a typical campaign).

Witness Ring explains that each month Bradford's management re-evaluates actual results and compares them to annual financial goals. Therefore, although the marketing budget is established in the beginning of the year, variances in the actual

results can trigger a re-evaluation and re-allocation of the budget as campaigns are reviewed and re-planned on a monthly basis. Accordingly, the marketing budget determines a significant percentage of Bradford's costs, which affects cash flow projections and overall financial management.

Witness Ring believes that postage constitutes the single most influential cost factor dictating which direct mail campaigns are executed as well as the volume of those campaigns since it is such a significant percentage of the cost of a typical campaign. She notes that even small changes in postage can have significant effects on Bradford's mail volume. She states that the greater the price incentive, the more Bradford will mail. She notes that Bradford can not forecast total number of mailpieces independently from its planning of other direct marketing campaigns and that its decision process, as outlined above, dictates that it can not offer a mail volume forecast "with great precision more than a few months in advance." BG-T-2 at 8. However, given these restraints, she states that Bradford's volume forecasts provided here are based on information that Bradford has at the present time.

Witness Ring explains that the single most predictable indicator that affects mail volumes is postage rates, which limit the segments of names that would qualify for a mailing campaign. She points out that the before-rates forecast shows a drop of over 20 million Standard Mail letter solicitations from relatively flat volumes. She anticipates a drop in Standard Mail letter solicitation volumes based upon the compounded effect of the 5.4 percent rate increase in FY 2006 and the postal rate increase implemented in May 2007. She also notes that the before-rates forecast also shows a drop of over 3 million Standard Mail flat solicitations in 2008 and modestly increasing volumes. She believes that if postage incentives are not provided, Bradford's combined letter and flat Standard Mail volumes would decline by more than 25 million in 2008 and stay at that reduced level through 2010.

In contrast, witness Ring believes that the after-rates forecasts will show no appreciable decline in Standard Mail letter and flats volumes since the proposed

incentives offer Bradford the opportunity to maintain their volume in both Standard Mail letter and flats by allowing Bradford to mail marginal segments and shift its acquisition efforts from other media to direct mail.

C. Witness Parr's Testimony (USPS-T-1)

Postal Service witness Parr is an economist in the Pricing Strategy Group at the Postal Service. His testimony presents the specific terms and conditions of the NSA that the Postal Service has negotiated with Bradford, describes the analytical support used to develop the NSA, explains the financial implications of the NSA, describes the provisions that are intended to minimize the risk associated with forecasting volumes for a single mailer, and explains the steps the Postal Service has taken to understand the market in which Bradford operates.

Witness Parr reviews the major elements of the Bradford NSA: the solicitation incentives and the multiplier effect; declining block rates with volume commitments; an annual adjustment mechanism for volume commitments; and termination clauses. He describes the incentives that are based on the volumes of Standard Mail solicitation letters and flats sent by Bradford. He believes these incentives will encourage Bradford to mail additional solicitation letters and flats, increasing its customer base. On the other hand, without such incentives, he believes that Bradford's marketing volumes are expected to be flat or falling due to the highly volume-variable nature of Bradford's operations. He argues that the Postal Service will benefit from the additional contribution generated by an increased volume of Standard Mail solicitations (\$5.4 million over the three-year period of the NSA). He also believes that the Postal Service will benefit from the additional revenue generated by increased volume for each new customer through the multiplier effect explained by witness Gustafson.

Witness Parr explains that the incentives for this NSA take the form of two declining block rate structures — one for Standard Mail letters and one for Standard Mail flats. He points out that the agreement uses a volume commitment mechanism to

mitigate risk from underestimation of before-rates volumes. In other words, before the discounts earned at negotiated volume levels are payable, Bradford must meet a higher volume commitment.

**Table III-C-1**

**Declining Block Rate Structure  
 Standard Mail Letters and Flats**

<b>Year 1 Structure</b>					
<b>LETTERS</b>			<b>FLATS</b>		
<b>Before-Rates Volume Forecast: 146,500,000</b>			<b>53,500,000</b>		
	<b>LETTER Volume Blocks</b>	<b>Incremental Discount</b>	<b>FLATS Volume Blocks</b>		<b>Incremental Discount</b>
	147,000,000   157,000,000	1.5 cents	53,500,000	55,500,000	1.0 cents
	157,000,001   167,000,000	2.0 cents	55,500,001	57,500,000	1.2 cents
	167,000,001   177,000,000	2.5 cents	57,500,001	59,500,000	1.5 cents
	177,000,001   183,000,000	3.0 cents	59,500,001	61,500,000	2.0 cents
<b>Volume Commitment: 154,000,000</b>			<b>54,500,000</b>		

**Table III-C-1 (Continued)**

<b>Year 2 Structure</b>						
<b>LETTERS</b>				<b>FLATS</b>		
<b>Before-Rates</b>						
<b>Volume Forecast: 147,600,000</b>				<b>54,400,000</b>		
	<b>LETTER Volume Blocks</b>		<b>Incremental Discount</b>	<b>FLATS Volume Blocks</b>		<b>Incremental Discount</b>
	147,000,000	157,000,000	1.5 cents	54,500,000	56,500,000	1.0 cents
	157,000,001	167,000,000	2.0 cents	56,500,001	58,500,000	1.2 cents
	167,000,001	177,000,000	2.5 cents	58,500,001	60,500,000	1.5 cents
	177,000,001	183,000,000	3.0 cents	60,500,001	62,500,000	2.0 cents
<b>Volume Commitment: 154,000,000</b>				<b>55,500,000</b>		

<b>Year 3 Structure</b>						
<b>LETTERS</b>				<b>FLATS</b>		
<b>Before-Rates</b>						
<b>Volume Forecast: 147,000,000</b>				<b>57,000,000</b>		
	<b>LETTER Volume Blocks</b>		<b>Incremental Discount</b>	<b>FLATS Volume Blocks</b>		<b>Incremental Discount</b>
	147,000,000	157,000,000	1.5 cents	57,000,000	59,000,000	1.0 cents
	157,000,001	167,000,000	2.0 cents	59,000,001	61,000,000	1.2 cents
	167,000,001	177,000,000	2.5 cents	61,000,001	63,000,000	1.5 cents
	177,000,001	183,000,000	3.0 cents	63,000,001	65,000,000	2.0 cents
<b>Volume Commitment: 154,000,000</b>				<b>58,000,000</b>		

Witness Parr reviews the annual adjustment mechanism for the volume commitments, which are subject to adjustment each year. He believes that the adjustment mechanism will mitigate both the risks associated with forecasting errors and the effects that future rate increases will have on volumes. He notes that the Agreement provides that, if at the end of the agreement year actual volumes are 12 percent or more above that year's commitment, the next year's commitment will be recalculated as the mean of the current year's actual volume and the original volume commitment for the next year. However, if at the end of the year actual volume is 5 percent or more below the year's volume commitment, then the next year's volume commitment will be decreased by the percentage difference between actual volume and that year's volume commitment. In the event that the volume commitment falls below the starting threshold in any year, the starting threshold will then equal the adjusted volume commitment. Furthermore, for letters, the new volume commitment will then become the beginning threshold plus 7 million pieces, while for flats, the new volume commitment will then become the beginning threshold plus 1 million pieces.

Witness Parr explains that the NSA includes two termination clauses that provide substantial protection to both parties. The first provides an unconditional right to terminate the contract without penalty on 30 days' written notice. The second provides that the Agreement automatically terminates, and all discounts cease if either: (1) Bradford mails more than 195,000,000 Standard Mail letters in any year of the Agreement; or (2) Bradford mails more than 73,500,000 Standard Mail flats in Year 1 of the Agreement, more than 74,500,000 Standard Mail flats in Year 2 of the Agreement, or more than 77,000,000 Standard Mail flats in Year 3 of the Agreement.

*Financial analysis.* Witness Parr provides the financial analysis used to evaluate the NSA. He bases his net contribution calculations on Bradford's projected volume forecasts for new letters and flats and obtains a new contribution of approximately \$6.6 million. He then subtracts the expected discount exposure on letters and flats. He believes that the expected discount exposure is only \$9,000 (after rounding) over the

three years of the Agreement since the declining block rates were designed to apply only to volumes that are above before-rates forecasted volume. The remaining financial impact that he calculates is the amount of the total incremental discounts. He calculates this at \$1.2 million. Accordingly, the financial impact on the Postal Service, according to witness Parr, is a net benefit to the Postal Service of \$5.4 million. He also notes that the multiplier effect should produce a “second stream of value for the Postal Service,” but he does not quantify this effect. USPS-T-1 at 8.

*Evaluation of Bradford’s volume forecasts.* Witness Parr used a variety of tools to evaluate Bradford’s before-rates volume forecasts and the potential for growth in its use of mail as a marketing medium. He believes his analysis is comparable to that performed in evaluating previous NSAs and includes company specific research, volume trend analysis, and the analysis of the market environment. He notes that the North American Industrial Code System (NAICS) classifies Bradford as a “Nonstore Retailer.” He points out that nonstore retailers such as catalogers have been losing market share from 2001–2005 while warehouse clubs and superstore retailers have been strengthening over the same time frame. Given this research, witness Parr believes that Bradford’s before-rates volume forecasts are consistent with the dynamics of the market within which Bradford operates.

Witness Parr also reviews company specific information on Bradford, although such information is limited because it is a privately held company. Nonetheless, witness Parr draws inferences regarding Bradford’s marketing strategies and its potential for growth on information obtained from the collectibles’ industry, past financial transactions, and discussions with Bradford. This research suggests, according to witness Parr, that the profitability and future growth prospects for Bradford may be limited due to market trends and due to the fact that between 2003 and 2006 the number of buyers for Bradford’s core collectible products has decreased by around 20 percent. He believes such research adds “credence” to the before-rates volume forecast provided by Bradford. *Id.* at 10.

Witness Parr did a volume trend analysis with counts of Bradford's Standard Mail letter and flat volumes for calendar years 2004 through 2006. These volumes, which have been reconciled with Postal Service permit data show, according to witness Parr, that Standard Mail letter volume through 2005 trended substantially upward, but declined in 2006. He expects this downward pressure to continue on Bradford's Standard Mail volume. He explains that this volume decline is expected to level off at the new lower level in the absence of a price incentive to increase solicitations.

