

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

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

Docket No. MC2005-3

**RESPONSES OF POSTAL SERVICE WITNESS YORGEY  
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND  
VALPAK DEALERS' ASSOCIATION, INC.  
(VP/USPS-T2-1-9d)**

The United States Postal Service hereby provides the responses of witness Yorgey to the following interrogatories of Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc., filed on September 7, 2005: VP/USPS-T2-1-9d. Interrogatory VP/USPS-T2-9e was redirected to witness Plunkett.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS YORGEY  
TO INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND  
VALPAK DEALERS' ASSOCIATION, INC.

**VP/USPS-T2-1.**

In Docket No. R2005-1, please refer to the Postal Service response filed on June 30, 2005 to VP/USPS-T28-49 (showing FY-06 PRC costs) and to VP/USPS-T28-50 (showing FY-06 USPS costs), both redirected from witness Taufique, and their Excel attachment named Cost\_Interrogatory-USPS2\_checked.xls. The USPS costs in the response to VP/USPS-T28-50 appear to be a subset, including additional detail, of the costs shown by witness Yorgey in her response to POIR No. 1, Question 2, Attachment 2, in the instant docket.

This interrogatory has six attachments. Each is based on either 'Sheet 3' or 'Sheet 5' of the above-referenced Excel attachment, with some modifications. The modifications are: (1) Below each single-layer or double-layer (cost) box, right justified, in small font, the rate associated with that box has been inserted in cents per piece. According to the heading on the attachment, it is either the Docket No. R2001-1 rate or the proposed Docket No. R2005-1 rate. (2) In the bottom layer of each triple-layer box, the actual rate difference (often referred to as a discount) appears. These are calculated directly from the associated small-font rates. (3) In the middle layer of each triple-layer box, the percentage passthrough implied by the rate difference (bottom layer, same box) and the cost difference (top layer, same box) is calculated. It is expressed as a percent. (4) In the single-layer and double-layer cost boxes: Attachments No. 1 and No. 3 contain USPS costs as provided in response to above-referenced VP/USPST28-50; Attachments No. 2 and No. 4 contain PRC costs as provided in response to abovereferenced VP/USPS-T28-49; and Attachments No. 5 and No. 6 contain what are hereinafter called Yorgey costs, as explained further below. (5) Three-layer boxes have been added to show each implicit passthrough of the letter/flat cost differences.

In Attachments No. 5 and No. 6, containing Yorgey costs, the workshare-related costs in the bottom layer of all two-layer boxes are set equal to the total costs in the top layer of the same boxes, because witness Yorgey appears to use only total costs. Also, beyond the USPS costs (for mail processing and delivery) provided in response to above-referenced VP/USPST28-50, the Yorgey costs contain an additional component. That component is equal, using applicable lines, to the total costs in column 13 of Attachment 2 to Question 2 of POIR No. 1 minus delivery costs (column 9) minus rural carrier costs (column 8) minus city carrier costs (columns 3, 4, 5, and 6) (which are zero in rows where these costs appear in column 9 instead) minus mail processing costs (column 1).

- a. Please confirm that the Yorgey costs (in Attachments No. 5 and No. 6) have been developed correctly. If you do not believe they are correct and are suitable for use in estimating the changes in Postal Service costs when pieces change from being flats to being letters, please provide a set of Yorgey costs that you support, explaining their meaning and indicating their source.
- b. Please compare the Yorgey costs in Attachments No. 5 and No. 6, after any modifications you make in response to part a of this question, with the USPS

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- costs in Attachments No. 1 and No. 3. Please explain in detail any extent to which you believe the Yorgey costs are not suitable for rate design purposes but are suitable for estimating the cost effects on the Postal Service when pieces (including Bookspan pieces) change from being flats to being letters.
- c. Please refer to the PRC costs shown in Attachments No. 2 and No. 4.
- (i) Please explain the extent to which you agree that (1) these are USPS estimates of FY-06 PRC costs, based on methods and spreadsheets from Docket No. R2001-1, and (2) by the end of Docket No. R2005-1, the Commission may make available a new set of PRC costs.
  - (ii) In view of any extent to which you know anything about any cost principles behind the currently available PRC costs, please explain any reasons you have for believing that the USPS costs are better suited to estimating the cost effects on the Postal Service of any flats that convert to letters as a result of the Bookspan NSA.
- d. Please explain the logic, fairness and consistency of using Docket No. R2005-1 Yorgey costs to estimate the effects of the Bookspan NSA on the Postal Service but not using either the Yorgey costs or the USPS costs or the PRC costs, of Docket No. R2005-1, to design the proposed rates in Docket No. R2005-1, but rather leaving the rates based costs of Docket No. R2001-1, with an across-the board increase applied.
- e. If the Commission in Docket No. R2005-1, using its own version of the costs shown in Attachments No. 2 and No. 4 were to develop and recommend new rates for Regular Standard and ECR Standard, would it be your position that the Postal Service should file updates to all its revenue and cost estimates in the instant docket? Please explain.
- f. Please refer to the three-layer box between 3/5-digit flats and 3/5-digit letters in Attachment No. 5, or a corresponding new version of it that you develop and support. It shows a cost difference of 4.486 cents and a rate difference of 4.0 cents. Please explain whether you agree that for a piece moving through this box from being a flat to being a letter, the contribution to institutional costs of the Postal Service would increase in the amount of 0.486 cents. If you disagree, please explain why.
- g. If you agree with the procedure outlined in part f of this question, please apply the product mix of Bookspan before and after the NSA to the Yorgey costs in Attachment No. 5, or to a similar attachment with costs and rates that you support, and calculate an average increase in contribution for the pieces estimated to switch from letters to flats in the Postal Service proposal.

