

USPS-T-1

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

RATE AND SERVICE CHANGES TO IMPLEMENT
BASELINE NEGOTIATED SERVICE AGREEMENT
WITH LIFE LINE SCREENING

Docket No. MC2007-5

DIRECT TESTIMONY OF
MICHELLE K. YORGEY
ON BEHALF OF THE
UNITED STATES POSTAL SERVICE

TABLE OF CONTENTS

AUTOBIOGRAPHICAL SKETCH	ii
I. PURPOSE AND SCOPE OF TESTIMONY	1
II. TERMS AND CONDITIONS OF LIFE LINE SCREENING OF AMERICA NSA....	1
A. Solicitation Incentives and the Multiplier Effect	1
B. Declining Block Rates with Volume Commitments	2
C. Annual Adjustment Mechanism for Letter-size Volume Commitment	5
D. Termination Clauses	6
III. FINANCIAL IMPACT	6
IV. EVALUATION OF VOLUME FORECASTS	7
A. Before-Rates Volume Forecast.....	7
1. Company-specific research.....	7
2. Volume trend analysis	7
3. Analysis of the market environment	8
B. After-Rates Volume Forecast.....	8
C. Risk mitigation	9
D. Sensitivity Analysis	10
V. OTHER IMPACTS	10
A. Competitors of Life Line Screening of America	10
B. Competitors of the Postal Service	11
C. Mail Users.....	12
VI. THE PROPOSALS ARE CONSISTENT WITH THE RATE AND CLASSIFICATION CRITERIA OF THE ACT	12
SUMMARY AND CONCLUSION	14

Appendix A: Financial Model

Appendix B: Explanation of Financial Model

Appendix C: Value To Volume Sensitivity Matrix

Appendix D: MC2004-3 Opinion and Further Recommended Decision Analysis

Appendix E: Proposed Data Collection Plan

1 **I. PURPOSE AND SCOPE OF TESTIMONY**

2 The purpose of my testimony is: (1) to present the specific terms and conditions
3 of the Negotiated Service Agreement (NSA) that the Postal Service has negotiated with
4 Life Line Screening of America; (2) to describe the analytical support used to develop
5 the NSA; (3) to explain the financial implications of this NSA; (4) to describe the
6 provisions that are intended to minimize the risk associated with forecasting volumes for
7 a single mailer; and (5) to explain the steps the Postal Service has taken to understand
8 the market in which Life Line Screening of America operates. Finally, my testimony will
9 show how the changes proposed to implement the NSA conform to the pricing and
10 classification criteria of the Postal Reorganization Act, as amended by the Postal
11 Accountability and Enhancement Act.

12 In addition to my testimony, the Postal Service relies on the Direct Testimony
13 made on behalf of Life Line Screening of America by Eric Greenberg (LLS-T-1). I
14 reviewed Mr. Greenberg's testimony, and affirm that it may be relied upon in
15 presentation of the Postal Service's direct case.

16 **II. TERMS AND CONDITIONS OF THE LIFE LINE SCREENING OF AMERICA**
17 **NSA**

18 **A. Solicitation Incentives and the Multiplier Effect**

19 The NSA is relatively simple, and designed to provide economic incentives to Life
20 Line Screening of America (hereafter Life Line) to increase its use of Standard Mail
21 letters for selling health care screening services to a nationwide customer base. Direct
22 mail expense is an important cost component for Life Line. Without such incentives as
23

1 contained in the proposed NSA, Life Line direct mail marketing volumes are expected to
2 decline due to its sensitivity to direct mail cost increases, alternative marketing channels
3 and certain business conditions that are inherent to Life Line's operations. The
4 incentives are based on volumes of, and are specific to Life Line's Standard Mail
5 solicitation letters.

6 Solicitation letters are defined as letter-size Standard Mail sent by Life Line
7 seeking customers in need of health care screening services. The incentives will
8 encourage Life Line to mail additional solicitation letters to increase its customer base
9 while maintaining its existing customer base. The Postal Service benefits from the
10 additional contribution generated by an increased volume of Standard Mail letter-size
11 solicitations. The total estimated net benefit to postal finances over the three-year
12 period of this NSA is \$5.4 million, as shown in Appendix A, and as explained in
13 Appendix B. Also, the Postal Service will realize an unintended benefit from additional
14 revenue generated by increased volume for each new screening event in the form of
15 First-Class Mail correspondence known as the multiplier effect.