Witness Parr also did an analysis of Bradford's market environment. He notes that the collectibles' market is highly fragmented across a wide variety of products, though competitors of Bradford include brick-and-mortar retail gift shops, mail order gift sellers, and internet sales. He finds Bradford unique in that it relies on the mail for almost all aspects of its business. In the collectibles industry, witness Parr notes that shoppers have been turning away from "giftables" categories such as flowers and plants, figurines, collectibles, stationery, seasonal decorations, and other gift items over the last six years. Many competitors to Bradford are diversifying their revenue streams to sustain growth, according to witness Parr, which indicates that extensive growth is not expected by firms that are solely in this business of marketing and distributing collectible gift items. Additionally, he notes that Bradford is being challenged by the internet, through retail, peer-to-peer, and auction sales. With such limited growth potential, he believes that retailers are competing for market share, rather than relying on increasing market size.

With respect to Bradford's after-rates volume forecasts, witness Parr believes that Bradford is in the best position to present its future plans. Nonetheless, he explains that they are consistent with the Postal Service's independent analysis. He believes that, *ceteris paribus*, the incentives will encourage Bradford to increase its use of the mail. The risk that the after-rates volume forecasts overestimate Bradford's response to the price incentives are mitigated by the risk mitigation features of the Agreement. To

the extent that the after-rates volume forecasts underestimate Bradford's response, the benefits to the Postal Service will exceed those estimated in this case.

Witness Parr also presents the sensitivity analysis that the Postal Service undertook in this case. *Id.* at Appendix C. He believes that the analysis shows that a net loss could only occur under "extreme mis-estimation assumptions." *Id.* at 14.

*Impact on competitors and other mail users.* Witness Parr believes that Bradford is unique among its competitors in its use of the mail for marketing purposes. He notes that competitors who use other forms of advertising have the ability to negotiate price terms with their suppliers, and that any competitor that intends to use mail as a marketing medium may negotiate a comparable agreement to Bradford's NSA. Thus, he believes that the effect on Bradford's competitors is not expected to be significant and may, in fact, bring increased competition to the marketplace.

With respect to competitors of the Postal Service, he believes that they are not affected by this Agreement. He notes that Bradford relies on the mail as a marketing channel because of its use of the mail as a fulfillment medium. Further, he believes that the response rates and secondary effects of other media are different than the mail and accordingly are imperfect substitutes for Bradford. He points out that nothing in the Agreement requires Bradford to continue to use the Postal Service for the distribution of its packages. With respect to other mail users, witness Parr does not believe the \$5.4 million contribution increase from this NSA will affect other specific mailers.

#### IV. FINDINGS AND CONCLUSIONS

##### A. Overview

The Commission's analysis of this Agreement is predicated on the general requirements for NSAs first set out in the Commission's opinion in Docket No. MC2002-2. Sections B and C of the Commission's Findings and Conclusions address the Accuracy of the Cost and Volume Estimates submitted by Bradford and the Postal Service in connection with this proposed three-year NSA with Bradford. In Section D, the Commission analyzes the financial impact of the Agreement. Section E focuses on whether the Agreement comports with the applicable legal requirements. Section F discusses changes to Domestic Mail Classification Schedule (DMCS) provisions, and Section G addresses the proposed Data Collection Plan.

##### B. Accuracy of Cost Estimates

To calculate the cost savings and determine the unit contribution for mailpieces sent under this Agreement, the Postal Service used Commission library reference 22 (PRC-LR-22) from the last completed rate case, Docket No. R2006-1. See Docket No. R2006-1, PRC-LR-22 (April 27, 2007). In prior NSA cases, the Postal Service has used previous versions of the Commission's library reference 15 (PRC-LR-15) to calculate cost savings and unit cost contribution. See, e.g., Docket No. R2006-1, PRC-LR-15.

ACMA argues that the Postal Service erred in using PRC-LR-22 to calculate contribution instead of using PRC-LR-15. ACMA asks the Commission to indicate that the Postal Service's use of PRC-LR-22 in this case does not create "binding precedent," and that its use may not be appropriate for certain future NSAs involving different mail profiles. ACMA Brief at 2-3. ACMA asserts that the Postal Service's use of PRC-LR-22 is inappropriate because it does not include the same level of detail as PRC-LR-15, aggregates costs differently, and could result in inaccurate contribution calculations

when applied to different NSAs. *Id.* It also contends that it inflates certain costs, inappropriately decreases estimated contribution, and consequently depresses future NSA discounts. *Id.* at 2,3, and 5. ACMA believes that the use of PRC-LR-22 creates the following two problems: (1) it obscures important cost differences in some instances because PRC-LR-22 aggregates presort levels and does not break down every unit cost by rate category, and (2) PRC-LR-15 isolates weight-related differences in mail processing costs while PRC-LR-22 inappropriately shifts some of these weight-related costs to per-piece costs. *Id.* at 3. ACMA is concerned that this latter problem could have an adverse effect on future mailers seeking NSAs for pound-rated flats. *Id.* at 4.

The Postal Service argues that the use of PRC-LR-15 would exclude entire categories of cost which would significantly inflate the estimated contribution gain from this NSA. Postal Service Reply Brief at 7. The Postal Service believes that the use of PRC-LR-22 is the more conservative and proper approach in this instance since it is more likely to overstate costs and, as a result, understate net contribution. *Id.* In the alternative, the Postal Service contends that the Commission should not reach ACMA's argument about the use of PRC-LR-15 since it does not affect the outcome of this case. *Id.* at 8.

The real issue raised by ACMA and the Postal Service here is not which library reference is appropriate, but rather, which Postal Service costs should be included in calculating Bradford's mailer-specific unit cost. In past NSA cases, the Commission has used mail processing and delivery unit costs from the last completed rate case as a starting point for calculating mailer-specific costs. The Commission then adjusted those costs to reflect the additional costs captured in the Cost and Revenue Analysis (CRA).

For each individual mailer, the unit cost is properly calculated using the mailer's mix of presort and dropship mail. With respect to Bradford, the Commission has performed this calculation using both the unit costs from PRC-LR-15. See library reference PRC-LR-1. While neither method is ideal, the Commission believes that PRC-LR-15 more appropriately captures worksharing cost differences because it

provides unit mail processing and delivery costs disaggregated by workshare category.<sup>18</sup> Therefore, the Commission uses the mailer-specific unit costs developed from PRC-LR-15 in its analysis of this case.

### C. Accuracy of Volume Estimates

In this case, it is necessary to examine the estimates that have been presented regarding Bradford's proposed solicitation mail volumes with and without the NSA. The purpose of the Agreement is to increase the volume of Standard Mail letters and flats which will generate additional contribution to the Postal Service. The Commission is concerned with the potential scenario where the before-rates estimates are too low, that is, discounts would be paid on mail that would have been mailed without the discount; then the NSA will not only fail to add to the Postal Service's net revenue, it could reduce contribution because some of that volume would have been mailed regardless of the NSA at the non-discounted rate.

#### 1. Derivation of Volume Estimates

In this case, the overall reliability and accuracy of the volume estimates is extremely important. The Bradford NSA depends heavily on the accuracy of the point estimates of volume devised by the potential NSA partners in the first instance. With NSAs designed under this point estimate model, there are two main issues with respect to the reliability of the before- and after-rates volume estimates.<sup>19</sup> The first is the underlying reliability of those point estimates. The second is the Postal Service's due diligence in verifying those volume estimates.

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<sup>18</sup> As a practical matter, it should be noted that, going forward with the final adjustment calculations that result in the unit costs in PRC-LR-22 will no longer be prepared, while the mail processing and delivery unit costs in PRC-LR-15 and an appropriate CRA benchmark should still be available.

<sup>19</sup> Although the Postal Service attempted to apply the Docket No. MC2004-3 Reconsideration Analysis in this case, it did not design the Agreement based on the design mechanism introduced by the Commission's reconsideration opinion in that case.

2. Bradford's Estimates

Bradford witness Gustafson provides the last four years of Bradford's historic volumes, adjusting them to correspond with the Postal Service's fiscal years, and then verifying them against the Postal Service permit data. BG-T-1 at 7. Witness Ring notes that while the Postal Service may project its future mail volumes based on historical experience, Bradford can not forecast its total number of mailpieces independently from its planning of other direct marketing campaigns. *Id.* at 8. Witness Ring testifies that because its decision-making process is dependent on operational campaigns, it can not offer a mail forecast "with great precision more than a few months in advance." *Id.* Nonetheless, to support this Agreement, she develops the best possible three-year before-rate and after-rate mail volume forecasts based on information Bradford presently possesses. These numbers are as follows:

**Table IV-C-1**  
**The Bradford Group's Forecasted Solicitation Volumes**

	<b>FY 2008</b>	<b>FY2009</b>	<b>FY2010</b>
Est. Volume Before-Rates			
Standard Mail letters	146,500,000	147,600,000	147,000,000
Standard Mail flats	53,500,000	54,400,000	57,000,000
<b>Total</b>	200,000,000	202,000,000	204,000,000
Est. Volume After-Rates			
Standard Mail letters	168,000,000	167,000,000	167,000,000
Standard Mail flats	58,000,000	58,000,000	60,000,000
<b>Total</b>	226,000,000	225,000,000	227,000,000

To arrive at these estimates, witness Ring uses past and present marketing budgets, together with Bradford's best estimate of future cost increases as well as expected growth in profitability. BG-T-2 at 4-9. There is nothing in the record to

contradict these estimates. Indeed, it would be very difficult for a participant to argue for different estimates since that would imply that it understood Bradford's business better than Bradford did. As the Commission pointed out in connection with the Bookspan NSA case,<sup>20</sup> it is more important to review and evaluate the Postal Service's due diligence in independently analyzing Bradford's point estimates to help alleviate the underlying inherent problems with "unquestioning reliance" on point estimates derived by the potential NSA partner as justification for the Agreement. *Id.* As a result, the Commission does not give much weight to the reliability of Bradford's estimates on their own.

### 3. Postal Service's Independent Analysis

The Postal Service attempts to independently analyze Bradford's before- and after-rates volume forecasts to determine their reliability. The primary methods used by the Postal Service in this case are: company-specific research, volume trend analysis, and an analysis of the market environment. USPS-T-1 at 8-12. Based on its analysis in these areas, the Postal Service accepts, without modification, the point volume estimates of Bradford witness Ring.<sup>21</sup> The Commission analyzes each element of the Postal Service's independent review of Bradford's estimates in turn and then discusses further difficulties with the Postal Service's independent analysis.

#### a. Company-Specific Research

The Postal Service notes that Bradford is not a publicly held company and therefore does not have the same reporting requirements as those firms whose shares are traded publicly. Nonetheless, witness Parr believes he "is able to make informed inferences regarding Bradford's marketing strategies and its potential for growth over

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<sup>20</sup> PRC Op. MC2005-3, ¶¶ 4072-73.

