

**Before The  
POSTAL RATE COMMISSION  
WASHINGTON, D.C. 20268B0001**

**Rate and Service Changes to Implement  
Baseline Negotiated Service Agreement  
with Bookspan**

**Docket No. MC2005-3**

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

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## **AUTOBIOGRAPHICAL SKETCH**

1  
2 My name is Michelle K. Yorgey. I am currently a Marketing Specialist in the  
3 Pricing Strategy group. My primary responsibilities include the implementation of and  
4 compliance for International Customized Mail (ICM) agreements and Negotiated Service  
5 Agreements (NSA). I develop reporting tools and provide performance analysis for  
6 ICMs and NSAs.

7 I joined the Postal Service in 1982 as a casual employee. Since that time, I have  
8 worked as a window clerk, distribution clerk, and Customer Service Representative.  
9 In 1992, I was accepted into the Management Associate program. My management  
10 duties included assignments in Mail Processing and In-Plant Support in Processing and  
11 Distribution Centers, a Bulk Mail Center, Labor Relations, Human Resources, Finance  
12 and Area level In-Plant Support Operations. My final assignment was Plant Manager of  
13 the Charlottesville Processing and Distribution Facility.

14 In 1996, I was selected as the Program Manager for International Customized  
15 Mail agreements in the newly formed International Business Unit. I was responsible for  
16 negotiation, development and implementation of ICM agreements. As part of a  
17 Marketing reorganization in 2003, I was moved to the Pricing Strategy group in the  
18 Pricing and Classification organization.

19 I have been an active participant of the Postal Service negotiating team that  
20 developed the Bookspan NSA. This is my first appearance before the Commission.  
21 I earned a Bachelor's Degree in Education from Lancaster Bible College.

## **I. PURPOSE AND SCOPE**

The purposes of my testimony are to present the specific terms and conditions of the new baseline Negotiated Service Agreement (NSA) that the Postal Service has negotiated with Bookspan, to describe the analytical support used to develop the NSA, to explain the financial implications of this NSA, to describe the provisions that are intended to minimize the risk associated with forecasting volumes for a single mailer, and to explain the steps the Postal Service has taken to understand the market in which Bookspan operates. Finally, my testimony shows how the changes proposed to implement the NSA conform to the pricing and classification criteria of the Postal Reorganization Act.

In addition to my testimony and that of witness Plunkett, the Postal Service relies on the Direct Testimonies on behalf of Bookspan of Robert Posch (Bookspan T-1) and Matthias Epp (Bookspan T-2). I have reviewed Mr. Posch's and Mr. Epp's testimonies, and affirm that they may be relied upon in presentation of the Postal Service's direct case.

## **II. TERMS AND CONDITIONS OF THE BOOKSPAN NSA**

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

The Bookspan NSA is relatively simple. It is designed to provide incentives to Bookspan to increase its use of Standard Mail letters for the purpose of soliciting members for its various book clubs. Without such an incentive, solicitation volumes are expected to be flat or falling.<sup>10</sup> The incentives are based on volumes of, and apply only to Bookspan's Standard Mail solicitation letters prepared and claimed at letter rates.

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<sup>10</sup> Bookspan T-2, p. 11, Table 2

1 Solicitation letters are defined as letters sent as Standard Mail by Bookspan seeking  
2 new members for a particular book club, or seeking members of a club to renew their  
3 expiring memberships.<sup>11</sup> The incentives will encourage Bookspan to mail additional  
4 solicitation letters, increasing its membership numbers. The Postal Service benefits  
5 from the additional revenue generated by an increased volume of Standard Mail letter  
6 solicitations. The total estimated net benefit to postal finances over the three-year  
7 period of this NSA is \$7.4 million,<sup>12</sup> as shown in Appendix A and explained in Appendix  
8 B. The Postal Service will also benefit from the additional revenue generated by  
9 increased volume for each new book club member in the form of Standard Mail  
10 catalogs, Bound Printed Matter book fulfillment, and First-Class Mail correspondence.  
11 This is the “multiplier effect” described fully by Mr. Posch in his testimony.<sup>13</sup>

## 12 **B. Declining Block Rates with Volume Commitments**

13 The incentives in this NSA take the form of declining block rates for volumes at  
14 negotiated levels, similar to the design of all other current NSAs. This NSA introduces a  
15 new mechanism designed to mitigate risk that could result from the underestimation of  
16 before-rates volume. According to the agreement, before the discounts earned at a  
17 negotiated volume level are payable, Bookspan must first meet a *higher* volume  
18 commitment. In addition, the lowest volume block threshold for discounts is set well  
19 above the before-rates volume forecast. For instance, in the first year of the agreement,  
20 78,000,000 pieces are projected before rates. Discounts would be *earned* for volumes

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<sup>11</sup> Bookspan NSA, I.A.

<sup>12</sup> Appendix A, page 9, line (6)

<sup>13</sup> Bookspan-T-1, pp. 3 - 5. The multiplier effect is not relied upon in estimating the financial impact of the NSA on postal finances.

- 1 above 87 million pieces (the threshold), but the discounts would *not* be paid unless
- 2 Bookspan actually mails 94 million pieces (the volume commitment).
- 3 The unadjusted levels for each year are shown in Table 1, which follows:<sup>14</sup>

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<sup>14</sup> Bookspan NSA, II.A.-D. An intended secondary effect of this agreement is that the declining block rates may encourage Bookspan to increase its conversion of Standard Mail solicitation material prepared and claimed at nonletter rates to mailpieces prepared and claimed at letter-size rates. Detailed descriptions of the effects of the conversion rate are included in the sensitivity analysis of the after-rates volume forecast.

**TABLE 1 — DECLINING BLOCK RATE STRUCTURE****Year 1 Structure**

Before-Rates Volume Forecast: 78,000,000

Volume Blocks		Incremental Discount
87,000,001	120,000,000	2.0 cents
120,000,001	150,000,000	3.0 cents

Volume Commitment: 94,000,000

**Year 2 Structure**

Before-Rates Volume Forecast: 75,000,000

Volume Blocks		Incremental Discount
85,000,001	110,000,000	2.0 cents
110,000,001	150,000,000	3.0 cents

Volume Commitment: 95,000,000\*

\*Subject to adjustment

**Year 3 Structure**

Before-Rates Volume Forecast: 75,000,000

Volume Blocks		Incremental Discount
94,000,001	100,000,000	1.0 cents
100,000,001	120,000,000	2.0 cents
120,000,001	150,000,000	3.0 cents

Volume Commitment: 105,000,000\*

\*Subject to adjustment

### 1           **C. Annual Adjustment Mechanism for Volume Commitments**

2           The volume commitment is subject to adjustment each year, based on actual  
3 volumes mailed in the previous year. The adjustment mechanism mitigates both the  
4 risks associated with forecasting errors, as well as the effects that future rate increases  
5 will have on volumes.

6           The agreement provides that, if at the end of the agreement year (12 consecutive  
7 months), actual volumes are 12 percent or more above that year's commitment, then  
8 the next year's volume commitment threshold will be calculated to be the arithmetic  
9 average of the current year's actual volume and the original volume commitment for the  
10 next year. For example, if at the end of Year 1 the actual volume of Standard Mail  
11 solicitation letters reached 110,000,000 pieces, the Year 2 volume commitment would  
12 increase from 95,000,000 to 102,500,000 pieces.<sup>15</sup> Thus, Bookspan would have to mail  
13 102.5 million letter solicitations in Year 2 in order to receive the discounts provided for  
14 volumes above 85 million pieces.