16 **B. Declining Block Rates with Volume Commitments**

17 The incentives in this NSA take the form of a declining block rate structure for
18 Standard Mail letter-size volumes at negotiated levels. This NSA uses the same
19 volume commitment mechanism as the Bookspan NSA, which mitigates risk that could
20 result from underestimation of before-rates volume. According to the agreement, before
21 the discounts earned at a negotiated volume level are payable, Life Line must first meet
22 a *higher* volume commitment. For instance, in the first year of the agreement,

- 1 90,000,000 letter pieces are Life Line's before rates. Discounts are for volumes above
- 2 the thresholds of 90,000,001 million pieces. However, the discounts are *not* paid unless
- 3 Life Line actually mails 95,000,000 letter-size mail pieces.

TABLE 1: DECLINING BLOCK RATE STRUCTURE – STANDARD MAIL LETTER-SIZE

Year 1 Structure

Before-Rates Volume Forecast:		
90,000,000		
LETTER Volume Blocks		Incremental Discount
-	90,000,000	0 cents
90,000,001	100,000,000	1.0 cents
100,000,001	110,000,000	2.0 cents
110,000,001	118,000,000	3.0 cents
Volume Commitment: 95,000,000		

TABLE 1: DECLINING BLOCK RATE STRUCTURE – STANDARD MAIL LETTER-SIZE (CONT.)

Year 2 Structure

Before-Rates Volume 87,000,000 Forecast:			
	LETTER Volume Blocks		Incremental Discount
	-	88,000,000	0 cents
	88,000,001	98,000,000	1.0 cents
	98,000,001	108,000,000	2.0 cents
	108,000,001	116,000,000	3.0 cents
Volume Commitment: 93,000,000			

Year 3 Structure

Before-Rates Volume 87,000,000 Forecast:			
	LETTER Volume Blocks		Incremental Discount
	-	88,000,000	0 cents
	88,000,001	98,000,000	1.0 cents
	98,000,001	108,000,000	2.0 cents
	108,000,001	116,000,000	3.0 cents
Volume Commitment: 93,000,000			

1 **C. Annual Adjustment Mechanism for Volume Commitments- Standard**
2 **Mail Letters**

3 The volume commitment is subject to adjustment each year, based on actual
4 volumes mailed in the previous year. The adjustment mechanism mitigates both the
5 risks associated with forecasting errors, and the effects that future rate increases will
6 have on volumes. The agreement provides that if at the end of the agreement year (12
7 consecutive months), actual volumes are 12 percent or more above that year's
8 commitment, the next year's volume commitment is recalculated as the arithmetic mean
9 of the current year's actual volume and the original volume commitment for the next
10 year. For example, if at the end of Year 1, the actual volume of Standard Mail letters
11 reached 107,000,000 pieces, the Year 2 volume commitment would increase from
12 93,000,000 to 100,000,000 letter-size pieces.¹ Thus, Life Line would have to mail
13 100,000,000 letter-size pieces in Year 2 in order to receive the discounts provided for
14 volumes above 88,000,001 letter-size pieces. If at the end of each year, actual volume
15 is five percent or more below that year's volume commitment, then the next year's
16 volume commitment will be decreased by the percentage difference between the actual
17 volume and that year's volume commitment. For example, if at the end of Year 2, the
18 volume of Standard Mail letters were 88,000,000, the Year 3 volume commitment is
19 reduced from 93,000,000 to 88,000,000 letter-size pieces.² In the event that the volume
20 commitment falls below the starting threshold in any year, the starting threshold will then
21 equal the adjusted volume commitment.

¹ $(107,000,000 + 93,000,000) \div 2 = 100,000,000$

² $93,000,000 - (93,000,000 \times ((93,000,000 - 88,000,000) \div 93,000,000)) = 88,000,000$

1 **D. Termination Clauses**

2 This NSA incorporates two unencumbered termination clauses that provide
3 substantial additional protection to both parties. The first provides both parties with an
4 unconditional right to terminate the agreement, without penalty, with 30 days' written
5 notice to the other party. The second provides that the agreement automatically
6 terminates and all discounts cease if Life Line's letter-size Standard Mail volume
7 exceeds 10 million above the top tier in any year.

8 **III. FINANCIAL IMPACT**

9 Three aspects of this NSA affect the Postal Service's finances. The first is the
10 net contribution from additional volumes of letter-size Standard Mail volume in response
11 to the rate incentive. Based on Life Line's projected volume forecast for new letter-size
12 volumes, the estimated new contribution for the three-year agreement is approximately
13 \$ 6.3 million. The second financial impact is the expected discount exposure on letter-
14 size volumes. The discount exposure is the result of price incentives applied to any
15 volume that would have been generated without a price incentive. The declining block
16 rates were designed to apply only to volumes that are above before-rates forecasted
17 volume after rounding the thresholds to the nearest million pieces, so there is no total
18 discount exposure on letter-size volume over the three-year agreement.