<sup>21</sup> Compare BG-T-2 at 8 (Table 1) with USPS-T-1 at Appendix A at 2.

the next several years” based on “research into the collectibles industry, past financial transactions and discussions with Bradford Group.” *Id.* at 9. The content of those discussions, past financial transactions, and research were not provided in this case. A thorough independent analysis would require verification through documents or other means that were not prepared for the sole purpose of persuading parties that this deal is in the Postal Service’s best interest. Without such information, witness Parr’s unsupported claims are of limited value to determining whether Bradford’s volume estimates are accurate.

b. Volume Trend Analysis

With respect to a volume trend analysis, the Postal Service found that the data show that Bradford’s Standard Mail letter volume through 2005 trended substantially upward but declined in 2006. USPS-T-1 at 10. It does not appear that the Postal Service ran any sort of regressions to identify any correlation between different categories of Bradford’s mail. From his trend analysis, witness Parr concludes that “this decline is expected to level off at the new lower level in the absence of an incentive to increase solicitation of customers.” *Id.*

The Commission has difficulty understanding how witness Parr’s trend analysis shows that “the decline is supposed to level off at the new lower level.” *Id.* The trend line is above both the before- and after-rates volume forecasts for both letters and flats for all three years of the Agreement. See PRC-LR-2.

c. Market Environment

With respect to the market environment, the Postal Service reviewed data and a graph provided by the Department of Commerce showing that nonstore retailers such as Bradford have been losing market share to warehouse clubs and superstores from 2001 to 2005. The Postal Service also believes that the following market-based factors

have contributed to a decline in Bradford's mail volume: (1) the internet has provided a challenge to Bradford and other traditional gift item retailers as it more easily attracts younger customers, and (2) collectibles and gift figurine sales have been steadily decreasing over the last six years. Additionally, the Postal Service does not anticipate "extensive growth" in the collectibles' industry as evidenced by competitors of Bradford diversifying their revenue streams.

The Postal Service's independent review of Bradford's market environment is an improvement over that done in the Bookspan case, Docket No. MC2005-3. Nonetheless, the Commission has reservations regarding the Postal Service's independent review. In particular, the Postal Service's analysis of market share using the graph from the Department of Commerce is flawed. The figures on that graph represent all merchandise sold by all warehouse clubs and superstores. Tr. 2/76. While the merchandise sold by clubs, superstores, and nonstore retailers may include merchandise sold in the collectibles' industry, it is not a good proxy for the collectibles' market. The Postal Service should have used a different proxy or attempted to adjust or correct for the fact that the collectibles' industry is only a very small part of the club, superstore, and nonstore retailer industry. This is especially true given that the Postal Service concluded that "Bradford is unique among its competitors in its use of the mail as an important means of marketing." USPS-T-1 at 1.

d. Further Difficulties

The Commission's review in this case also uncovered several additional areas that the Postal Service should have explored further before deciding to enter into this Agreement. The proposed DMCS language to implement this NSA defines eligible Standard Mail as "pieces sent by Bradford Group for the purpose of soliciting prospective customers and clients of Bradford Group, *as well as advertising to existing Bradford clients.*" Request at Attachment A, proposed DMCS § 621.11 (emphasis added). This is the first NSA to allow discounts on Standard Mail pieces that are sent to

current clients. Bradford submits that it has a “problem distinguishing between ‘new’ and ‘existing’ customers.” Tr. 2/13. These limitations in Bradford’s accounting processes raise an issue with respect to the probability that the Postal Service will provide discounted postage on mailpieces that would have been sent in the absence of the NSA.

If Bradford has already used the mail to obtain a customer, there is an increased likelihood that Bradford will send a continuing series of marketing mail to that existing customer in the absence of the NSA. This is due, in part, to the fact that “[t]he vast majority of [Bradford’s] offers are for a series or subscription plan.” BG-T-1 at 3. A series or subscription plan necessitates an ongoing relationship between Bradford and the customer. Tr. 2/15. This encourages Bradford to continue sending Standard Mail solicitation mailpieces to current customers due to the ongoing relationship rather than due to the NSA discount. This is especially true for those mailings that are sent to current customers that have already agreed to purchase a minimum number of items on a more or less regular basis. See BG-LR-1. Bradford will be sending those current customers Standard Mail solicitations so they can determine which collectibles and gifts to purchase in order to complete their agreements to purchase a minimum number of items.

This concern is compounded by the fact that, from time to time, Bradford mails solicitations to customers already enrolled in a subscription plan that Bradford believes will be of interest to those current customers. Tr. 2/15. While it is difficult to determine if solicitations would have been sent to new customers in the absence of the NSA, it is even more difficult to believe that a vast amount of the solicitation mail sent to existing customers would not have been sent in the absence of the proposed NSA. The Postal Service should have explored this issue and submitted its analysis with the filing of the NSA with the Commission, as part of its due diligence.

The Postal Service also should have calculated the price elasticity of demand implicit in the Agreement based upon the NSA’s discounted rates and Bradford’s

before- and after-rates point volume estimates. This would have allowed the Postal Service to prepare and present analysis to help determine if Bradford's before- and after-rates volume estimates are in the realm of reasonableness.

4. OCA's Evaluation of the Postal Service's Financial Model/Sensitivity Analysis

The Postal Service provides a sensitivity analysis of the Agreement. See USPS-T-1 at Appendix C. The Postal Service believes the analysis shows that a net loss could only occur under extreme mis-estimation assumptions. *Id.* at 14.

OCA argues that the Postal Service's sensitivity analysis model can not be used to show that the Bradford NSA will improve the financial position of the Postal Service because the financial model fails to take into account the effects of non-price exogenous factors. OCA Brief at 4-10. This failure, OCA contends, results in an "overly optimistic" estimate of the financial value of the Agreement.

In particular, OCA asserts the Postal Service's financial model assumes that the NSA price incentives are solely responsible for any increase in Bradford's mail volumes that exceed the before-rates volume forecast. Tr. 2/35. Without an elasticity of demand specific to Bradford, a reasonable estimate of the effect of the NSA on the Postal Service's net contribution can not be obtained. However, OCA believes that the spreadsheets used by the Postal Service to perform its sensitivity analysis in this case can be used to estimate the effect of these non-price exogenous factors (OCA Exhibit 1). USPS-T-1 at Appendix C, Table 1. It alters the Postal Service's sensitivity matrix by assuming that all changes are caused by non-price exogenous factors rather than discounts from the proposed NSA. See OCA Brief at 7.

The Postal Service and Bradford argue that the record indicates that any own price elasticity specific to Bradford would produce an unreliable estimate given that there are only three years of data with one price change during those years. See Postal Service Reply Brief at 4-5 (quoting Tr. 2/22); Bradford Reply Brief at 6-7. The Postal Service and Bradford also contest OCA's use of the Postal Service's spreadsheets to

attempt to estimate the effect of non-price exogenous factors. They submit that OCA's use of the spreadsheets in that manner is improper since it attempts to input an assumption about non-price exogenous factors which is in direct conflict with the foundational assumptions of the original financial model. Postal Service Reply Brief at 5-6 (citing Tr. 2/73-74). Further, Bradford contends that OCA's financial model does not take into account the likelihood that certain exogenous factors might affect the outcomes. Without such information, Bradford argues, OCA's model is "based on pure speculation." Bradford Reply Brief at 6-7.

The Commission finds witness Parr's rationale for not producing a customer-specific elasticity of demand for Bradford to be adequate. Nonetheless, the Postal Service should also consider attempting to verify data presented through an industry elasticity of demand or even using the subclass elasticity of demand to help independently analyze any point estimates provided by an NSA partner. The Commission agrees with OCA that deriving a customer-specific elasticity of demand for Bradford would be very helpful in evaluating the information provided in this case. While a mailer-specific own price elasticity is not required for approval of an NSA, its absence means that the Postal Service should more thoroughly exercise due diligence in negotiating and evaluating proposed NSAs.

The Commission finds that while a sensitivity analysis like the one provided by the Postal Service may provide some useful information, it can not be relied upon to assess the relative desirability of a given NSA. The analysis presented by the Postal Service does not provide any explanation for the volume change assumptions. Therefore, it is difficult to assess whether the volume scenarios are representative. In addition, the implicit elasticity differs at each point of the analysis. The Commission finds this problematic in that it makes it difficult to isolate a realistic set of before- and after-rates volumes. In the Commission's opinion, an analysis of the before-rates volumes and corresponding after-rates volumes based on a constant elasticity of

demand would be more useful. Such an analysis could be further enhanced to show the effects of a range of plausible elasticity assumptions.

## 5. Findings

Bradford candidly acknowledges that its volume estimates are unreliable more than a few months in advance, although the Commission finds that those offered by Bradford in this case were made in good faith. Because the accuracy of the point volume estimates are so important in the way this Agreement was structured, the Commission can not accept its admittedly unreliable three years worth of estimates as accurate enough to support the Agreement. The Postal Service's due diligence attempts at independently reviewing Bradford's estimates are also inadequate and do not justify reliance on Bradford's estimates. Further, neither the Postal Service's sensitivity analysis nor OCA's recharacterization of that analysis can be relied upon to allow the Commission to recommend adoption of the Agreement.

### D. Financial Impact

Under the PRA, the Commission must be reasonably certain that this Agreement will not result in a lower net contribution than would occur in the absence of this NSA before it can recommend approval. The admittedly unreliable volume estimates provided by Bradford would not allow the Commission to recommend approval. Consequently, the Commission must explore other areas of the Agreement to determine if the risk of the Postal Service losing net contribution due to this NSA is at an acceptable level. In this section, the Commission reviews the Agreement's multiplier effect, and the Agreement's procedural safeguards. It also applies the Docket No. MC2004-3 Analysis to this Agreement and analyzes the financial impact over the range of possible after-rates volumes.

## 1. Multiplier Effect

The Postal Service believes that it will additionally benefit from implementation of the Agreement through a “second stream of value” known as the multiplier effect. This multiplier effect generates additional revenue through increased volume for each new Bradford customer in the form of First-Class Mail and Standard Mail correspondence, fulfillment, and additional solicitations. USPS-T-1 at 2. The Postal Service does not quantify these perceived additional benefits in its evaluation of the financial impact of this NSA. Witness Gustafson explains the benefits of the multiplier effect and concludes that a successful solicitation “generates approximately sixty-seven mail pieces.” BG-T-1 at 3. Nonetheless, up to 40 of these pieces are further Standard Mail solicitation letters or flats for other products or offerings. *Id.* at 4. This raises an issue in that almost 60 percent of the mail that is considered part of Bradford’s multiplier effect is eligible for a discount under the terms of the NSA. This means that Bradford’s multiplier effect is not as compelling as Bradford and the Postal Service argue since the contribution from approximately 60 percent of the multiplier effect mail could be reduced up to 3 cents per piece for letters and 2 cents per piece for flats.