15           If at the end of each year, actual volume is 5 percent or more below that year's  
16 volume commitment, then the next year's volume commitment volume will be decreased  
17 by the percentage difference between the actual volume and that year's commitment  
18 volume, but it would not be lower than 90 million pieces. For example, if at the end of  
19 Year 2, the volume of Standard Mail solicitation letters were 90,000,000, the Year 3  
20 volume commitment would be reduced from 105,000,000 to just under 99,500,000.<sup>16</sup>

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<sup>15</sup>  $(110,000,000 + 95,000,000) / 2$

<sup>16</sup>  $105,000,000 - (105,000,000 * ((95,000,000 - 90,000,000) / 95,000,000)) =$   
99,473,684

## 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.<sup>17</sup> The second provides that the agreement automatically  
6 terminates and all discounts cease if Bookspan's Standard Mail letter solicitation volume  
7 exceeds 150,000,000.<sup>18</sup>

## 8           **III. FINANCIAL IMPACT**

9           Three aspects of this NSA affect the Postal Service's finances.<sup>19</sup> The first is the  
10 contribution from additional volumes of Standard Mail letters in response to the rate  
11 incentive.<sup>20</sup> Based on Bookspan's projected volume forecast for new letters, the  
12 estimated new contribution for the three-year agreement is approximately \$3.3 million.

13           The second impact is the net contribution gain from conversion of Standard Mail  
14 solicitation flats to letters. The three-year value of new contribution from Standard Mail  
15 flat-size solicitations converted to Standard Mail letter-size solicitations represents  
16 approximately \$5.1 million.<sup>21</sup>

17           The third financial impact is the expected discount exposure. The discount  
18 exposure is the result of price incentives applied to any volume that would have been  
19 generated without a price incentive. The declining block rates apply only to volumes  
20 that are above before-rates forecasted volume; therefore discount exposure is zero.

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<sup>17</sup> Bookspan NSA, III.F.1.

<sup>18</sup> Bookspan NSA, III.F.2.

<sup>19</sup> The model I used to estimate the financial impact is provided in hard-copy form as Appendix A and the electronic version is being filed electronically with my testimony.

<sup>20</sup> Appendix A, page 9, line (1).

<sup>21</sup> Appendix A, page 9, line 2.

1           The final financial impact is the amount of the total incremental discounts,  
2 projected to be \$0.96 million.<sup>22</sup> Thus, the total estimated financial impact over the three-  
3 year period of this NSA, is a net benefit to the Postal Service of \$7.4 million.<sup>23</sup> The  
4 Postal Service proposes to collect data necessary to determine the actual financial  
5 impact of the NSA. The data collection plan is described in Appendix E.

6           A second stream of value for this NSA is the “multiplier effect.”<sup>24</sup> Based on  
7 Bookspan’s historical volumes, the multiplier effect is expected to result in an additional  
8 25 million pieces of Standard Mail catalogs, Bound Printed Matter book fulfillment, and  
9 First-Class Mail correspondence. The Postal Service did not include the financial  
10 benefits from the “multiplier effect” in evaluating the financial value of this NSA.

#### 11           **IV. EVALUATION OF VOLUME FORECASTS**

##### 12           **A. Before-Rates Volume Forecasts**

13           To evaluate Bookspan’s before-rates volume forecasts,<sup>25</sup> and the potential  
14 growth in its use of mail as a marketing medium, I utilized a variety of tools. The  
15 analysis is comparable to that performed in evaluating previous NSAs and includes  
16 company-specific research, volume trend analysis, and analysis of the market  
17 environment. Based on this analysis, which is described below, the before-rates  
18 volume forecasts provided by Bookspan are reasonable.

##### 19           **1. Company-specific research**

20           Data on Bookspan is limited because it is a privately held company and therefore  
21 is not subject to the same reporting requirements as firms whose shares are traded

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<sup>22</sup> Appendix A, page 9, line (5)

<sup>23</sup> Appendix A, page 9, line (6)

<sup>24</sup> Bookspan T-1, page 3 - 5

<sup>25</sup> Bookspan-T-2, p. 11, Table 2

1 publicly. Based on research into the book industry, past financial transactions and  
2 statements by Bookspan's parent companies (Bertelsmann and Time Warner), and  
3 discussions with Bookspan, the Postal Service is able to make informed inferences  
4 regarding Bookspan's marketing strategies and its potential for growth over the next  
5 several years.

6 For Bookspan, unlike its competitors who rely on a variety of marketing media  
7 other than mail as their primary marketing channels, Bookspan relies primarily on mail.  
8 Our research suggests that the profitability and future growth prospects for Bookspan  
9 may be limited due to market trends discussed further below. It is unlikely that  
10 Bookspan's mail volume could increase significantly in the current business and market  
11 environment in the absence of this proposed agreement. This adds credence to the  
12 before-rates volume forecast provided by Bookspan, which is consistent with its recent  
13 volume trend.

## 14 **2. Volume trend analysis**

15 Bookspan provided the Postal Service with counts of its Standard Mail letter-size  
16 and flat-size solicitation volumes for calendar years 2002 through 2004. These volumes  
17 have been reconciled with Postal Service permit data.<sup>26</sup> The data show that  
18 Bookspan's Standard Mail letter-size and flat-size solicitation volumes through 2003  
19 trended substantially downward. That trend continued for Standard Mail flat-size  
20 volume in 2004, but there was a deviation from this trend for Standard Mail letter-size  
21 volume in 2004. Bookspan explained to us that this was a one-time occurrence in  
22 response to new legislation limiting telephone solicitation, which resulted in a

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<sup>26</sup> Appendix A, p. 2.

1 reallocation of marketing dollars for 2004. This deviation is not expected to have a  
2 materially lasting effect on Bookspan's Standard Mail letter-size solicitation volume.

3         The trend analysis indicates that Bookspan's total Standard Mail solicitation  
4 mailings have been decreasing on average by almost 8 percent over the past two  
5 years.<sup>27</sup> The decrease projected in the before-rates volume forecast is consistent in  
6 terms of percentage decrease in letter volume noted in previous years. Because mail is  
7 one of Bookspan's primary means of acquiring customers, this trend would result in  
8 diminished customer account growth for Bookspan and further reduction of various  
9 types of mail for the Postal Service. This trend is expected to continue in the absence of  
10 an incentive to increase solicitation of customers.

### 11                 **3. Analysis of the market environment**

12         The book market is highly fragmented across a wide variety of products. For  
13 purposes of comparing Bookspan, we removed commercial publications and textbooks  
14 in evaluating the size and trends of the market. We removed both products because  
15 Bookspan does not compete in those market segments. Competitors of Bookspan  
16 include brick and mortar bookstores, general retail merchandisers, mail order book  
17 sellers, and internet book sellers. Some competitors are in more than one category.  
18 Bookspan is unique in its reliance on the mail for almost all aspects of its business.