19 The final financial impact is the amount of the total incremental discounts,
20 projected to be \$ 0.9 million. Thus, the total estimated financial impact over the three-
21 year period of this NSA is a net benefit to the Postal Service of \$ 5.4 million. The Postal
22 Service proposes to collect data necessary to determine the actual financial impact of
23 the NSA. The data collection plan is described in Appendix E.

1 A second stream of value is generated for the Postal Service because of the
2 “multiplier effect.” Life Line’s multiplier effect is described more fully in the testimony of
3 Witness Greenberg (LLS-T-1). The Postal Service did not include the financial benefits
4 from the multiplier effect in evaluating the financial value of this NSA.

5 **IV. EVALUATION OF VOLUME FORECASTS**

6 **A. Before-Rates Volume Forecasts**

7 To evaluate Life Line’s before-rates volume forecasts and the potential growth in
8 its use of mail as a marketing medium, I utilized a variety of tools. My analysis is
9 comparable to that performed in evaluating previous NSAs and includes company-
10 specific research, volume trend analysis, and analysis of the market environment.
11 Based on this analysis, which is described below, the before-rates volume forecasts
12 provided by Life Line are reasonable.

13 **1. Company-specific research**

14 Life Line, a mobile health screening service provider is headquartered in
15 Cleveland, OH. They are among more than 90 companies supported by Polaris
16 Ventures Partners in the technology, healthcare, manufacturing, media,
17 communications, and business services sectors. Life Line was founded in 1996 and
18 currently has more than 1,000 employees.

19 **2. Volume trend analysis**

20 Life Line provided the Postal Service with counts of its letter-size Standard Mail
21 volumes for calendar years 2004 through 2006. These volumes have been reconciled
22 with Postal Service permit data. The data show that Life Line’s letter-size Standard Mail
23 volume from 2004 has trended substantially upward. Life Line has projected a decline

1 within the next three years due to (1) an increase in Standard Mail rates in 2006 and
2 2007, (2) a decrease in the pace of geographic expansion and (3) and movement to
3 non-direct mail marketing channels. These factors will affect volumes as shown in the
4 forecasts presented by Witness Greenberg (LLS-T-1).

5 Solicitation mail is a significant means for Life Line to acquire new customers and
6 promote to existing customers health-screening events. This volume decline could
7 result in diminished customers attending health screening events for Life Line and
8 further reduction in the volumes of First Class Mail correspondence and follow-up
9 Standard Mail solicitations (multiplier effect) for the Postal Service. This decline expects
10 to level off at the new lower level in the absence of an incentive to increase solicitation
11 of health screening events.

12 **3. Analysis of the market environment**

13 The health care industry is the largest industry representing 13.5 million jobs.
14 Health care for the elderly is projected to change dramatically as the U.S. population
15 age 65 and over is expected to double in size within the next 25 years. The age group
16 85 and older is now the fastest growing segment of the U.S. population. In 2005,
17 Americans without health insurance rose to 46.6 million (15.9%) compared to 45.3
18 million (15.6%) in 2004. Based on these findings, mobile preventive health care
19 screenings, provided by companies like Life Line, may address the need to prevent
20 complications of stroke and vascular disease that face our aging society.

21 **B. After-Rates Volume Forecasts**

22 Although Life Line itself is in the best position to provide after-rates volume
23 forecasts, the Postal Service believes that Life Line's presentations of its plans are

1 reasonable and are relied on to support the agreement. These incentives will
2 encourage Life Line to increase its use of mail. The risks associated with
3 overestimating the after-rates volume is addressed in more detail below. As described
4 above, risk-mitigating features are incorporated into this agreement. To the extent that
5 the after-rates volume forecasts underestimate Life Line's volume response to the price
6 incentives, the benefits to the Postal Service will exceed those presented in this case.

7 **C. Risk Mitigation**

8 The Life Line NSA, when considered in purely economic terms, provides the
9 Postal Service with an increase in net contribution with very limited risk. As described
10 above, there are four contractual terms that limit the residual risk in the out-years of the
11 agreement. These features provide additional protection from various risks. The first
12 feature, which reduces risk from deviation in volume forecasts, is an adjustment
13 mechanism that uses actual volumes from the previous year to establish projected
14 commitment volume thresholds for the following year as further described in Section
15 II.C. above. The second feature, which provides additional protection from deviation in
16 forecasting before-rates volumes and also reduces the risk of discount leakage,
17 requires that actual volumes exceed incentive volume thresholds before discounts are
18 payable as further described in Section II.B. above. The third feature, which provides
19 protection for the Postal Service against overestimation of after-rates volumes, is the
20 automatic termination provision of the agreement, also described in Section II.D above.
21 The fourth feature is a provision that unconditionally allows either party to terminate the
22 agreement with 30 days' written notice to the other party. This reduces risks to the
23 Postal Service that could result from a change in Life Line's business model or use of

1 the mails, reduces the risk of discount exposure, and protects both parties against a
2 broad range of unforeseen risks.