Bradford and the Postal Service argue that this issue does not change the analysis since the multiplier effect was never quantified. See, e.g., Bradford Brief at 17-18. While it is easy to conclude that a lower benefit is still a benefit, the fact that this issue was not explored by the Postal Service and discussed in its presentation to the Commission is unfortunate. The Postal Service needs to review a proposed agreement from all angles and determine how changes from one agreement to another affect the various benefits to the Postal Service. The Postal Service must improve its financial analysis when negotiating these agreements to assure that each particular agreement is in the Postal Service’s best interest.

## 2. Contractual Protective Mechanisms

### a. Overview

The Postal Service and Bradford argue that the terms of the Agreement itself also help protect the Postal Service from any potential errors in the before- and after-rates volume forecasts. See, e.g., USPS Brief at 7-9; Bradford Brief at 14-16. They point out that these contract terms are similar to those recommended by the Commission in connection with the Bookspan NSA with the addition of a discount cap provision.

The protective mechanisms in this proposal are designed to prevent net contribution from decreasing. Each risk reduction mechanism is addressed in turn below.

### b. Volume Commitments

As in the Bookspan NSA, the proposed Bradford NSA has a contractual provision which allows Bradford to earn discounts for Standard Mail letter volumes that exceed specific volume thresholds, but the discounts do not become payable until Bradford reaches a higher volume level. This volume commitment will help protect the Postal Service by reducing the risk of discount leakage from variations from before-rates forecasts by helping minimize the potential that discounts will be paid on mail that would have been sent if there was no NSA.

### c. Volume Commitment Adjustments

To further protect the Postal Service against discount leakage, there is a volume commitment adjustment mechanism in the Bradford NSA. The volume commitment adjustments provide that if at the end of either the first or second years, the actual

volume is 12 percent or more above the prior year's actual volume, the following year's commitment will be revised to be the average of the prior year's actual volume and the following year's original commitment. USPS-T-1 at 6. This mechanism reduces the risk of discount leakage from more significant variations in forecasted volumes or an acquisition or merger that increases Bradford's mail volumes. If Bradford fails to reach the adjusted volume commitment level, it will not be paid any discounts for that year of the Agreement.

d. Discount Cap

This contractual provision ends Bradford's ability to earn discounts on otherwise eligible mail sent that exceeds certain volume thresholds for Standard Mail flats and letters. This may limit the Postal Service's discount exposure in case unexpected non-price exogenous factors significantly boost Bradford's Standard Mail volumes.<sup>22</sup>

e. Automatic Termination

This contractual provision automatically terminates the Agreement and all discounts (for both letters and flats) cease if either Bradford's Standard Mail letter or flat volume exceeds 12 million pieces above their discount cap. *Id.* at 7. This provision essentially operates as a protection against changed circumstances since a very large increase in volume may not be due to the price incentives, but rather to other factors that may cause sharp changes in volume.

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<sup>22</sup> However, volumes in excess of the discount cap can be viewed as an indication that the incentive to mail is not due to the discount. This raises issues with proper application of the Docket No. MC2004-3 Analysis at volumes in excess of the discount cap.

f. Unconditional Withdrawal

This contractual provision gives both parties the unconditional right to terminate the Agreement without penalty upon 30 days' notice. *Id.* at 13. It allows the Postal Service to terminate the Agreement if it later determines that circumstances have changed in a way such that the Agreement is no longer in the Postal Service's best interest. This provision allows the Postal Service some protection from unanticipated major complications. The Commission finds the unconditional withdrawal contractual protection to be appropriate and desirable for this NSA.

g. Issues and Findings

OCA contends that these protective mechanisms are not as useful as they seem since the Postal Service can not determine after the fact whether any increase in volume is due to the NSA or non-price exogenous factors. OCA Brief at 10-13. The Postal Service appears to concede the point. *See* Tr. 2/26 and *id.* at 36. Nonetheless, the Postal Service and Bradford argue that the contractual protective mechanisms protect against mis-estimation of volumes. *See, e.g.,* Postal Service Reply Brief at 6-7.

The protective mechanisms, while beneficial, do not significantly mitigate the risk of over- or under-estimation of volumes in agreements predicated on the volume point estimate model. Since the parties can not determine with any degree of certainty whether any increase in volume is due to the NSA or due to other factors, it makes it extremely difficult for the Postal Service to know whether or not its net contribution increased due to the discounts. Currently, the NSA design mechanism discussed in the Bank One reconsideration opinion is one of the only demonstrated methods that allows meaningful insight into the probability that an after-rates volume increase is due to the NSA or other exogenous factors.

### 3. Docket No. MC2004-3 Analysis

Under the PRA, the Commission must be satisfied there is “reasonable assurance that the Postal Service will not lose money on this NSA.” See PRC Op. MC2002-2, ¶ 8013. The analysis introduced by the Commission in the Bank One reconsideration is a way to quantify the additional contribution generated by an individual NSA using the average subclass elasticity to determine plausible before-rates volumes. It was first applied by the Commission to a pending case with respect to the Bookspan NSA. It is rooted in the Commission’s first Opinion and Recommended Decision in Capital One. In that case, the Commission found, based in part on the testimony of witness Panzar, that “[t]he impact of the tariff on postal net revenue has two parts.” PRC Op. MC2002-2, ¶ 5012. The first is the increase in net revenue that results from the increase in volume. This is the increase from new mail volume, or “new contribution.” The second part of the impact is a decrease in net revenue. This decrease in net revenue constitutes discounts on volume that the potential NSA partner would have mailed at the higher rate if there were no discounts. If the new contribution produced by the response to the lower block rate exceeds the loss of net revenue, the Postal Service’s overall net revenue will increase at that after-rates volume. See *id.*, ¶ 5013. If not, then the Postal Service will lose net revenue at that after-rates volume.

The Commission’s Docket No. MC2004-3 Analysis is most useful in monitoring the success of a given NSA that is already in place as it can be performed using actual after-rates volumes and working backwards to determine plausible before-rates volumes.<sup>23</sup> When using the test to design NSAs, it is important to introduce penalties to the mailer for overly conservative estimates of after-rates volumes. As originally designed, the Commission’s test would require a significant penalty at the point where

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<sup>23</sup> An after-the-fact analysis of the currently effective NSAs was presented in chapter X of the Commission’s FY 2007 Annual Compliance Determination.

the Postal Service's gain in contribution equaled zero.<sup>24</sup> The Postal Service did not employ such a tactic here.

The Postal Service attempted to apply the Commission's Docket No. MC2004-3 Analysis to this Agreement.<sup>25</sup> See USPS-LR-L-1. This could have provided additional independent analysis and information as to the relative value of the Agreement to the Postal Service on a more objective basis than several of the other independent methods used by the Postal Service in exercising its due diligence in this case. However, the Postal Service did not discuss or directly use the results of this analysis in any fashion. For example, the analysis done by the Postal Service shows that the Agreement would be worth approximately \$200,000 for the first year of the Agreement at the forecasted volume as opposed to the Postal Service's estimate of \$1.88 million. *Compare id. with* USPS-T-1, Appendix A at 10. No attempt was made to reconcile this substantial difference, nor was the difference analyzed in the Postal Service's review. These differences appear to arise from assumptions relating to the appropriate before-rates volume. The Postal Service assumes that the mailer's forecasted before-rates volume is correct and calculates the increase in contribution as the contribution generated at the forecasted after-rates volume less the contribution generated at the forecasted before-rates volume. In contrast, the Commission's analysis was designed to lessen the reliance on mailers' forecasts. The analysis begins with the forecasted after-rates volume, but uses the subclass average elasticity<sup>26</sup> to calculate the before-rates volume. Using this method, the calculated before-rates volume is higher than the mailer's forecasted before-rates volume. Thus, the increase in contribution is lower.

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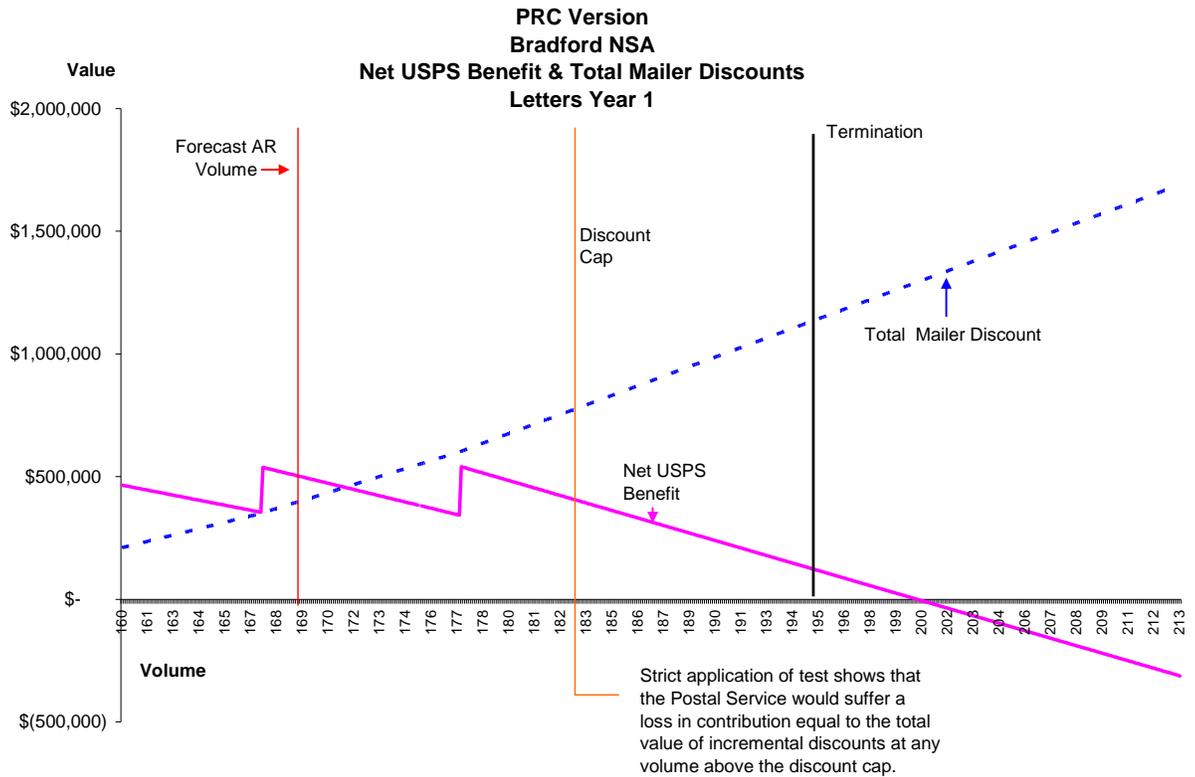
<sup>24</sup> The purpose of this penalty is to shift some sort of meaningful risk of loss to the NSA partner in order to ensure that the range of volumes estimated by the mailer is accurate. *Cf.* PRC Op., MC2004-3, ¶¶ 5012, 5018 (stating that if the mailer's actual volume fell outside the agreed-upon range of after-rates volumes, the agreement would be void).