19         The market for book sales through book clubs and mail order books in the United  
20 States has been steadily decreasing over the past 10 years.<sup>28</sup> The industry appears to  
21 be maturing as many competitors of Bookspan diversify their revenue streams in order

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<sup>27</sup> Appendix A, page 2.

<sup>28</sup> Association of American Publishers. *Association of American Publishers : Annual Report Fiscal Year 2003/2004*, [http://www.publishers.org/industry/S1\\_04.pdf](http://www.publishers.org/industry/S1_04.pdf).

1 to sustain growth.<sup>29</sup> This indicates that extensive growth is not expected by firms that  
 2 are solely in the business of marketing and distributing books, such as Bookspan.

3 With limited growth potential for the total U.S. book market, retailers are  
 4 increasingly competing for market share, rather than relying on increasing market size,  
 5 as the primary opportunity for sales increases. Moreover, it appears that general  
 6 merchandisers and online retailers may continue to increase market share at the  
 7 expense of mail-order clubs.

### 8 **B. After-Rates Volume Forecasts**

9 Although Bookspan itself is in the best position to provide the after-rates volume  
 10 forecasts, the Postal Service believes that Bookspan's presentations of its future plans  
 11 are reasonable and can be relied upon to support the agreement. They are also  
 12 consistent with the Postal Service's independent analysis, as discussed previously with

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<sup>29</sup> Publishers Weekly, *Industry Sales Inch Ahead*, March 7, 2005, page 1, by Jim Milliot, [www.publishersweekly.com](http://www.publishersweekly.com); Publishers Weekly, *Study Says Indies Add Up to a Lot*, April 4, 2005, by Jim Milliot, [www.publishersweekly.com](http://www.publishersweekly.com); Association of American Publishers, *Book Publishing Industry Net Sales Totaled \$23.7 Billion in 2004*, February 22, 2005, by Kathryn Blough, [www.publishers.org/industry/index.cfm](http://www.publishers.org/industry/index.cfm); Association of American Publishers, *AAP Releases 2004 EI-Hi Annual Net Sales Figure*, June 14, 2005, by Kathryn Blough, [www.publishers.org/press/releases.cfm](http://www.publishers.org/press/releases.cfm); Association of American Publishers, *Consumers Book Sales Up in Some Categories*, May 13, 2005, by Kathryn Blough, [www.publishers.org/press/releases.cfm](http://www.publishers.org/press/releases.cfm); Book Industry Study Group Inc., *BISG: Book Industry Revenues to Increase 18.3 percent over next Five Years*, May 18, 2005 by David Grogan, <http://news.bookweb.org/news/3536.html>; Book Industry Study Group Inc., *BISG Trend Report Sees Industry Growth*, May 16, 2005 by Rachel Deah, [www.thebookstandard.com/bookstandard/news/retail/article\\_display.jsp?vnu\\_content\\_id=1000921346](http://www.thebookstandard.com/bookstandard/news/retail/article_display.jsp?vnu_content_id=1000921346); Book Industry Study Group Inc., *New Study Reveals Billions More in Book Sales*, April 6, 2005 by Jeff Abraham, <http://www.bisg.org/news/press>; American Booksellers Association, *March Bookstore Sales Even with Last Year*, May 17, 2005, *Independent Bookstore Sales Continue Upward Trend*, May 20, 2005, *April Bookstore Sales Fall*, June 14, 2005 by Meg Smith, <http://news.bookweb.org/news>; American Wholesale Booksellers Association, *Discounts and Used Books Continue to Drive Consumers Demand*, April 29, 2004 by Barrie Rappaport, *Children's Book Buyers Spending More, Buying Less*, June 9, 2005 by Barrie Rappaport, [www.ipsos-insight.com/pressrelease](http://www.ipsos-insight.com/pressrelease).

1 respect to the before-rates forecast. *Ceteris paribus*, the incentives will encourage  
2 Bookspan to increase its use of mail. This should enable Bookspan to compete more  
3 effectively, since it will be able to increase its marginal marketing spending in order to  
4 add to its customer base.

5 The risks associated with overestimating the after-rates volume is a topic that is  
6 addressed in more detail below. And as described above, risk mitigating features are  
7 incorporated into this agreement. To the extent that the after-rates volume forecasts  
8 underestimate Bookspan's volume response to the price incentives, the benefits to the  
9 Postal Service will exceed those presented in this case.

#### 10 **1. Conversion of flats to letters**

11 Bookspan has preferred to use Standard Mail flats for the majority of their  
12 acquisition mailings in the past. However, Bookspan's solicitation flat-size mail volume  
13 has been declining at percentage rates higher than the decline of its total solicitation  
14 volume,<sup>30</sup> implying a slight migration from flat-size volume to letter-size volume,  
15 presumably for its own business reasons. In future solicitation mailings, this migration is  
16 expected to continue and to be accelerated as a result of the discounts on letters that  
17 the NSA offers.<sup>31</sup>

18 To estimate the possible effects of this migration on the value of this NSA, I  
19 conducted a sensitivity analysis of differing percentages of conversion. This analysis,  
20 presented in Appendix D, shows that even if Bookspan were to convert all of its  
21 solicitation flats to letters, the NSA provides the Postal Service with a \$7.2 million  
22 increase in contribution. This occurs because although an increase in the conversion

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<sup>30</sup> Appendix A, page 2

<sup>31</sup> Bookspan T-2, page 12 & 13

1 rate decreases the value of this NSA, conversion of flats to letters provides the benefit  
2 of lower-cost, higher-contribution pieces for the Postal Service.

### 3 **2. Risk mitigation**

4 The terms of the Bookspan NSA, when considered in purely economic terms,  
5 provide the Postal Service with an increase in net contribution, with very limited risk. As  
6 described above, there are four contractual terms that limit the residual risk in the out-  
7 years of the agreement. These features, which are new to this NSA, provide additional  
8 protection from various risks. The first feature, which reduces risk from deviation in  
9 volume forecasts, is an adjustment mechanism that uses actual volumes from the  
10 previous year to establish projected commitment volume thresholds for the following  
11 year. The second feature, which provides additional protection from deviation in  
12 forecasting before-rates volumes and also reduces the risk of discount leakage,  
13 requires that volumes exceed incentive volume thresholds before discounts are  
14 payable. The third feature, which provides protection for the Postal Service against  
15 underestimation of after-rates volumes, is automatic termination of the agreement if  
16 volume exceeds 150 million pieces. The fourth feature is a provision that  
17 unconditionally allows either party to terminate the agreement, with 30 days' written  
18 notice to the other party. This reduces risks to the Postal Service that could result from  
19 a change in Bookspan's business model or use of the mails, reduces the risk of  
20 discount exposure, and protects both parties against a broad range of unforeseen risks.

### 21 **C. Sensitivity Analysis**

22 By definition, forecasts are estimates, and the actual volume will almost certainly  
23 deviate from the point estimates used in my analysis. Such deviation from forecasts

1 would cause changes in the valuation of this NSA agreement. As stated previously, and  
2 as shown in Appendix A, based on the volume projections presented by Bookspan, the  
3 three-year NSA has a value to the Postal Service of at \$7.4 million.<sup>32</sup>

4 To evaluate deviations from this projection, a sensitivity analysis was used to  
5 identify the possible value of the NSA, assuming varying percentage changes in the  
6 before-rates volumes forecast and varying percentage changes in the after-rates  
7 volume forecasts.<sup>33</sup> The table presented in Appendix C is a sensitivity matrix which  
8 shows the potential range of values of this NSA under alternative sets of assumptions.  
9 The table illustrates that under a net loss could occur only under the most extreme  
10 misestimation assumptions.