3 **D. Sensitivity Analysis**

4 By definition, forecasts are estimates, and the actual volumes are likely to
5 deviate from the point estimates used in my analysis. Such deviation from forecasts
6 would cause changes in the actual value of this NSA agreement. As stated previously,
7 and as shown in Appendix A, based on the volume projections presented by Life Line,
8 the three-year NSA has a value to the Postal Service of \$ 5,4 million. To evaluate
9 deviations from this projection, a sensitivity analysis was used to identify the possible
10 value of the NSA, assuming varying percentage changes in the before-rates volumes
11 forecast and varying percentage changes in the after-rates volume forecasts. The table
12 presented in Appendix C is a sensitivity matrix which shows the potential range of
13 values of this NSA under alternative sets of assumptions. The table illustrates that a net
14 loss could occur only under extreme mis-estimation or erroneous assumptions.

15 **V. OTHER IMPACTS**

16 The Commission's rules require an examination of the effects of the NSA on the
17 competitors of the NSA partner, competitors of the Postal Service, and mail users. A
18 summary of the examination I conducted follows.

19

20 **A. Competitors of Life Line**

21 As noted above, while negotiating this NSA, the Postal Service analyzed the
22 mobile health care screening industry within which Life Line Screening operates.

1 According to my analysis of internal Postal Service customer data, Life Line Screening
2 is unique among its competitors in its use of the mail as an important means of
3 marketing. Although its competitors may make some use of the mail for marketing
4 purposes, their reliance on mail is not comparable to that of Life Line Screening. Life
5 Line Screening could earn over \$0.9 million in price incentives over the three years of
6 the agreement.

7 Any potential competitor of Life Line Screening that intends to use and increase
8 its share of mail as a marketing medium may negotiate a comparable agreement to this
9 NSA. Thus, the NSA's effects on Life Line Screening's competitors are not expected to
10 be significant and the NSA may bring the benefits of increased competition to the
11 marketplace.

12 **B. Competitors of the Postal Service**

13 Competitors of the Postal Service are not affected by this agreement. Life Line
14 relies on the mail as a marketing channel because of its broad reach and targeting
15 abilities. The response rates and secondary effects of mail and other marketing
16 mediums differ, and they are therefore imperfect substitutes for Life Line.

17 The incentives in this agreement are intended to allow Life Line to use the mail
18 and to market more potential customers than it would otherwise have found profitable.
19 Given the business model that is described by the Life Line witness, this will inevitably
20 result in growth in Standard Mail letter-size volume mailed by Life Line.

1 **C. Mail Users**

2 Mail users will experience minimal impact from this NSA. Although the estimated
3 total USPS value of the three-year proposal is \$ 5.4 million is positive, it is small enough
4 that there will be little measurable value to any other specific mailers.

5 **VI. THE PROPOSALS ARE CONSISTENT WITH THE RATE AND**
6 **CLASSIFICATION CRITERIA OF THE ACT**

7 Title 39, Section 3623 requires that the Commission evaluate proposed changes
8 in the classification schedule in accordance with the policies of the Title and the
9 following factors:

- 10 1. The establishment and maintenance of a fair and equitable classification
11 system for all mail;
- 12 2. The relative value to the people of the kinds of mail matter entered into the postal
13 system and the desirability and justification for special classifications and
14 services of mail;
- 15 3. The importance of providing classifications which do not require an extremely
16 high degree of reliability and speed of delivery;
- 17 4. The desirability of special classifications from the point of view of both the user
18 and of the Postal Service; and
- 19 5. Such other factors as the Commission may deem appropriate.

20 Section 3622(b) requires that postal rates and fees reflect the policies of the Postal
21 Reorganization Act, and accord with the following factors:

- 22 1. The establishment and maintenance of a fair and equitable schedule;
- 23 2. The value of the mail service actually provided each class or type of mail service
24 to both the sender and the recipient, including but not limited to, the collection,
25 mode of transportation, and priority of delivery;
- 26 3. The requirement that each class of mail or type of mail service bear the direct
27 and indirect postal costs attributable to that class or type plus that portion of all
28 other costs of the Postal Service reasonably assignable to such class or type;
- 29 4. The effect of rate increases upon the general public, business mail users, and
30 enterprises in the private sector of the economy engaged in the delivery of mail
31 matter other than letters;
- 32 5. The available alternative means of sending and receiving letters and other mail
33 matter at reasonable costs;