<sup>25</sup> See PRC Op. and Further Recommended Decision, MC2004-3, ¶¶ 5001-38.

<sup>26</sup> The Commission believes that the most appropriate elasticity available should be used. In this case, the subclass average elasticity is the best available estimate.

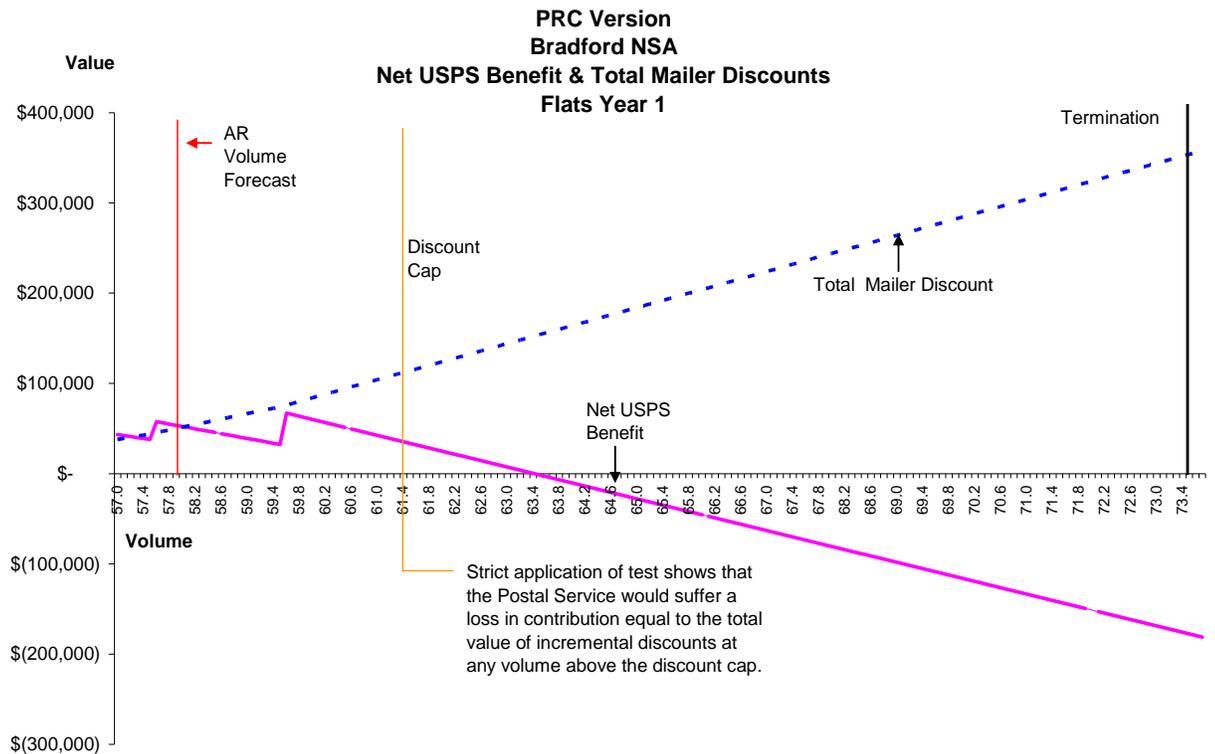
The Commission's application of its Docket No. MC2004-3 Analysis to the three years of the proposed agreement for both letters and flats are reproduced and discussed below. The analyses incorporate the Commission's estimate of the mailer-specific unit contribution for letters and flats. In addition, the Commission relaxed the strict interpretation of the test results that would indicate a loss in net contribution when volume exceeds the discount cap.

**Chart IV-D-1**



For Year 1 of the Agreement, if the total Standard Mail letter solicitations mailed by Bradford are below the automatic termination level, the test demonstrates that the Postal Service will not lose Standard Mail contribution on the letters part of the NSA for that year. Moreover, below the automatic termination level, the letters portion of the Agreement is expected to increase net contribution as shown in PRC-MC2007-4-LR-2.

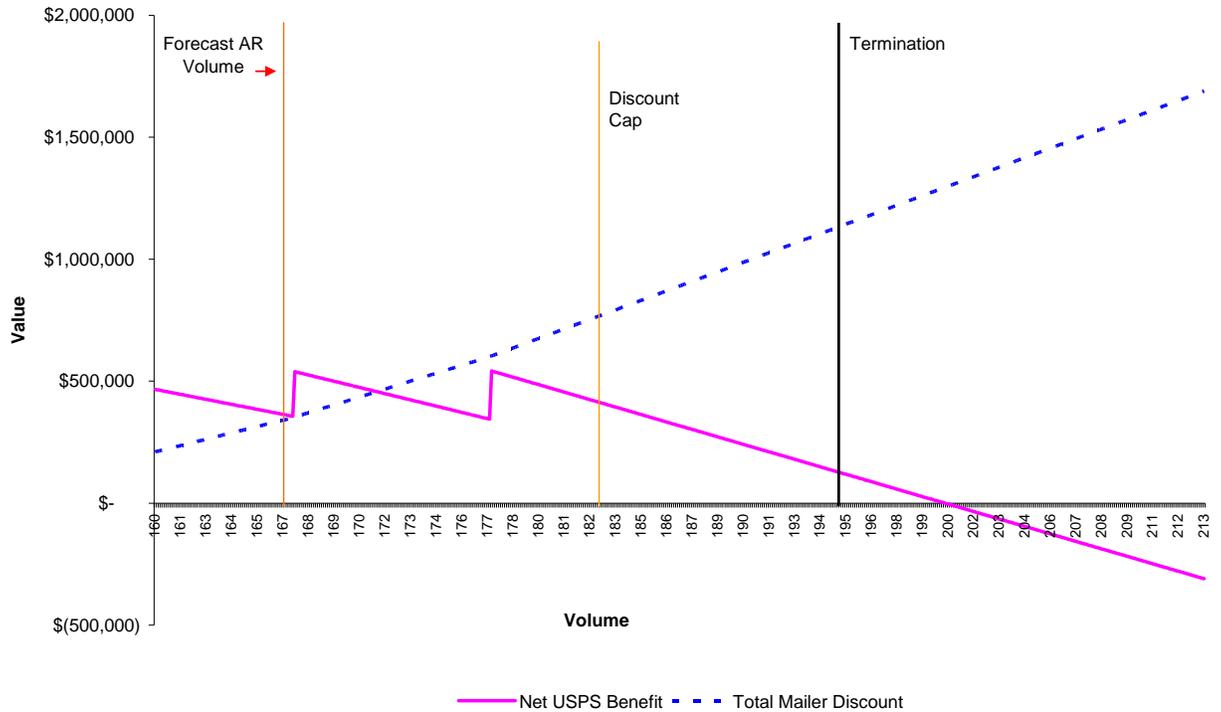
Chart IV-D-2



For Year 1 of the Agreement, if the total Standard Mail flat solicitations mailed by Bradford are below 63.6 million pieces, the test demonstrates that the Postal Service will not lose Standard Mail contribution on this NSA. If, however, the total Standard Mail solicitation flats volume for Bradford is greater than 63.6 million pieces, the test shows that the Postal Service will lose Standard Mail contribution on the flats part of the NSA for that year.<sup>27</sup> Moreover, below the automatic termination level, the flats portion of the Agreement is expected to result in a change of net contribution as shown in PRC-MC2007-4-LR-L-2.

**Chart IV-D-3**

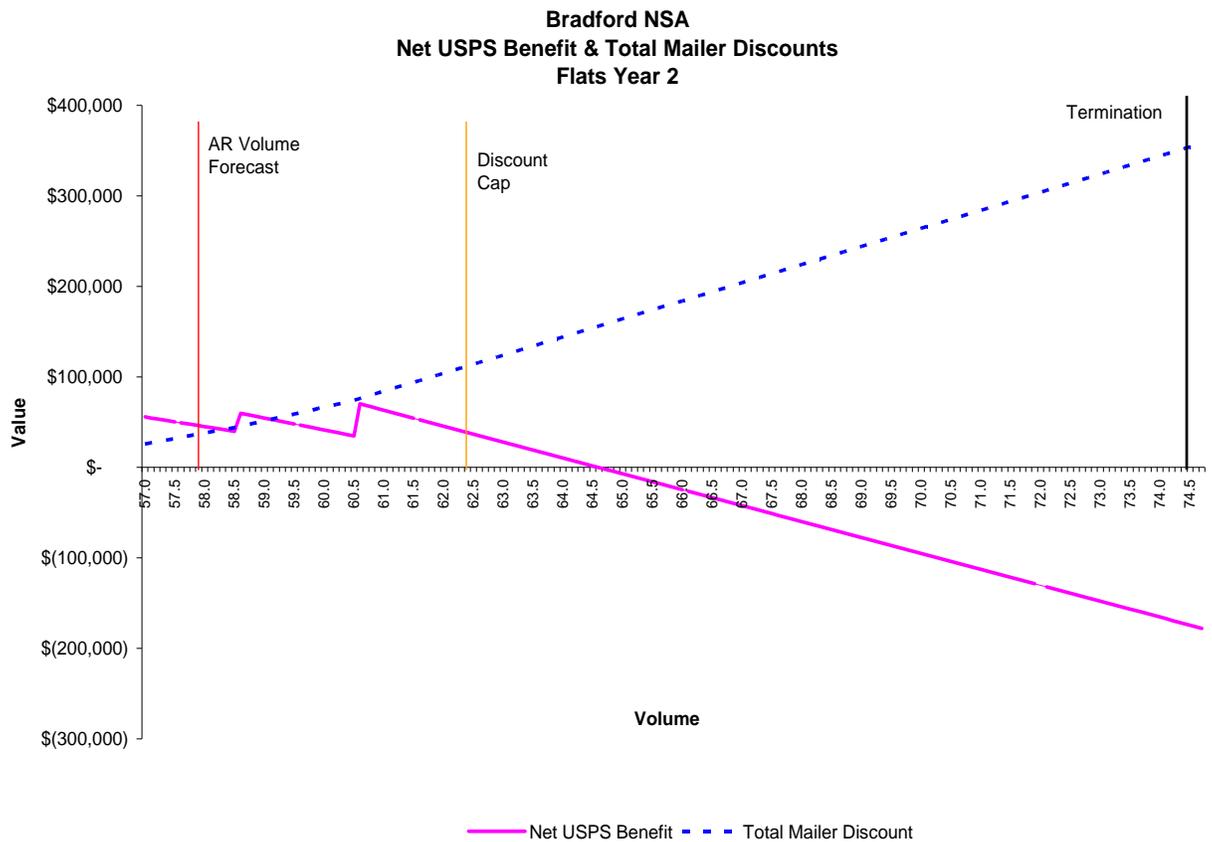
**Bradford NSA  
 Net USPS Benefit & Total Mailer Discounts  
 Letters Year 2**



For Year 2 of the Agreement, if the total Standard Mail letter solicitations mailed by Bradford are below the automatic termination level, the test demonstrates that the Postal Service will not lose Standard Mail contribution on the letters part of the NSA for that year. Moreover, below the automatic termination level, the letters portion of the Agreement is expected to increase net contribution as shown in PRC-MC2007-4-LR-L-2.