## 11 **V. OTHER IMPACTS**

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

### 15 **A. Competitors of Bookspan**

16 As noted above, while negotiating this NSA, the Postal Service analyzed the  
17 market within which Bookspan operates. Included in this analysis was an examination  
18 of Bookspan's competitors' uses of various marketing media.

19 According to my analysis of internal Postal Service customer data, Bookspan is  
20 unique among its competitors in its use of the mail as a primary means of marketing.  
21 Although its competitors may make some use the mail for marketing purposes, their  
22 reliance on mail is not comparable to that of Bookspan.

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<sup>32</sup> Appendix A, page 9, line (6).

<sup>33</sup> Appendix C, page 1, Table 1

1 To earn the price incentives in this NSA, Bookspan would have to increase its  
2 total marketing spending significantly. This contrasts directly with the trend in the  
3 industry of average advertising spending decreasing by 0.8 percent in 2004.<sup>34</sup>

4 Optimistically, Bookspan could earn \$1 million in price incentives over the three-  
5 years of the agreement.<sup>35</sup> Research indicates that the industry spent over \$350 million  
6 in 2004 on marketing.<sup>36</sup> In terms of total advertising dollars spent by these competitors,  
7 the \$0.33 million incentive that Bookspan might earn<sup>37</sup> is not large enough to have a  
8 substantial impact on the industry.

9 Furthermore, Bookspan's competitors who rely more on other forms of  
10 advertising already have the ability to negotiate price terms with their suppliers. Thus,  
11 the NSA may serve to rectify a competitive disadvantage that currently exists for  
12 Bookspan in the context of fixed postal rates. Moreover, any competitor of Bookspan  
13 that intends to use and increase its share of mail as a marketing medium may negotiate  
14 a comparable agreement, to the extent that such an agreement would qualify as  
15 functionally equivalent. Thus, the NSA's effect on Bookspan's competitors is not  
16 expected to be significant and the NSA may bring the benefits of increased competition  
17 in the marketplace.

## 18 **B. Competitors of the Postal Service**

19 Competitors of the Postal Service are not affected by this agreement. Bookspan  
20 relies on the mail as a marketing channel because its use of mail as a fulfillment

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<sup>34</sup> <http://www.adage.com/page.cms?pagelid=1064>.

<sup>35</sup> Based on maximum volume of 150 million per year and Appendix A, p 7, line (4).

<sup>36</sup> TNS Media, Measured Media spend January thru December 2003.

<sup>37</sup> Based on Bookspan's projected after-rates volume forecast and Appendix A, p 7, line (4).

1 medium makes mail a more natural acquisition medium. The response rates and  
2 secondary effects of mail and other marketing mediums differ, and they are therefore  
3 imperfect substitutes for Bookspan.

4 The incentives in this agreement are intended to allow Bookspan to use the mail  
5 to market to more potential customers than it would otherwise have found profitable to  
6 do so. Given the business model that is described by the Bookspan witnesses, this will  
7 inevitably cause growth in package volumes shipped by Bookspan. Because Bookspan  
8 has used the Postal Service for almost all of its fulfillment needs and intends to continue  
9 to do so, the expected increase in package volumes shipped by Bookspan will not come  
10 at the expense of competitors. Nothing in the agreement requires Bookspan to continue  
11 to utilize the Postal Service for its distribution of packages.

#### 12 **C. Mail Users**

13 Mail users will experience minimal impact from this NSA. Although the estimated  
14 net contribution of \$7.4 million is positive, it is small enough that there will be little  
15 measurable value to any other specific mailers.

#### 16 **VI. THE PROPOSALS ARE CONSISTENT WITH THE RATE AND** 17 **CLASSIFICATION CRITERIA OF THE ACT**

18  
19 Title 39, Section 3623 requires that the Commission evaluate proposed changes  
20 in the classification schedule in accordance with the policies of the Title and the  
21 following factors:

- 22 1. The establishment and maintenance of a fair and equitable classification system  
23 for all mail;
- 24 2. the relative value to the people of the kinds of mail matter entered into the postal  
25 system and the desirability and justification for special classifications and  
26 services of mail;
- 27 3. The importance of providing classifications which do not require an extremely  
28 high degree of reliability and speed of delivery;

- 1 4. the desirability of special classifications from the point of view of both the user
- 2 and of the Postal Service; and
- 3 5. such other factors as the Commission may deem appropriate.
- 4

5 Section 3622(b) requires that postal rates and fees reflect the policies of the  
6 Postal Reorganization Act, and accord with the following factors;

- 7 1. establishment and maintenance of a fair and equitable schedule;
- 8 2. the value of the mail service actually provided each class or type of mail service
- 9 to both the sender and the recipient, including but not limited to, the collection,
- 10 mode of transportation, and priority of delivery;
- 11 3. the requirement that each class of mail or type of mail service bear the direct and
- 12 indirect postal cards attributable to that class or type plus that portion of all other
- 13 costs of the Postal Service reasonably assignable to such class or type;
- 14 4. the effect of rate increases upon the general public, business mail users, and
- 15 enterprises in the private sector of the economy engaged in the delivery of mail
- 16 matter other than letters;
- 17 5. the available alternative means of sending and receiving letters and other mail
- 18 matter at reasonable costs;
- 19 6. the degree of preparation of mail for delivery into the postal system performed by
- 20 the mailer and its effect upon reducing costs to the Postal Service;
- 21 7. simplicity of structure for the entire schedule and simple, identifiable relationships
- 22 between the rates or fees charged the various classes of mail for postal services;
- 23 8. the educational, cultural, scientific, and informational value to the recipient of mail
- 24 matter; and
- 25 9. such other factors as the Commission deems appropriate.
- 26

27 The proposed agreement between Bookspan and the Postal Service satisfies  
28 these criteria. First, the Postal Service believes that by negotiating directly with  
29 individual customers, it may be possible to more accurately present prices that  
30 represent the value that the user places on the service being provided (pricing criterion  
31 2) for mail classifications that are desirable to the mailer and the Postal Service  
32 (classification criterion 5). The customer-specific rates offered to Bookspan more than  
33 cover the costs associated with Bookspan's mail (pricing criterion 3) directly address the  
34 requirement of covering all costs. The classifications and prices presented in this

1 agreement confer beneficial effects on the affected general public, or other business  
2 mail users (pricing criterion 4). The affected public benefits with additional information  
3 regarding book purchase options. The business user obviously benefits with the  
4 enhanced ability to market to additional customers. The ability to retain and grow the  
5 contribution from Bookspan conceivably helps defray the need to obtain equivalent  
6 amounts of contribution from other customers. The proposed declining block rate  
7 structure is relatively simple and maintains a transparent, identifiable relationship  
8 between volume levels and applicable rates and fees (pricing criterion 7). As Bookspan  
9 witness Epp (Bookspan T-1, page 6) mentions, Bookspan has alternatives to the use of  
10 Standard Mail, such as print advertising). As such, criterion 5 is not applicable in the  
11 sense that Bookspan needs special protection due to the lack of available alternatives.  
12 While the proposal does not specifically create new workshare categories, it provides  
13 the incentives for low-cost Standard Mail letters consistent with criterion 6.