- 1 6. The degree of preparation of mail for delivery into the postal system performed
- 2 by the mailer and its effect upon reducing costs to the Postal Service;
- 3 7. Simplicity of structure for the entire schedule and simple, identifiable
- 4 relationships between the rates or fees charged the various classes of mail for
- 5 postal services;
- 6 8. The educational, cultural, scientific, and informational value to the recipient of
- 7 mail matter; and
- 8 9. Such other factors as the Commission deems appropriate.
- 9

10 The proposed agreement between Life Line and the Postal Service satisfies

11 these criteria. First, the Postal Service believes that by negotiating directly with

12 individual customers, it may be possible to more accurately present prices that

13 represent the value that the user places on the service being provided (pricing criterion

14 2) for mail classifications that are desirable to the mailer and the Postal Service

15 (classification criterion 5). The customer-specific rates offered to Life Line covers the

16 costs associated with Life Line's mail (pricing criterion 3) and directly address the

17 requirement of covering all costs. The classifications and prices presented in this

18 agreement confer beneficial effects on the general public and other business mail users

19 (pricing criterion 4). The public will benefit from receiving additional information

20 regarding alternative health care services offered by Life Line. The business user

21 obviously benefits with the enhanced ability to market to additional customers. The

22 proposed declining block rate structure is relatively simple and maintains a transparent,

23 identifiable relationship between volume levels and applicable rates and fees (pricing

24 criterion 7). While the proposal does not specifically create new workshare categories,

25 it provides the incentives for low-cost letter-size Standard Mail volumes consistent with

26 criterion 6.

27 The proposed agreement between the Postal Service and Life Line also meets the

28 relevant classification criteria. The proposal provides a special classification that meets

1 the needs of the customer and reflects the relative value of the additional pieces. In
2 addition, the classification is desirable from the point of view of the customer and the
3 Postal Service.

4 Finally, the proposed rates and classifications under this NSA are fair and
5 equitable. The proposal reflects a balanced consideration of the applicable criteria. I
6 believe the directly affected customers are served by the proposal and no customer is
7 harmed. In addition, as discussed earlier in my testimony, the pricing structure
8 promoting additional usage of the mail is not that different from structures employed by
9 other media that promote additional usage. As such, the Postal Service does not
10 unfairly compete.

11

12

SUMMARY AND CONCLUSION

13 For the reasons given above, the Commission should recommend the changes in
14 rates and classifications proposed by the Postal Service to allow it to effect its
15 agreement with Life Line. As explained above, I estimate that the NSA will produce
16 incremental contribution gains of \$ 5.4 million. Additionally, the Postal Service benefits
17 not only from the additional contribution generated by an increased Standard Mail letter-
18 size solicitation volumes, but also from a stream of additional volume and contribution
19 generated for each new customer, in the form of First-Class Mail correspondence and
20 additional Standard Mail solicitation letters described as the “multiplier effect.”

Lifeline Screening

Negotiated Service Agreement

Appendix A, page 1

	Year 1	Year 2	Year 3
(1) Letter Inflation cost/price adjustment factor		2.1%	1.9%
(2) Contingency Factor	1.01		

- (1) Global Insight April 2007 Macro Forecast.
- (2) Docket No.R2006-1, USPS-T-6, p. 62.

Lifeline Screening

Negotiated Service Agreement

Appendix A, page 2

FY 2004

FY 2005

FY 2006

Year 1

Year 2

Year 3

Volume calculations (1)	Forecast Volumes (2)					
Before Rates (BR)						
Standard Mail (SM) Letters	50,768,084	79,196,082	94,992,856	90,000,000	87,000,000	87,000,000
After Rates (AR)						
SM Letters	50,768,084	79,196,082	94,992,856	104,000,000	110,000,000	110,000,000

(1) Sum of Billing Determinants

(2) LLS-T-1

Lifeline Screening
Negotiated Service Agreement
Appendix A, page 3

Standard Mail Regular Letter Unit Revenue

Mail Category		Revenue per piece (1)	Volume (2)	Revenue (3)
Automation				
Mixed AADC	\$	0.239	4,777,599	\$ 1,141,271
AADC	\$	0.224	5,351,442	\$ 1,197,666
3-Digit	\$	0.214	22,151,087	\$ 4,746,773
5-Digit	\$	0.181	62,093,344	\$ 11,265,478
Nonautomation				
Mixed AADC	\$	0.246	427	\$ 105
AADC	\$	0.204	63,283	\$ 12,914
3-Digit	\$	0.411	112,206	\$ 46,092
5-Digit	\$	0.318	256,942	\$ 81,745
ECR				
Basic	\$	0.225	183,081	\$ 41,281
High-Density	\$	0.186	3,445	\$ 641
	Total		94,992,856	\$ 18,533,966
Lifeline Unit Revenue				\$ 0.195

- (1) FY 2006 Lifeline Billing Determinants, adjusted to reflect R2006-1 AR prices and rate categories
- (2) FY 2006 Lifeline Billing Determinants, adjusted to reflect R2006-1 AR rate categories
- (3) (1) * (2)