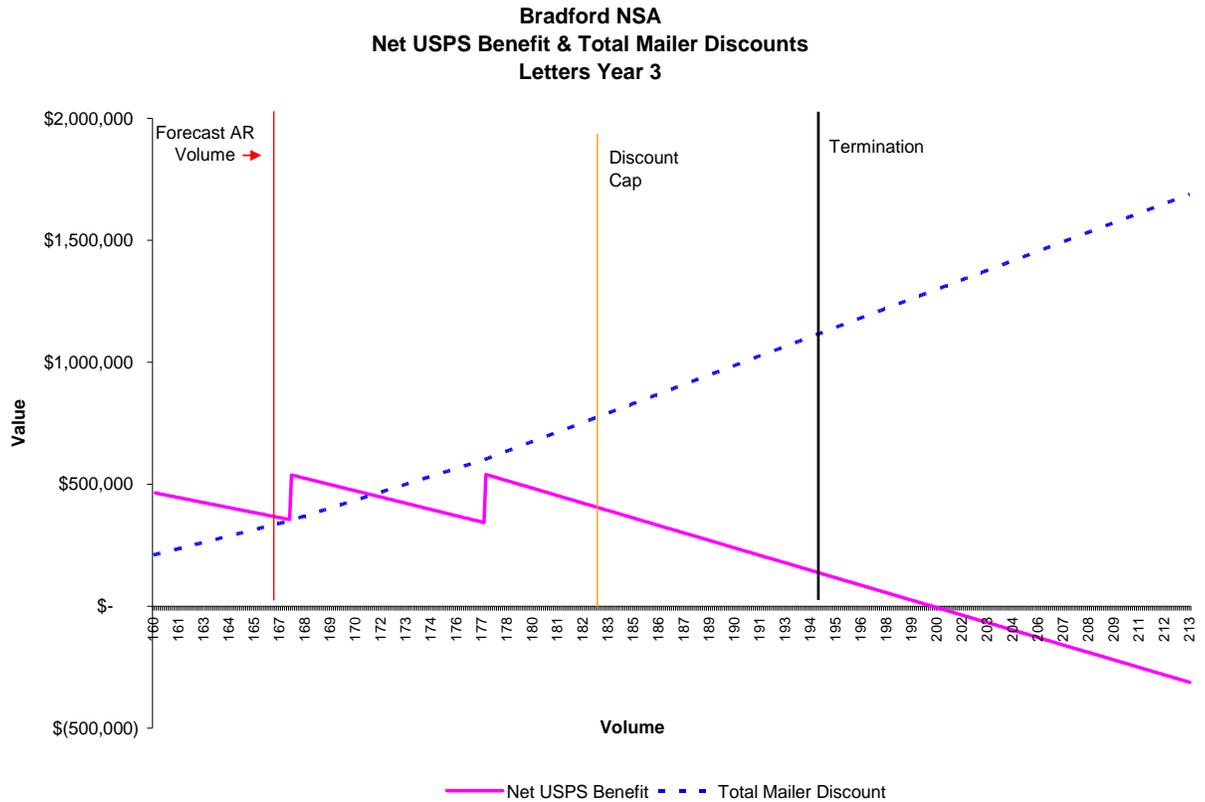
<sup>27</sup> Under strict application of the test, the Postal Service will lose net contribution if flats volume exceeds the discount cap.

**Chart IV-D-4**



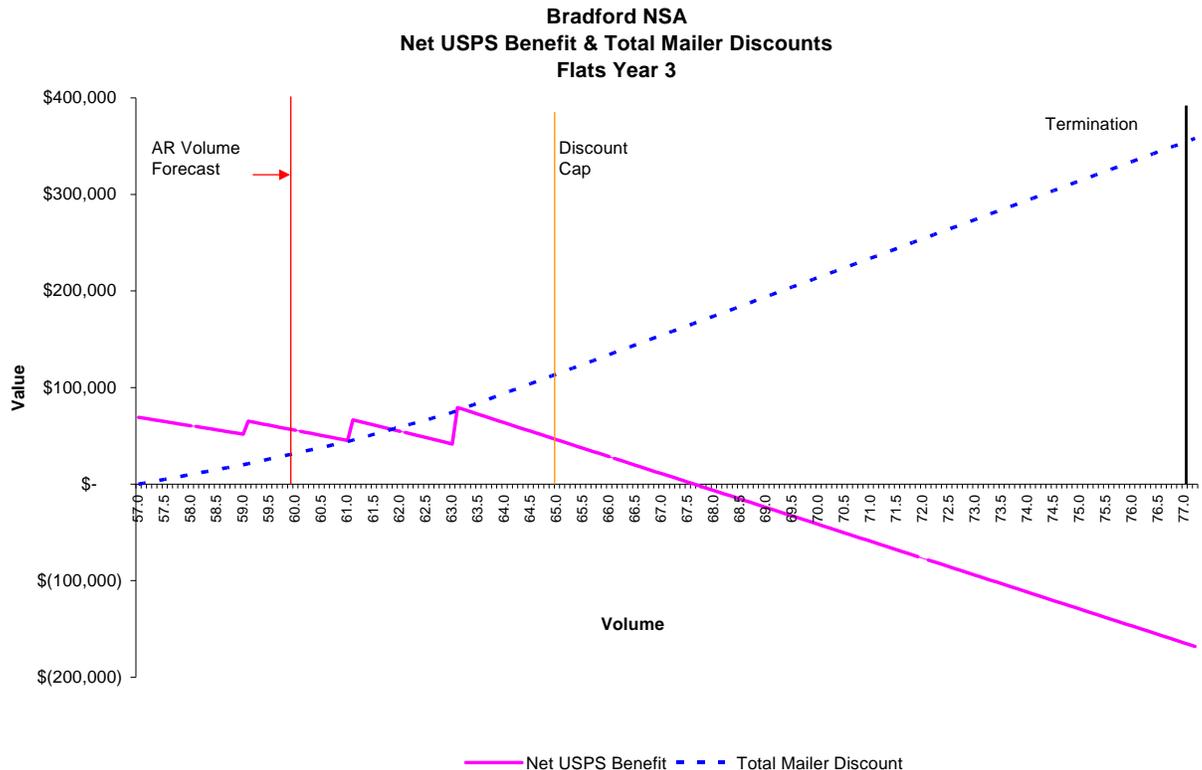
For Year 2 of the Agreement, if the total Standard Mail flat solicitations mailed by Bradford are below 64.8 million pieces, the test demonstrates that the Postal Service will not lose Standard Mail contribution on this NSA. If, however, the total Standard Mail solicitation flats volume for Bradford is greater than 64.8 million pieces, the test shows that the Postal Service will lose Standard Mail contribution on the flats part of the NSA for that year. Moreover, below the automatic termination level, the flats portion of the Agreement is expected to result in a change of net contribution as shown in PRC-MC2007-4-LR-L-2.

**Chart IV-D-5**



For Year 3 of the Agreement, if the total Standard Mail letter solicitations mailed by Bradford are below the automatic termination level, the test demonstrates that the Postal Service will not lose Standard Mail contribution on the letters part of the NSA for that year. Moreover, below the automatic termination level, the letter portion of the Agreement is expected to increase net contribution as shown in PRC-MC2007-4-LR-L-2.

**Chart IV-D-6**



For Year 3 of the Agreement, if the total Standard Mail flat solicitations mailed by Bradford are below 67.7 million pieces, the test demonstrates that the Postal Service will not lose Standard Mail contribution on this NSA for that year. If, however, the total Standard Mail solicitation flats volume for Bradford is greater than 67.7 million pieces, the test shows that the Postal Service will lose Standard Mail contribution on the flats part of the NSA for that year. Moreover, below the automatic termination level, the flats portion of the Agreement is expected to result in a change of net contribution as shown in PRC-MC2007-4-LR-L-2.

The Commission finds the automatic termination provision and its relationship to the Agreement a positive factor. In the Commission's Bank One reconsideration opinion, where the Commission set forth an alternative design mechanism, the Commission discussed voiding the agreement if the NSA partner's mail volumes were

outside the agreed upon plausible range of mail volumes. See Op. and Further Recommended Decision, MC2004-3, ¶ 5018.<sup>28</sup> This measure was introduced as a means of offering incentive for the mailer to provide the most accurate mail forecast possible. It was also intended to shift some of the risk of an overly conservative after-rates volume forecast from the Postal Service to the mailer.

Voiding the Agreement may not be the only sufficient mechanism to encourage accurate volume forecasts. Other meaningful and usable methods of shifting some of the NSA's risk of loss onto the mailer may exist.<sup>29</sup> The automatic termination provision may be on the right track, at least for the first year. If the mailer sends too many mailpieces in the first year, it will lose its right to participate in the Agreement in the second and third years.<sup>30</sup> The goal is to shift some sort of meaningful risk of loss or penalty to the NSA partner. Placing a meaningful risk of loss on the NSA partner provides a much needed incentive to develop a range of accurate after-rates volume estimates.

The foregoing discussion should help to address ACMA's request for Commission guidance as to what may be acceptable NSA methodologies under its new compliance review responsibilities under the PAEA. ACMA Reply Brief at 3. However, just as pronouncements of law by a court without a case or controversy are inappropriate, the Commission does not find it appropriate to prejudge whether or not some hypothetical future NSA will be found in compliance with the PAEA at a future compliance review.

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<sup>28</sup> *Id.* ("The agreement would stipulate that if the mailer's actual volume under the agreement fell outside the agreed-upon range, this would represent an unexpected major shift in the mailer's demand due to changes in non-price factors, thereby voiding the agreement.").