14 The proposal also meets the relevant classification criteria. The proposal  
15 provides a special classification that meets the needs of the customer and reflects the  
16 relative value of the additional pieces. In addition, the classification is desirable from  
17 the point of view of the customer and the Postal Service. In fact, the application of  
18 classification 2, 3 and 4 are the primary focus of the Postal Service and Bookspan  
19 testimonies where we lay out how the proposed prices better reflect relative value,  
20 provide classifications that do not require extremely high degree of reliability and speed  
21 of delivery as a Standard Mail service.

22 And finally, the resulting rates and classification are fair and equitable. The  
23 proposal reflects a balanced consideration of the applicable criteria. We believe the

1 directly affected customers are served by the proposal and no customer is harmed. In  
2 addition, while as discussed earlier in my testimony, the pricing structure promoting  
3 additional usage of the mail is no that different from structures employed by other media  
4 that promote additional usage. As such, the Postal Service does not unfairly compete.

## 5 **SUMMARY AND CONCLUSION**

6 For the reasons given above, the Commission should recommend the changes in  
7 rates and classifications proposed by the Postal Service to allow it to effectuate its  
8 agreement with Bookspan. As explained above, I estimate that the NSA will produce  
9 incremental contribution gains of \$7.4 million. Additionally, the Postal Service benefits  
10 not only from the additional revenue generated by an increased volume of Standard  
11 Mail solicitation letters, but also from a stream of additional volume and revenue  
12 generated for each new book club member, in the form of additional Standard Mail  
13 catalogs, Bound Printed Matter book fulfillment, and First-Class Mail correspondence,  
14 described as the “multiplier effect.”

# Bookspan

## Negotiated Service Agreement

### Appendix A, page 1

FY 2006      FY 2007      FY 2008

(1) Inflation cost adjustment factor	4.0%	4.0%	4.0%
(2) Conversion of Standard Mail Flats to Standard Mail Letters	63.0%	63.3%	62.5%
(3) Contingency Factor	1.00		

- (1) Docket No. MC2004-4/USPS-T-1, pg 13
- (2) Docket No. MC2005-3, Bookspan T-2, p11
- (3) Contingency provision of zero percent, Docket No.R2005-1, USPS-T-6, p. 18.

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FY 2002      FY 2003      FY 2004      FY 2006      FY 2007      FY 2008

	Forecast Volumes (2)				
<b>Volume calculations (1)</b>					
<b>Before Rates (BR)</b>					
New Membership Std letter-size	84,694,802	82,991,923	94,014,756	78,000,000	75,000,000
New Membership Std Flat-size	215,324,921	196,631,597	164,378,427	137,000,000	129,000,000
<b>Total</b>	<b>300,019,723</b>	<b>279,623,520</b>	<b>258,393,183</b>	<b>215,000,000</b>	<b>204,000,000</b>
<b>After Rates (AR)</b>					
New Membership Std letter-size				105,000,000	107,000,000
New Membership Std Flat-size				120,000,000	110,000,000
<b>Total</b>				<b>225,000,000</b>	<b>217,000,000</b>

(1) CBCIS - FY 2002, 2003, 2004 volumes  
 (2) Docket No. MC2005-3, Bookspan T-2, p11

## Bookspan

Negotiated Service Agreement  
Appendix A, page 3

### Standard Mail Regular Letter-size Revenue per piece

Mail Category	Bookspan average	Revenue per piece (1)	Volume (2)	Revenue (3)
Nonauto Basic	\$	0.262	1,518,805	\$ 398,179
Nonauto 3/5-Digit	\$	0.236	58,859	\$ 13,882
Auto Mixed AADC	\$	0.216	7,078,780	\$ 1,529,430
Auto AADC	\$	0.205	12,572,357	\$ 2,575,943
Auto 3-digit	\$	0.183	60,973,641	\$ 11,138,540
Auto 5-digit	\$	0.167	4,830,798	\$ 805,554
<b>Total</b>			87,033,240	\$ 16,461,528
<b>Revenue per piece</b>				\$ <b>0.189</b>

### Standard Mail ECR Letter-size Revenue per piece

Mail Category	Revenue per piece	Volume	Revenue
Nonauto Basic Letters	\$ 0.171	5,575,871	\$ 952,919
Auto Basic Letters	\$ 0.148	1,405,645	\$ 208,620
<b>Total</b>		6,981,516	\$ 1,161,539
<b>Revenue per piece</b>			\$ <b>0.166</b>
<b>Average Revenue per piece</b>			\$ <b>0.187</b>

- (1) (3)/(2)
- (2) CBCIS, Bookspan FY2004 volume
- (3) CBCIS, Bookspan FY2004 revenue
- (4) Bookspan (Standard Mail Regular Revenue + Standard Mail ECR Revenue) / (Standard Mail Regular Total Volume + Standard Mail ECR Total Volume)
- (5) Docket No. R2005-1, USPS-LR-K-77, FY2004 Standard Mail Regular Billing Determinants
- (6) Docket No. R2005-1, USPS-LR-K-77, FY2004 Standard Mail Regular Volume
- (7) Docket No. R2005-1, USPS-LR-K-77, FY2004 Standard Mail Regular Revenue
- (8) Average USPS (Standard Mail Regular Revenue + Standard Mail ECR Revenue) / (Standard Mail Regular Total Volume + Standard Mail ECR Total Volume)

USPS Totals (USPS-LR-K-77)			
Revenue per piece (5)	Volume (6)	Revenue (7)	
\$ 0.268	793,501,993	\$ 212,264,084	
\$ 0.240	1,065,186,190	\$ 255,806,937	
\$ 0.217	1,950,273,409	\$ 423,917,198	
\$ 0.207	2,201,484,140	\$ 455,753,816	
\$ 0.189	15,819,321,120	\$ 2,987,383,691	
\$ 0.170	16,402,050,918	\$ 2,790,244,409	
	38,231,817,770	\$ 7,125,370,135	
		\$ <b>0.186</b>	

Revenue per piece	Volume	Revenue
\$ 0.173	2,144,903,041	\$ 370,356,707
\$ 0.150	1,914,433,081	\$ 287,098,257
	4,059,336,122	\$ 657,454,964
		\$ <b>0.162</b>
		\$ <b>0.184</b>

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**Standard Regular Unit Cost**

	USPS			Bookspan			Company Avg. Letter Cost w/Contingency (Dollars) (8)
	TYBR 2006	FY 2006	FY 2006	TY 2006	FY 2004	FY 2004	
	Total	Mail Volume (Pieces) (2)	Mail Volume (Percent) (3)	Total Unit Cost (Dollars) (4)	Mail Volume (Pieces) (6)	Mail Volume (Percent) (7)	
<b>LETTERS</b>							
Nonauto Basic	0.235	809,733,939	1.9%	0.235	1,518,805	1.7%	
Nonauto 3/5-Digit	0.220	697,778,977	1.6%	0.220	58,859	0.1%	
Auto Mixed AADC	0.094	2,217,147,820	5.1%	0.094	7,078,780	8.1%	
Auto AADC	0.085	2,496,325,308	5.7%	0.085	12,572,357	14.4%	
Auto 3-digit	0.081	17,989,964,663	41.4%	0.081	60,973,641	70.1%	
Auto 5-digit	0.070	19,265,167,056	44.3%	0.070	4,830,798	5.6%	
<b>Total/Average</b>	<b>0.082</b>	<b>43,476,117,763</b>	<b>100.0%</b>	<b>0.085</b>	<b>87,033,240</b>	<b>100.0%</b>	<b>\$ 0.085</b>