Lifeline Screening
 Negotiated Service Agreement
 Appendix A, page 4

Standard Mail Regular Letter Unit Cost

	TYAR 2008 Total Unit Cost (Dollars) (1)	Mail Volume (Pieces) (3)	Mail Volume (Percent) (4)	Unit Letter Cost w/Contingency (Dollars) (5)
Mail Category				
Automation				
Mixed AADC	0.120	4,777,599	5.0%	
AADC	0.106	5,351,442	5.6%	
3-Digit	0.100	22,151,087	23.3%	
5-Digit	0.085	62,093,344	65.4%	
Nonautomation				
Mixed AADC	0.132	427	0.0%	
AADC	0.132	63,283	0.1%	
3-Digit	0.124	112,206	0.1%	
5-Digit	0.124	256,942	0.3%	
ECR				
Basic	0.097	183,081	0.2%	
High-Density	0.055	3,445	0.0%	
	(2)			
Total/average	0.091	94,992,856	100.0%	\$ 0.092

- (1) Postal rate Commission (PRC) PRC-LR-22 April 27 2007 (Changed to reflect volume shift of Carrier route volume from ECR to Regular 5-digit Presort) FinAdj2008-PRC-PRCREM1 (Adjusted using full piggybacks instead of final adjustment piggyback.)
- (2) (1) * (4)
- (3) FY 2006 Lifeline Billing Determinants, adjusted to reflect R2006-1 AR rate categories
- (4) Each row in (3) divided by total in (3)
- (5) Total Unit Cost (2) x Contingency Factor [Assumptions]

Agreement Structure

Year 1			Year 2			Year 3		
Threshold		Discount	Threshold		Discount	Threshold		Discount
90,000,001	100,000,000	\$ 0.010	88,000,001	98,000,000	\$ 0.010	88,000,001	98,000,000	\$ 0.010
100,000,001	110,000,000	\$ 0.020	98,000,001	108,000,000	\$ 0.020	98,000,001	108,000,000	\$ 0.020
110,000,001	118,000,000	\$ 0.030	108,000,001	116,000,000	\$ 0.030	108,000,001	116,000,000	\$ 0.030

Discount on volume above threshold

(1) Before Rates Forecast	90,000,000	87,000,000	87,000,000
(2) After Rates Forecast	104,000,000	110,000,000	110,000,000
(3) Discount in first tier	\$ 100,000	\$ 100,000	\$ 100,000
Discount in second tier	\$ 80,000	\$ 200,000	\$ 200,000
Discount in third tier	\$ -	\$ 60,000	\$ 60,000
(4) Discount Earned	\$ 180,000	\$ 360,000	\$ 360,000

Exposure on volume above threshold

(5) Threshold	100,000,000	98,000,000	98,000,000
(6) Before Rates Forecast	90,000,000	87,000,000	87,000,000
(7) Exposed Pieces	-	-	-
(8) After Rates Forecast	104,000,000	110,000,000	110,000,000
(9) Discount Exposure in first tier	\$ -	\$ -	\$ -
Discount Exposure in second tier	\$ -	\$ -	\$ -
Discount Exposure in third tier	\$ -	\$ -	\$ -
Discount Exposure in fourth tier			
(10) Total Exposure	\$ -	\$ -	\$ -

- (1) Before Rates Total Letter Volume [Vol]
- (2) After Rates Total Letter Volume [Vol]
- (3) Discount Earned on volume above negotiated threshold
- (4) Sum of discounts earned in first tier to third tier
- (5) Agreement Structure Beginning Threshold
- (6) (1)
- (7) If the Before Rates Forecast volume (6) is greater than the Threshold volume (5), then the total pieces represent the volume on which Discount Exposure occurs
- (8) (2)
- (9) Exposure on volume above negotiated threshold [see rate chart above]
- (10) Sum of Exposure in first tier to third tier

Lifeline Screening

Negotiated Service Agreement
Appendix A, page 6

(4)

Year 1

(5)

Year 2

(6)

Year 3

Standard Mail Letters

(1)	SM Letters Unit Revenue	0.195	0.199	0.203
(2)	SM Letters Unit Cost	0.092	0.094	0.096
(3)	SM Letters Unit Contribution	0.103	0.105	0.107

(1) Lifeline Average Unit Revenue [SML rev]

(2) Lifeline Average Unit Cost [SML cost]

(3) (1) - (2)

(5) (4) * (1 + Inflation for Year 2) [Assumpt]

(6) (5) * (1 + Inflation for Year 3) [Assumpt]