<sup>29</sup> In the proposed and all past NSAs, there is no downside for the mailer. That is, under the worst case scenario, the mailer would have to pay the tariff rate. However, under the worst case scenario for the Postal Service, it could lose several hundred thousand dollars per year in net contribution.

<sup>30</sup> The provision's effectiveness for this purpose in the second and third years of the Agreement is more questionable.

The Commission believes that NSAs, when designed and implemented appropriately, are a promising vehicle for encouraging volume growth and product innovation. The Commission will not starve innovation by stating that there is a preferred way to design an NSA. Nonetheless, in connection with this Agreement, the Commission reaffirms the alternative design mechanism first announced in the Bank One reconsideration opinion. See Docket No. MC2004-3, PRC Op. and Further Recommended Decision, ¶¶ 5001 *et. seq.* While the Commission has confidence in that model, the Commission is sure that it can be improved over time. Other methods or methodologies may also come into existence which may completely overtake that model.

While the model is useful in the Commission's current pre-implementation evaluation of agreements, it was meant to be used as a negotiating tool to allow the parties to come to an agreement with terms that will allow the Postal Service to moderate its risk of loss. *Id.*, ¶¶ 5017-38. The analysis also may be used as an after-the-fact evaluation to determine whether, given a known after-rates volume, an agreement was beneficial to the Postal Service.<sup>31</sup> This would seem to fit with the overall structure of the PAEA in that the analysis discussed in the Bank One reconsideration opinion may be better applied as an after-the-fact review in the context of a compliance review.

#### 4. Conclusion

The Commission finds that, after the adjustments and revisions to the financial analysis noted above are taken into consideration, the financial risk of the Agreement is acceptable. The Commission improves the cost estimates to make them more accurate. This increases the potential benefits to the Postal Service. The Commission does not find the proponents' point volume estimates to be reliable and usable.

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<sup>31</sup> See, e.g., FY 2007 Annual Compliance Determination, March 27, 2008.

However, based on the Commission's Docket No. MC2004-3 Analysis, there is a wide range of values where the NSA appears to result in increased contribution for letters. While the analysis shows many unfavorable ranges of values for flats — especially close to the trend line, most of the NSA's value to the Postal Service is in the letter portion of the Agreement. Given that the letter portion represents the vast majority of the Agreement's value, the potential unfavorable ranges for the flats volume are significantly mitigated with respect to the value of the Agreement as a whole. The Agreement also contains a number of safeguards designed to limit the Postal Service's exposure to risk. Taking all these factors into consideration, the Commission is satisfied that the negative outcomes discussed above are mitigated sufficiently to place the total risk of loss at an acceptable level.

#### E. Statutory Criteria

This case is filed under the provisions of the pre-PAEA, Postal Reorganization Act. 39 U.S.C., §§ 101 *et seq.*, as in effect prior to amendment, Pub. L. 109-435. Therefore, the Commission is required to evaluate how former sections 3622 and 3623 apply to the proposal. The Commission has reviewed each of the applicable factors and determined that, on balance, its recommended decision is consistent with the policies of the PRA.

The Commission first considers whether the proposed classification is consistent with the establishment and maintenance of a fair and equitable rate schedule and classification system for all mail. See former §§ 3622(b)(1) and 3623(c)(1). In every negotiated service agreement request, the Commission must consider the impact of the agreement on competitors to the Postal Service, on competitors to its NSA partner, and mail users in general. See rule 193(f). No record evidence has been presented indicating any adverse effect on competitors to the parties of the Agreement, nor has any evidence been presented that would indicate any likelihood that there would be any unreasonable harm to competition in the marketplace generated by recommending this

Agreement. Moreover, any competitor who is similarly situated may seek to negotiate a functionally equivalent agreement with the Postal Service comparable to Bradford's proposed NSA.

The Commission estimates that the financial risk of the Agreement is acceptable at this time. The evidence shows that the mail sent under the Agreement will cover its attributable costs. See 39 U.S.C. § 3622(b)(3). The Agreement has a *de minimus* effect on the simplicity of the rate structure (§ 3622(b)(7)), the importance of classifications with high degrees of reliability and speed of delivery (§ 3622(c)(3)), and the importance of classifications which do not require high degrees of reliability and speed of delivery (§ 3622(c)(4)). Tariff rates remain available to all users of the mails. Thus, the Agreement does not affect the availability of alternative means of sending and receiving letters and other mail matter at reasonable costs (§ 3622(b)(5)).

The mail matter sent by Bradford is generally not considered to be "educational, cultural, scientific, or informational" as that term is used in § 3622(b)(8). Accordingly, that factor is not applicable here. Similarly, this NSA does not affect the degree of preparation required to enter mail into the postal system. Therefore, factor 3622(b)(6) is inapplicable.

NSAs allow the Postal Service to tailor its rates and services to the particular needs of individual mailers. Thus, as the Postal Service points out, by directly negotiating with a customer, rates may more accurately represent the value that the user places on the service. This results in an increase in the desirability and value of the service to both Bradford and the Postal Service. See former §§ 3622(b)(2) and 3623(c)(5).

The Commission finds the enactment of the PAEA to be an extremely important factor in considering whether to recommend this NSA since it provides a clear Congressional expression of public policy. See PRC Op. MC2007-1, ¶ 4059. The Commission concludes that the policies and objectives of the PAEA are relevant and should be given considerable weight under the PRA §§ 3622(b)(9) and 3623(c)(6).

These provisions of the PRA specifically allow and encourage the Commission to apply “such other factors as the Commission deems appropriate.” *Id.*

OCA argues that if the Commission is going to take the PAEA’s expression of public policy into account under former §§ 3622(b)(9) and 3623(c)(6), the Commission should also take into consideration the PAEA’s specific instruction that the agreements for market dominant products must “improve the net financial position of the Postal Service through ... increasing the overall contribution to institutional costs of the Postal Service.” The Commission has also promulgated a regulation bearing on this factor. See 39 C.F.R. § 3010.40.

The Commission agrees with OCA that this factor is relevant in determining whether to recommend the Bradford NSA. Whether or not the Agreement improves the net financial position of the Postal Service is of considerable importance in evaluating an NSA — both from the point of view of the Postal Service when it negotiates the NSA, and the Commission and the Governors in evaluating the positives and negatives of the Agreement. Indeed, this is a factor that the Commission has consistently evaluated in every NSA case even prior to the passage of the PAEA; it is not a new criteria. See, e.g., PRC Op. MC2005-3, ¶ 4089; PRC Op. MC2002-2, ¶ 8013. The Commission has taken this factor into account in its financial analysis of this Agreement and trusts that the Governors in their ultimate decision on this Agreement find the Commission’s analysis helpful in that regard.

In addition to codifying that the likelihood that an NSA will result in a net benefit to the Postal Service is an important consideration for evaluating whether to enter into an NSA, the PAEA introduced an entirely new criteria for the Commission to consider in evaluating these agreements. This criterion was recently discussed in the Commission’s Bank of America recommended decision. See PRC Op. MC2007-1, ¶¶ 4059-61. There, the Commission noted that:

One goal of the PAEA is to provide the Postal Service with a level of flexibility to set rates and develop classifications,

including the ability to enter into mailer-specific agreements that it finds beneficial. To provide this flexibility, it is necessary to shift the initial responsibility to review and to determine whether or not to proceed with mailer-specific agreements to the Governors of the Postal Service. The Commission provides this Opinion and Recommended Decision with its analysis of the BAC Agreement, both financial and statutory, to the Governors for consideration. Although the Commission's review is consistent with the legislation that predates the PAEA, the Commission is well aware that review under PAEA standards is soon to become the norm.

*Id.*, ¶ 4060. The Commission believes that the same considerations are applicable here. Accordingly, the Commission provides its thorough analysis based on the record evidence to assist the Governors in making an informed determination, based on the financial and statutory factors of the PRA on whether to implement the proposed NSA.

#### F. DMCS Language

The Postal Service proposes to add a new DMCS section 621 to specify the general parameters of the Bradford NSA. See Request, Attachment A. The Commission recommends the DMCS language as proposed by the Postal Service with minor technical corrections that should have no effect on the intended meaning. The Commission also will develop similar language for incorporating into the draft Mail Classification Schedule. See C.F.R. part 3200, subpart A.

The Postal Service proposes the addition of three new rate schedules to the DMCS: 621A, 621B, and 621C. Rate schedule 621A specifies the volume block incremental discounts in Year 1 of the Agreement. Rate schedule 621B specifies the volume block incremental discounts in Year 2 of the Agreement. Rate schedule 621C specifies the volume block incremental discounts in Year 3 of the Agreement. See Request, Attachment B. The Commission recommends the addition of rate schedules 621A, 621B, and 621C as proposed by the Postal Service.

#### G. Data Collection Plan

The Postal Service states that it intends to follow the same data collection plan in this case as recommended by the Commission in the Bookspan case, Docket No. MC2005-3. See Tr. 2/21. The Commission recommends the data collection plan as proposed by the Postal Service with minor technical corrections that should have no effect on the intended meaning. See USPS-T-1 at Appendix E (corrected). The complete data collection and reporting to be required during the term of the NSA are set out below:

1. The volume of solicitation Standard Mail letter-shape and flat-shape pieces by rate category in eligible Bradford Group accounts and any other accounts in which Bradford sends its mail;
2. The discounts paid to The Bradford Group for letter-shape and flat-shape solicitation Standard Mail by incremental volume block;
3. Monthly estimates of the amount of time spent on compliance and a description of the activities performed;
4. A comparison of the estimated mailer-specific costs and revenues with the actual mailer-specific costs and revenues;
5. An evaluation of the impact of the Agreement on contribution;
6. An evaluation of the effectiveness of the Agreement using the Docket No. MC2004-3 Analysis;
7. A narrative comparison of The Bradford Group's actual volumes by rate category with:
  - a. Before-rates forecast
  - b. After-rates forecast
  - c. Subclass totals
  - d. Relevant benchmarks based on research using available and/or commissioned sources where possible. This will include an analysis of any significant exogenous impacts;

8. The volume of solicitation Standard Mail letter- or flat-sized mailpieces that included strategic business alliance inserts on a quarterly basis. This information shall be provided by rate category and by whether the mailpieces included one or two inserts.

An annual report of the data collected and the information analyzed are to be provided to the Commission yearly within 120 days of the NSA anniversary date. Items 1 and 3 are to be reported as monthly data for the previous year of the Agreement. Items 7 and 8 shall be provided every six months within 30 days of the ending of that six-month period. The Postal Service shall provide the data in a PC-available format.