**Standard ECR Unit Cost**

	USPS			Bookspan			Company Avg. Letter Cost w/Contingency (Dollars) (16)
	TYBR 2006	FY 2006	FY 2006	TY 2006	FY 2004	FY 2004	
	Total	Mail Volume (Pieces) (10)	Mail Volume (Percent) (11)	Total Unit Cost (Dollars) (12)	Mail Volume (Pieces) (14)	Mail Volume (Percent) (15)	
<b>LETTERS</b>							
Nonauto Basic Letters	0.094	2,204,590,228	52.3%	0.094	5,575,871	79.9%	
Auto Basic Letters	0.046	2,008,138,417	47.7%	0.046	1,405,645	20.1%	
<b>Total/Average</b>	<b>0.071</b>	<b>4,212,728,645</b>	<b>100.0%</b>	<b>0.084</b>	<b>6,981,516</b>	<b>100.0%</b>	<b>\$ 0.084</b>

**Bookspan Average Cost per piece**

**\$ 0.085** (17)

- (1) Docket No. R2005-1 (USPS-LR-K-48 as revised 05/20/05, USPS-LR-K-67, USPS-LR-K-119)
- (2) Docket No. R2005-1 (USPS-T-7, Attachment A, pg. 7)
- (3) Each row in (2) divided by total in (2)
- (4) (1)
- (5) (4) x (7) Bookspan weighted average
- (6) CBCIS, Bookspan FY2004 volume (Appendix A, pg. 3)
- (7) Each row in (6) divided by total in (6)
- (8) Total Unit Cost (5) x Contingency Factor Assumption (Appendix A, pg. 1, (3))
- (9) Docket No. R2005-1 (USPS-LR-K-67, USPS-LR-K-84, USPS-LR-K-119)
- (10) Docket No. R2005-1 (USPS-T-7, Attachment A, pg. 7)
- (11) Each row in (10) divided by total in (10)
- (12) (9)
- (13) (12) x (15) Bookspan weighted average
- (14) CBCIS, Bookspan FY2004 volume (Appendix A, pg. 3)
- (15) Each row in (14) divided by total in (14)
- (16) Total Unit Cost (13) x Contingency Factor Assumption (Appendix A, pg. 1, (3))
- (17) ((8)x(6) + (16)x(14)) / ((6) + (14))

**Bookspan**  
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 Appendix A, page 5

**Standard Mail Regular Non-letter Revenue per piece**

Mail Category	Revenue per piece (1)	Volume (2)	Revenue (3)
Nonauto Basic	0.374	29,186	10,917
Nonauto 3/5 Digit	0.290	1,367,428	395,959
Auto Basic	0.295	167,112	49,264
Auto 3/5 Digit	0.239	97,096,345	23,192,500
<b>Total</b>		<b>98,660,071</b>	<b>\$ 23,648,640</b>
<b>Revenue per piece</b>			<b>\$ 0.240</b>

USPS Totals (USPS-LR-K-77)			
Revenue per piece (5)	Volume (6)	Revenue (7)	
0.535	479,656,633	256,645,917	
0.498	1,052,913,950	524,611,357	
0.383	338,554,022	129,723,419	
0.289	10,609,272,685	3,070,777,750	
	<b>12,480,397,290</b>	<b>\$ 3,981,758,443</b>	
			<b>\$ 0.319</b>

**Standard Mail ECR Non-letter Revenue per piece**

Mail Category	Revenue per piece	Volume	Revenue
Basic Non-letter	0.169	65,718,356	11,116,946
<b>Total</b>		<b>65,718,356</b>	<b>\$ 11,116,946</b>
<b>Revenue per piece</b>			<b>\$ 0.169</b>
<b>Average Revenue per piece</b>			<b>\$ 0.211</b>

Revenue per piece	Volume	Revenue
0.198	11,396,910,120	2,255,864,010
	<b>11,396,910,120</b>	<b>\$ 2,255,864,010</b>
		<b>\$ 0.198</b>
		<b>\$ 0.261</b>

- (1) (3)/(2)
- (2) CBCIS, Bookspan FY2004 volume
- (3) CBCIS, Bookspan FY2004 revenue
- (4) Bookspan (Standard Mail Regular Revenue + Standard Mail ECR Revenue) / (Standard Mail Regular Total Volume + Standard Mail ECR Total Volume)
- (5) Docket No. R2005-1, USPS-LR-K-77, FY2004 Standard Mail Regular Billing Determinants
- (6) Docket No. R2005-1, USPS-LR-K-77, FY2004 Standard Mail Regular Volume
- (7) Docket No. R2005-1, USPS-LR-K-77, FY2004 Standard Mail Regular Revenue
- (8) USPS (Standard Mail Regular Revenue + Standard Mail ECR Revenue) / (Standard Mail Regular Total Volume + Standard Mail ECR Total Volume)



**Agreement Structure**

FY2006		FY2007		FY2008	
Threshold	Discount	Threshold	Discount	Threshold	Discount
87,000,001	\$ 0.020	85,000,001	\$ 0.020	94,000,001	\$ 0.010
120,000,001	\$ 0.030	110,000,001	\$ 0.030	100,000,001	\$ 0.020
				120,000,001	\$ 0.030

**Discount on volume above threshold**

(1) Before Rates Forecast	78,000,000	75,000,000	75,000,000
(2) After Rates Forecast	105,000,000	105,000,000	107,000,000
(3) Discount in first tier	\$ 360,000	\$ 400,000	\$ 60,000
Discount in second tier	\$ -	\$ -	\$ 140,000
Discount in third tier	\$ -	\$ -	\$ -
(4) <b>Discount Earned</b>	<b>\$ 360,000</b>	<b>\$ 400,000</b>	<b>\$ 200,000</b>

**Exposure on volume above threshold**

(5) Threshold	87,000,001	85,000,001	94,000,001
(6) Before Rates Forecast	78,000,000	75,000,000	75,000,000
(7) Exposed Pieces	-	-	-
(8) After Rates Forecast	105,000,000	105,000,000	107,000,000
(9) Discount Exposure in first tier	\$ -	\$ -	\$ -
Discount Exposure in second tier	\$ -	\$ -	\$ -
Discount Exposure in third tier	\$ -	\$ -	\$ -
(10) <b>Total Exposure</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>

- (1) Before Rates Total Volume (Appendix A, pg. 2)
- (2) After Rates Total Volume (Appendix A, pg. 2)
- (3) Discount Earned per discount tier based on rate chart above.
- (4) Sum of discounts earned in first tier to fifth 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) If the Before Rates Forecast volume (6) is greater than the Threshold volume (5), then the Discount Exposure represents the discount X the volume per discount tier.
- (10) Sum of Exposure in first tier to third tier