Lifeline Screening
Negotiated Service Agreement
Appendix A, page 7

	Year 1	Year 2	Year 3	Total
(1) Contribution from new Standard Mail letters	\$ 1,438,104	\$ 2,411,270	\$ 2,458,048	\$ 6,307,423
(2) Total Exposure - letters	\$ -	\$ -	\$ -	\$ -
(3) Total Incremental Discounts - letters	\$ 180,000	\$ 360,000	\$ 360,000	\$ 900,000
(4) Total USPS Value	\$ 1,258,105	\$ 2,051,270	\$ 2,098,048	\$ 5,407,423

- (1) (SM Letter After Rates - SM Letter Before Rates) * SM Letter Unit Contribution [Assumpt, Vol, Contrib]
- (2) Total Exposure [Disc&Exp]
- (3) Total Discounts - Total Exposure [Disc&Exp]
- (4) (1) + (2) - (3) - (4)

Appendix B Explanation of Financial Model

The Life Line model incorporates all of the relevant cost and revenue-per-piece data into one dynamic comprehensive workbook. It serves as a presentation mechanism for the customer-specific revenue and cost calculations. Life Line witness Greenberg provides the historical and forecasted volumes. These inputs provide the basis for calculating the value of the NSA.

Assumptions

The assumptions page contains two factors impacting the three-year duration of the agreement. The first assumption, the inflation adjustment factor, represents the inflationary cost growth and average price increase projected by the Postal Service. Currently, the inflation factor is 2.1 percent and 1.9 percent respectively in the second and third years. (CPI growth from Global Insight April 2007 baseline macroeconomic forecast). Year 1 costs use Docket No. R2006-1 Test Year data, and need not be inflated. The second assumption, the contingency factor, is the multiplicative factor applied uniformly to all forecast costs. Currently, the contingency provision is 1.01. (Docket No.R2006-1, USPS-T-6, page 62)

Volume Calculations

The volume calculations contain Life Line FY 2004 thru FY2006 historical letter-size Standard Mail volumes for solicitation mailings. These volumes have been identified through the USPS permit system and through the reconciliation process conducted with Life Line. To illustrate the letter-size volume response to rate incentives,

the Life Line Witness Greenberg (LL-T-1) has provided the volume forecasts for Life Line, both in the absence of an agreement (Before Rates) and in the presence of an agreement (After Rates).

Standard Mail Revenue Calculations

The rate categories presented in the model represent the specific letter-size Standard Mail volume profile of Life Line. Life Line revenue-per-piece calculation is based on the total revenue per rate category divided by the total volume per rate category. This provides a representation of the estimated revenue per piece for Life Line letter-size solicitation volumes. The revenue calculation uses current prices, and the volume data are adjusted to conform to rate-category changes associated with the May 14, 2007 price change.

Standard Mail Cost Calculations

The rate categories presented in the cost calculation represent the Standard Mail profile of Life Line. The unit cost per rate category for letter-size Standard Mail is based on the PRC work papers Docket No. R2006-1, Test Year FY2008. The total unit cost is derived by multiplying the weighted distribution of FY2006 volume (adjusted for rate-category changes) by the Test Year unit cost per rate category. Life Line FY2006 letter-size Standard Mail volumes are used since these are the latest full year historical volumes available. The total unit cost estimate, for Life Line, is derived by multiplying the weighted distribution of Life Line FY2006 historical volumes by the Test Year FY2008 unit costs per rate category.

Discount and Exposure

For Year 1 of the NSA, the declining block rate structure for letters begins with a discount of 1.0 cents per piece for the block beginning at 90,000,001 pieces, and ends at 100,000,000 pieces. The second discount tier of 2.0 cents per piece begins at 100,000,001 pieces, and ends at 110,000,000. The third discount tier of 3.0 cents per piece begins at 110,000,001 pieces and ends at 118,000,000. The discount is effective once the volume level has reached 95,000,000 pieces. For the second and third years of the NSA, the blocks are 88,000,001 to 98,000,000, 98,000,001 to 108,000,000, and 108,000,001 to 116,000,000 pieces, with a volume commitment of 93,000,000 pieces. The exposure to the USPS measures the discounted revenue associated with declining block rates for mail volume that Life Line would have mailed in the absence of the proposed NSA (before-rates forecast volumes). In no year of the agreement is there any projected exposure. The model calculates exposure by multiplying the difference between the volume tier and before-rates forecast volume by the corresponding discount.

Contribution Inputs

The contribution inputs calculate the contribution per piece of Life Line's letter-size Standard Mail solicitation volumes. The per-piece calculation provides the Postal Service with before and after-rates revenue, cost, and contribution for letter-size Standard Mail on a customer-specific basis. It allows for forecasting future contribution per piece in the out-years of the agreement by allowing the inflationary growth (referenced Appendix A, page 1, (1)) multiplied by the cost and revenue of each letter-size mail piece.