#### H. Conclusion

The Commission has reviewed the evidentiary record pursuant to its statutory obligation under chapter 36 of title 39 of the U.S. Code. This includes an independent review of the evidentiary testimony of Postal Service witness Parr, the testimony of The Bradford Group witnesses Gustafson and Ring, the designated written cross-examination, the designated responses to Commission Information Request No. 1, and the briefs filed by the participants. This review leads to the conclusion that the record supports the proposed classification changes and the related discounts set out in the Request dated August 3, 2007, and that these changes are consistent with the policies of the Postal Reorganization Act. The Commission therefore recommends to the Governors of the Postal Service that the DMCS be amended as set forth in Appendices One and Two of the accompanying Recommended Decision.

UNITED STATES OF AMERICA  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

Before Commissioners:

Dan G. Blair, Chairman;  
Mark Acton, Vice Chairman;  
Ruth Y. Goldway; and Tony  
Hammond

Rate and Service Changes to Implement  
Functionally Equivalent Negotiated Service  
Agreement With The Bradford Group

Docket No. MC2007-4

RECOMMENDED DECISION

(Issued April 18, 2008)

The Commission, having considered the Postal Service Request, has issued its Opinion thereon. Based on that Opinion, which is attached hereto and made a part hereof,

IT IS ORDERED:

1. The Commission's Opinion and Recommended Decision shall be transmitted to the Governors of the Postal Service and that the Governors shall thereby be advised that the proposed discounts (set forth in Appendix One) and the proposed amendments to the Domestic Mail Classification Schedule (set forth in Appendix Two) are in accordance with the policies of title 39 of the United States

Code and the factors set forth in §§ 3622(b) and 3623(c) thereof; and they are hereby recommended to the Governors for approval.

2. Except to the extent granted or otherwise disposed of herein, all motions, exceptions, and other outstanding requests filed in Docket No. MC2007-4 hereby are denied.

By the Commission.

Steven W. Williams  
Secretary

## Dissenting Opinion of Commissioner Goldway

After carefully reviewing the record in this case, as well as the foregoing discussion of my fellow Commissioners, I respectfully reach a different conclusion than my colleagues.

I fully recognize that the monetary value of this Agreement is not, in this instance, important to the overall financial health of the Postal Service. Nonetheless, the inconsistent results of the various financial analyses performed by the Postal Service and its failure to analyze these differences or attempt to harmonize them force me to conclude that the Postal Service did not perform an adequate level of due diligence before presenting this Agreement for Commission review. See *e.g.*, PRC Op. MC2007-4 at 36. For this reason, I can not recommend The Bradford Group NSA to the Governors for approval.

Accordingly, I respectfully dissent.

**APPENDIX ONE**

**RECOMMENDED CHANGES IN RATE SCHEDULES**

The following changes represent the rate schedule recommendations of the Postal Regulatory Commission in response to the Postal Service's Docket No. MC2007-4 Request. The changes require addition of three new rate schedules – 621A, 621B and 621C.

**BRADFORD GROUP NSA  
RATE SCHEDULE 621A**

**(First Year of Agreement)**

**Eligible Standard Mail Letters**

<b>Volume Block<sup>1</sup></b>	<b>Incremental Discount</b>
147,000,000 to 157,000,000	1.5¢
157,000,001 to 167,000,000	2.0¢
167,000,001 to 177,000,000	2.5¢
177,000,001 to 183,000,000	3.0¢

**Eligible Standard Mail Flats**

<b>Volume Block<sup>1</sup></b>	<b>Incremental Discount</b>
53,500,000 to 55,500,000	1.0¢
55,500,001 to 57,500,000	1.2¢
57,500,001 to 59,500,000	1.5¢
59,500,001 to 61,500,000	2.0¢

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<sup>1</sup> Volume block beginning and ending thresholds are subject to adjustment for mergers, acquisitions, sales, or closures in accordance with DMCS § 621.24.

**BRADFORD GROUP NSA  
RATE SCHEDULE 621B**

**(Second Year of Agreement)**

**Eligible Standard Mail Letters**

<b>Volume Block<sup>1</sup></b>	<b>Incremental Discount</b>
147,000,000 to 157,000,000	1.5¢
157,000,001 to 167,000,000	2.0¢
167,000,001 to 177,000,000	2.5¢
177,000,001 to 183,000,000	3.0¢

**Eligible Standard Mail Flats**

<b>Volume Block<sup>1</sup></b>	<b>Incremental Discount</b>
54,500,000 to 56,500,000	1.0¢
56,500,001 to 58,500,000	1.2¢
58,500,001 to 60,500,000	1.5¢
60,500,001 to 62,500,000	2.0¢

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<sup>1</sup> Volume block beginning and ending thresholds are subject to adjustment for mergers, acquisitions, sales, or closures in accordance with DMCS § 621.24.

**BRADFORD GROUP NSA  
RATE SCHEDULE 621C**

**(Third Year of Agreement)**

**Eligible Standard Mail Letters**

<b>Volume Block<sup>1</sup></b>	<b>Incremental Discount</b>
147,000,000 to 157,000,000	1.5¢
157,000,001 to 167,000,000	2.0¢
167,000,001 to 177,000,000	2.5¢
177,000,001 to 183,000,000	3.0¢

**Eligible Standard Mail Flats**

<b>Volume Block<sup>1</sup></b>	<b>Incremental Discount</b>
57,000,000 to 59,000,000	1.0¢
59,000,001 to 61,000,000	1.2¢
61,000,001 to 63,000,000	1.5¢
63,000,001 to 65,000,000	2.0¢

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<sup>1</sup> Volume block beginning and ending thresholds are subject to adjustment for mergers, acquisitions, sales, or closures in accordance with DMCS § 621.24.

**APPENDIX TWO**

**RECOMMENDED CHANGES IN  
DOMESTIC MAIL CLASSIFICATION SCHEDULE**

The following material represents changes to the Domestic Mail Classification Schedule recommended by the Postal Regulatory Commission in response to the Postal Service's Docket No. MC2007-4 Request. The underlined text signifies that the text is new, and shall appear in addition to all other Domestic Mail Classification Schedule text. Information to be added upon approval by the Board of Governors appears in brackets and is underlined>.

**NEGOTIATED SERVICE AGREEMENTS  
CLASSIFICATION SCHEDULE**

\*\*\*\*\*

**621**            **BRADFORD GROUP NEGOTIATED SERVICE AGREEMENT**

**621.1**           **Eligible Standard Mail**

**621.11**        **Bradford Group.** Eligible Standard Mail under this section is defined as letter-shaped and flat-shaped pieces sent by Bradford Group for the purpose of soliciting prospective customers and clients of Bradford Group, as well as advertising to existing Bradford Group clients. Such letters and flats may be sent by Bradford Group, by entities in which Bradford Group holds controlling shares, or by their vendors on their behalf. Such solicitations may include up to two inserts promoting Bradford Group's strategic business alliances.

**621.2**           **Standard Mail Declining Block Rates**

**621.21**        **Volume Commitments.** The following volume commitments for otherwise eligible letter-shaped and flat-shaped Standard Mail pieces must be met before any discounts under this section are payable:

- a.    154 million letter-shaped pieces and 54.5 million flat-shaped pieces for the first year of the Agreement;
- b.    154 million letter-shaped pieces and 55.5 million flat-shaped pieces for the second year of the Agreement, subject to adjustment as specified below; and,
- c.    154 million letter-shaped pieces and 58 million flat-shaped pieces for the third year of the Agreement, subject to adjustment as specified below.

If Bradford Group does not mail at least 166 million Standard Mail letter-shaped and flat-shaped pieces during the first year of this Agreement, it will pay the Postal Service a one-time transaction fee of \$200,000.

**621.22** **Volume Commitment Adjustment Mechanism.** At the end of each year of the Agreement other than its final year, the volume commitment for the following year will be adjusted, as follows.

- a. If, at the end of the year, actual volume is 12 percent or more above that year's volume commitment, the following year's commitment will be revised to be the average of the completed year's actual volume and the original volume commitment for the following year.
- b. If, at the end of the year, actual volume is 5 percent or more below that year's volume commitment, the following year's commitment will be decreased by the percentage difference between the completed year's original volume commitment and its actual volume, but in no case to lower than 140 million for letters or 50 million for flats. If the volume commitment as adjusted by the previous sentence falls below the following year's starting threshold: the starting threshold must then be adjusted to equal the following year's volume commitment as adjusted by the previous sentence; and, the following year's volume commitment will be further adjusted to equal the following year's starting threshold plus 7 million pieces for letters, and the following year's starting threshold plus 1 million pieces for flats.

**621.23** **Incremental Discounts.** Bradford Group's eligible Standard Mail is subject to the otherwise applicable Standard Mail postage in Rate Schedules 321A or 321B, less the discounts shown in Rate Schedule 621A for the first year of the Agreement, in Rate Schedule 621B for the second year of the Agreement, and in Rate Schedule 621C for the third year of the Agreement, if Bradford Group meets the applicable volume commitments specified in 621.21, or as adjusted in accordance with 621.22. Each incremental discount applies only to the incremental volume within each volume block.

**621.24** **Volume Block Adjustments for Mergers, Acquisitions, Sales, or Closures.** In the event that Bradford Group merges with and/or acquires an entity or entities and/or purchases a portfolio with annual Standard Mail

letters and flats volume in excess of 5 million pieces, the volume blocks will be adjusted to add the volume of Standard Mail sent by the merged or acquired entity during the 12 months preceding the merger, acquisition, or purchase. The adjustment becomes effective for the succeeding fiscal quarter immediately following the date that mail volumes due to the merger, acquisition, or purchase begin to be mailed through the threshold permit accounts.

In the event that Bradford Group has sold or close one or more divisions or entities with combined annual Standard Mail volume in excess of 5 millions pieces, the volume blocks will be adjusted to subtract the volume of Standard Mail sent by the sold or closed division or entity during the 12 months preceding the sale or closure. The adjustment becomes effective for the succeeding fiscal quarter immediately following the date that mail volumes due to the sale or closure begin to be mailed through the threshold permit accounts.

**621.25**      **Termination.** The Agreement automatically terminates and eligibility for all discounts under this section ceases if Bradford Group's Standard Mail volume exceeds 12 million pieces above the maximum volume in the top tier of Rate Schedules 621A, 621B, or 621C (for either letters or flats), in any year of this Agreement, or if the Agreement is terminated by either party with 30 days' written notice to the other party.

**621.3**      **Rates**

The rates applicable to this Agreement are set forth in the following Rate Schedules:

621A  
621B  
621C

**621.4**      **Expiration**

The provision of section 621 expire on [insert date three years from implementation date set by the Board of Governors].

**621.5**      **Precedence**

To the extent any provision of section 621 is inconsistent with any other provision of the Domestic Mail Classification Schedule, the former shall control.

**APPENDIX A**

**PARTICIPANTS AND COUNSEL**

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