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	FY2006	(7) FY2007	(8) FY2008
<b>Standard Mail Letters</b>			
(1) Standard letters Revenue per Piece	0.187	0.187	0.187
(2) Standard letters Cost per Piece	0.085	0.088	0.092
(3) Standard letters Contribution per Piece	0.103	0.099	0.096
<b>Standard Mail Non-letters</b>			
(4) Standard Non-letter Revenue per Piece	0.211	0.211	0.211
(5) Standard Non-letter Cost per Piece	0.196	0.204	0.212
(6) Standard Non-letter Contribution per Piece	0.016	0.008	(0.000)
(1) Average Revenue per Piece (Appendix A, pg. 3, (4))			
(2) Average Cost per Piece (Appendix A, pg. 4, (17))			
(3) (1) - (2)			
(4) Average Revenue per Piece (Appendix A, pg. 5, (4))			
(5) Average Cost per Piece (Appendix A, pg. 6, (17))			
(6) (4) - (5)			
(7) Year 1 * Inflation cost adjustment factor Year 2 (Appendix A, pg. 1, (1))			
(8) Year 2 * Inflation cost adjustment factor Year 3 (Appendix A, pg. 1, (1))			

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	FY2006	FY2007	FY2008	Total
(1) Contribution from new Standard letter mail	\$ 1,025,701	\$ 1,090,924	\$ 1,147,727	3,264,351
(2) Contribution from Standard non-letter mail converted to Standard letter mail	\$ 1,476,602	\$ 1,734,608	\$ 1,918,177	5,129,387
<b>(3) Total New Contribution</b>	<b>\$ 2,502,302</b>	<b>\$ 2,825,532</b>	<b>\$ 3,065,904</b>	<b>8,393,738</b>
(4) Total Discount Exposure	\$ -	\$ -	\$ -	-
(5) Total Incremental Discounts	\$ 360,000	\$ 400,000	\$ 200,000	960,000
<b>(6) Total USPS Value</b>	<b>\$ 2,142,302</b>	<b>\$ 2,425,532</b>	<b>\$ 2,865,904</b>	<b>\$ 7,433,738</b>

- (1) Assumption (2), (Appendix A, pg. 1) X (Volume Before Discount (Appendix A, pg. 2) - Volume After Discount (Appendix A, pg. 2))  
 X (Contribution Standard letter mail (3), (Appendix A, pg. 8) - Contribution Standard non-letter mail (6), (Appendix A, pg. 8))
- (2) 1 minus Assumption (2), (Appendix A, pg. 1) X (Volume After Discount (Appendix A, pg. 2) - Volume After Discount (Appendix A, pg. 2))  
 X Contribution Standard letter mail (Appendix A, pg. 8)
- (3) Sum of (1) + (2)
- (4) Total Discount Exposure (10)(Appendix A, pg. 7)
- (5) Discount Earned (4) (Appendix A, pg. 7)
- (6) (3) - (4) - (5)

**USPS-T-2  
Appendix B  
Explanation of Financial Model**

The Bookspan Model incorporates all of the cost and revenue per piece data into one comprehensive workbook. It serves as a presentation mechanism for the customer-specific revenue and cost calculations. The historical and forecasted volumes are provided by Bookspan witness Epp (Bookspan T-2, page 10 and 11 respectively). These inputs provide the basis for calculating the value of the NSA.

**Assumptions**

The assumptions page contains three factors impacting the three-year duration of the agreement. The first assumption, inflation cost adjustment factor, represents the inflationary cost growth projected by the Postal Service. Currently, the inflation factor is 4 percent for each year (Docket No. MC2004-4, USPS-T-1, pg. 13). The second assumption represents the percentage of volume migration of Standard Mail letters converted from Standard Mail non-letters. This assumption is based on the ratio between the difference of Before Rates and After Rates forecast volumes for Standard non-letter mail and the difference of Before Rates and After Rates forecast volumes for Standard Mail letters. These forecast volumes are provided by Bookspan witness Epp (Bookspan T-2, page 11) and shown on page 2 of Appendix A. The third assumption, contingency factor, is the multiplicative factor applied uniformly to all

forecast postal costs. Currently, the contingency provision is zero. Docket No. R2005-1, USPS-T-6, page 18.

### **Volume Calculations**

The volume calculations contain Bookspan historical mail volumes for FY 2002 - 2004 for solicitation of new membership, identified by letter and non-letter (flat) volumes. These volumes have been identified through the USPS permit system and through the reconciliation process conducted with Bookspan. To illustrate the volume response to rate incentives, Bookspan witness Epp (Bookspan T-2, page 11) has provided the volume forecasts for Bookspan, both in the absence of an agreement (Before Rates) and in the presence of an agreement (After Rates).

### **Standard Mail Regular Letter size Revenue Calculations**

The rate categories presented in the model represent the specific Standard Mail letter mail profile of Bookspan. The Bookspan 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 Bookspan solicitation letter volume. A comparison to USPS revenue per piece, by rate categories specific to Bookspan's profile, has been provided. This calculation is based on FY2004 Standard Mail Regular Billing Determinants provided in USPS Library Reference K-77. The USPS average revenue per piece is based on the total revenue of the rate categories represented divided by

the total volume of the rate categories represented. The USPS average revenue per piece is slightly lowered that Bookspan average revenue per piece for Standard Mail letters

### **Standard Mail Regular Letter Size Cost Calculations**

The rate categories presented in the cost calculation represent the Standard Mail profile of Bookspan, as shown on page 3 of Appendix A. The unit costs per rate category for Standard Mail letters are based on the USPS Docket No. R2005-1, Test Year 2006. The total unit cost is derived by multiplying the weighted distribution from FY2006, before rates volume forecast documented in USPS T-7, Attachment A, page 7, by the unit cost per rate category. Bookspan FY2004 Standard Mail letter size volumes are used since these are the latest full year historical volume available. These volumes are documented on Appendix A, page 3. The total unit cost estimate for Bookspan has been derived by multiplying the weighted distribution from Bookspan FY2004 historical volumes by the USPS Test Year FY2006 unit costs per rate category. The Total Unit Cost Estimates (Appendix A, page 4, source 7 and 15) are equal to Total Unit Cost Estimates (Appendix A, page 4, source 8 and 16), including a contingency provision of zero. (Attachment A, page 1)

### **Standard Mail Regular Non-letter size Revenue Calculations**

The rate categories presented in the model represent the specific Standard Mail non-letter profile of Bookspan. The Bookspan 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 Bookspan solicitation non-letter Standard Mail volume. A comparison to USPS revenue per piece, by rate categories specific to Bookspan's profile, has been provided where?. This calculation is based on FY2004 Standard Mail Regular Billing Determinants provided in USPS Library Reference K-77. The USPS average revenue per piece is based on the total revenue of the rate categories represented divided by the total volume of the rate categories represented. The USPS average revenue per piece is slightly lowered that Bookspan average revenue per piece for Standard Mail non-letters

### **Standard Mail Regular Non-letter size Cost Calculations**

The rate categories presented in the cost calculation represent the Standard Mail profile of Bookspan as shown on page 5 of Appendix A. The unit costs per rate category for Standard Mail non-letters are based on the USPS Docket No. R2005-1 Test Year 2006. The total unit cost is derived by multiplying the weighted distribution from FY2006 before rates volume forecast documented in USPS T-7, Attachment A, page 7, by the unit cost per rate category. Bookspan FY2004 Standard Mail non-letter size volumes are used since these are the latest full year historical volume available. These volumes are documented on Appendix A, page 5. The total unit cost estimate for Bookspan has been derived by multiply the weighted distribution from Bookspan FY2004 historical volumes by the USPS Test Year FY2006 unit costs per rate category. The Total

Unit Cost Estimates (Appendix A, page 6, source 7 and 15) are equal to Total Unit Cost Estimates (Appendix A, page 6, source 8 and 16), including a zero percent contingency (Attachment A, page 1).