USPS Value

The total USPS value is calculated by taking the total new contribution less the total exposure and discount. The total new contribution value is calculated from new contribution of new letter-size solicitation mail volume above the before rates forecast volumes multiplied by the contribution value per piece.

Appendix C
Value To Volume Sensitivity Matrix
Based on Year 1

Table 1

		After Rates Letter Volume							
Volumes (millions)		88.4	93.6	98.8	104.0	109.2	114.4	118.0	
% Change		(15.0%)	(10.0%)	(5.0%)	0.0%	5.0%	10.0%	13.5%	
Before Rates Letter Volume	54.0	(40.0%)	\$ 3.5	\$ 4.0	\$ 4.5	\$ 5.0	\$ 5.4	\$ 5.8	\$ 6.0
	63.0	(30.0%)	\$ 2.6	\$ 3.1	\$ 3.6	\$ 4.0	\$ 4.5	\$ 4.8	\$ 5.1
	72.0	(20.0%)	\$ 1.7	\$ 2.2	\$ 2.7	\$ 3.1	\$ 3.5	\$ 3.9	\$ 4.2
	81.0	(10.0%)	\$ 0.8	\$ 1.3	\$ 1.7	\$ 2.2	\$ 2.6	\$ 3.0	\$ 3.3
	90.0	0.0%	\$ (0.2)	\$ 0.3	\$ 0.8	\$ 1.3	\$ 1.7	\$ 2.1	\$ 2.3
	99.0	10.0%	\$ (1.1)	\$ (0.6)	\$ (0.1)	\$ 0.3	\$ 0.8	\$ 1.1	\$ 1.4
	108.0	20.0%	\$ (2.0)	\$ (1.5)	\$ (1.0)	\$ (0.6)	\$ (0.2)	\$ 0.2	\$ 0.5
	117.0	30.0%	\$ (2.9)	\$ (2.4)	\$ (2.0)	\$ (1.5)	\$ (1.1)	\$ (0.7)	\$ (0.4)
	126.0	40.0%	\$ (3.9)	\$ (3.4)	\$ (2.9)	\$ (2.4)	\$ (2.0)	\$ (1.6)	\$ (1.4)

Table 1 shows the value of the Lifeline NSA to the Postal Service under a variety of assumptions about Lifeline’s mailing behavior. This analysis intends to show the net value under a wide variety of conditions. It is important to note that the ranges provided are extremes, which the Postal Service believes, have little probability of occurring. In addition, the risk-mitigating contractual provisions identified in my testimony shield the Postal Service from the extremes presented in this matrix. The row stubs show the assumed variance between the before-rates volume forecast and the “actual” before-rates volume. The column headings show the assumed variance between the after-rates volume forecast and the “actual” after-rates volume. The interior cells are expected

USPS values in millions of dollars because of the before- and after-rates volume combinations. For instance, at 0 percent change for before-rates and after-rates volumes, the expected USPS value is \$1.3 million, the expected USPS value in Year 1 of the agreement. Other before- and after-rates volumes and their corresponding USPS values are because of the percentage change from the Year 1 expected before- and after-rates volumes.

The relationship between before- and after-rates volumes also provides a type of implicit protection for the Postal Service. Assuming that price incentives will encourage volume response under all circumstances, it is highly unlikely that the before-rates volume could be underestimated at the same time the after-rates volumes are overestimated. Exogenous changes that affect the before-rates volume will have a very similar impact on after-rates volume, since it is highly unlikely that a variable could cause the before-rates volumes to rise and after-rates volume to decrease. Simply because it is a forecast, the actual before-rates letter volume for Year 1 is uncertain. For illustrative purposes, the table presents a range of before- and after-rates volumes beyond those that that Life Line and the Postal Service believe are reasonable estimates.

Appendix D
MC2004-3 Opinion and Further Recommended Decision Analysis
Panzar Formula

As explained by the Commission in Docket No. MC2004-3, the “Panzar” test seeks to assure a net increase in contribution to the Postal Service for every possible after-rates volume within the range of a proposed NSA, thereby contributing positive value to the Postal Service while protecting non-participating mailers. Life Line NSA satisfies parameters of the analysis, assuming Life Line’s own-price elasticity of demand for letter-size Standard Mail volume is equal to the subclass average as calculated in the models used by witness Thress in Docket No. R2006-1 (USPS-T-7).

Appendix E
Proposed Data Collection Plan

The USPS plans to collect the following data pertaining to the NSA with

Life Line:

1. The volume of letter-size solicitation Standard Mail pieces by rate category in eligible Life Line accounts;
2. The discounts paid to Life Line for letter-size 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.

As part of each data collection report, the USPS will provide an evaluation of the impact on contribution.