### **Discount and Exposure**

In the first year of the NSA, the declining block rate structure begins with a discount of 2.0 cents per piece for the block beginning at 87,000,001 and ends at 120,000,000 pieces. The second discount tier discount of 3.0 cents per piece begins at 120,000,001 and ends at 150,000,000. The discount is effective once the volume level has reached 94,000,000. The exposure to the USPS measures the discounted revenue associated with declining block rates for mail volume that Bookspan would have mailed in the absence of the proposed NSA (referenced as Before Rates forecast volumes). For each year, before rates forecast volumes (Appendix A, page 2) are below the initial starting discount level.

Therefore, there is no exposure for the volumes that Bookspan will mail with the NSA (referenced as after rates forecast volumes, Appendix A, page 2) However, the model will calculate exposure, if the before rates forecast volumes were above the volume tiers, by reducing the difference in the volume tier and multiplying by the corresponding discount. The discount earned for FY2006 is \$360,000.00, based on the after rates forecast volume of 105,000,000 pieces.

In the second year of the NSA, the declining block rate structure begins with a discount of 2.0 cents per piece for the block beginning at 85,000,001 and ending

at 110,000,000 pieces. This discount is effective once the volume level has reached 95,000,000 pieces. As explained above, the before rates volume is below the initial starting discount level, therefore there is no exposure for FY2007. The block for the second discount of 3.0 cents per piece begins at 110,000,001 pieces and ends at 150,000,000 pieces. The discount earned for FY2007 is \$400,000.00 based on the after rates forecast volume of 105,000,000 pieces.

In the third year of the NSA, the declining block rate structure with a discount of 1.0 cents per piece for the block beginning at 94,000,001 pieces and ending at 100,000,000 pieces. This discount is effective once the volume level has reached 105,000,000 pieces. The before rates volume is below the initial starting discount level, therefore there is no exposure for FY2008. The second discount of 2.0 cents per piece begins at 100,000,001 pieces and ends at 120,000,000 pieces. The third discount of 3.0 cents per piece begins at 120,000,001 pieces and ends at 150,000,000 pieces. The discount earned for FY2008 is \$200,000.00 based on the after rates forecast volumes of 107,000,000 pieces.

### **Contribution Inputs**

The contribution inputs calculate the contribution per piece of Bookspan's Standard Mail solicitation letter mail volume and non-letter mail volume. The per piece calculation provides the Postal Service with before and after rates revenue, cost and contribution for 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)) to be multiplied by the cost of each mail shape. Unit revenue remains constant over the three-year agreement.

### **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 solicitation letter volume above the before rates forecast volume and the new contribution from solicitation letter mail converted from solicitation non-letter mail. The contribution from new solicitation letter mail volume is based on the percentage of new letter mail (Appendix A, page 1, (2)) multiplied by the difference in the before-rates forecast volume and the after-rates forecast volume of solicitation letter mail. The contribution from new solicitation letter converted from solicitation non-letter mail is based on the percentage of the conversion (Appendix A, page 1, (2)) multiplied by the difference in the before rates forecast volume and the after rates forecast volume of solicitation letter mail and multiplied by the difference in the contribution of Standard Mail letters and non-letters.

**USPS-T-2  
 Appendix C  
 Value To Volume Sensitivity Matrix  
 Based on Year 1**

**Table 1**

			After Rates Volume							
			84.0	89.3	94.5	105.0	115.5	126.0	136.5	147.0
Before Rates Volume	% Change		-20%	-15%	-10%	0%	10%	20%	30%	40%
	62.4	-20%	1.9	2.4	2.9	3.7	4.6	5.4	6.2	6.9
	66.3	-15%	1.5	2.0	2.5	3.3	4.2	5.0	5.8	6.5
	70.2	-10%	1.1	1.6	2.1	2.9	3.8	4.6	5.4	6.1
	78.0	0%	0.3	0.8	1.3	2.1	3.0	3.8	4.6	5.3
	85.8	10%	-0.5	0.0	0.5	1.3	2.2	3.0	3.8	4.5
	93.6	20%	-1.4	-0.9	-0.5	0.4	1.3	2.1	2.8	3.6
	101.4	30%	-2.3	-1.8	-1.4	-0.5	0.3	1.1	1.9	2.7
	109.2	40%	-3.3	-2.8	-2.4	-1.5	-0.6	0.2	0.9	1.7

The row headings show the assumed variance between the before-rates volume forecast and the “actual” before-rates volume.<sup>1</sup> The column headings show the assumed variance between the after-rates volume forecast and the “actual” after-rates volume. This example results in an estimated loss to the Postal Service of \$1.4 million. 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 provision identified previously shields the Postal Service from the extremes presented in this matrix.

Solicitation volumes for Bookspan have declined overall by 6 to 8 percent in recent years. Thus, the probability of a sudden 20 percent increase without an incentive is very low. This low probability is further supported by internal Postal Service data that indicate that less than 1 percent of our largest customers have experienced growth rates in excess of 20 percent in a given year.

The relationship between before-rates volume and after-rates volume 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.

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<sup>1</sup> In reality, the true before rates forecast is unknowable, but for illustrative purposes a range of assumptions.

**USPS-T-2  
Appendix D  
COMPARISON OF FLATS TO LETTERS CONVERSION RELATIVE TO NSA THREE-YEAR VALUE**

% Conversion of Flats to Letters	0	10	20	30	40	50	60	70	80	90	100
3-Year Value (\$M)	7.85	7.78	7.71	7.65	7.58	7.52	7.45	7.39	7.32	7.26	7.19

This sensitivity analysis identifies the possible range of value of the NSA to the Postal Service if the conversion of flat-size solicitations to letter-size solicitations deviates from the estimate implied in the forecasts, which is approximately 63 percent.<sup>1</sup> Increases in the conversion of flats to letters decrease the value of this NSA. In terms of the financial loss, the risk is limited, as the analysis shows, due to the higher contribution of letters compared to the contribution of flats.

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<sup>1</sup> Appendix A, p. 1, line (2), based on Bookspan T-2, page 11, Table 2.

**USPS-T-2  
Appendix E  
Proposed Data Collection Plan**

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

1. The volume of solicitation Standard Mail letter-size and Flat-size (non-letter) by rate category in eligible Bookspan account;
2. The amount of discounts paid to Bookspan for solicitation Standard Mail letter-size by incremental volume block;
3. Monthly estimates of the amount of time spend on compliance activity and a description of the activities performed.

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