**RESPONSE:**

- a. I confirm that these costs have been developed correctly as national average unit costs.

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- b. I am not designing rates based on these costs. I am using them as proxies in my model to demonstrate the financial impact of this NSA.
- c.
  - i. This is consistent with my understanding.
  - ii. I am not an expert in the details of these postal costing theories. In developing the analysis to support the Bookspan NSA, I relied on the costs that were the most current at the time. However, it is my understanding that, in most cases, the Postal Service develops and presents rates designed based on costs as it develops them. I understand that there have been exceptions to this approach, usually when the Postal Service was attempting to minimize the potential areas of contention and the choice of the cost methodology would not have changed the conclusions of the analysis in a major way.
- d. See my response to part b above. It is my understanding that there is more information on the subject of rate development and the choice of costs in Docket No. R2005-1 in the testimonies of witnesses Potter and Robinson.
- e. To the extent that different rates come into effect from those I have assumed, it would be appropriate to revise my financial analysis, if the timing in this case allowed and if the differences were significant enough.
- f. I would agree for the average piece.
- h. g. I did not make this calculation; however, the financial model that I filed with my testimony is designed to calculate various assumptions, including this one, using the electronic spreadsheet.

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**VP/USPS-T2-2.**

- a. Please refer to your Appendix A, page 6, and confirm that if Bookspan were to mail the same volume of Standard Mail Regular non-letters in FY 2006 as it did in FY 2004, and if that volume were to be distributed over the same rate categories in FY 2006 as it was in FY 2004, using USPS Test Year costs from Docket No. R2005-1, the total cost before rates for such Standard Mail non-letters would amount to \$25,668,813, computed as follows:

	TY 2006 Total Unit Costs (Dollars)	FY 2004 Mail Volume (Pieces)	Total Cost
Nonauto Basic	0.351	29,186	\$ 10,244
Nonauto 3/5 Digit	0.260	1,367,428	355,531
Auto Basic	0.347	167,112	57,988
Auto 3/5 Digit	0.260	<u>97,096,345</u>	<u>25,245,050</u>
 TOTAL		 98,660,071	 \$25,668,813

If you do not confirm, please provide the correct total cost and show how it was derived.

- b. Please refer to your Appendix A, page 5, and confirm that the same volume of Standard Mail non-letters as shown above, when mailed at current rates, generated revenue of \$23,648,640 for the Postal Service in FY 2004. If you do not confirm, please provide the correct figure.
- c. Please confirm that if Bookspan were to mail the same volume of Standard Mail non-letters as shown above in FY 2006, with no rate increase the Postal Service could expect to suffer a total out-of-pocket loss of \$2,020,173 from such mail, representing the difference between the revenues in preceding part b and the costs in preceding part a, and a unit loss of \$0.0205. Please explain fully any non-confirmation.

**RESPONSE:**

- a. The calculations appear to be correct. Please see my response to VP/USPS-T2-1.

The average costs were used as proxies for Bookspan's costs in the absence of a Bookspan-specific costs. Please see my response to POIR No. 1, question 4(b)(ii) and attachment 5.

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b.-c. Although the calculations appears to be correct, the national averages do not take account of Bookspan's specific dropship profile and difference in its average weights compared to the national average. As I noted in response to VP/USPS-T2-1b, I do not use these averages to set rates.

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**VP/USPS-T2-3.**

- a. Please refer to your response to POIR No. 1, Question 4.b.ii, Attachment 5, showing Appendix A, page 6 (revised), and confirm that if Bookspan were to mail the same volume of Standard Mail Regular non-letters in FY 2006 as it did in FY 2004, and if that volume were to be distributed over the same rate categories in FY 2006 as it was in FY 2004, using USPS Test Year costs from Docket No. R2005-1, the total cost before rates for such Standard Mail non-letters would amount to \$25,772,746 computed as follows:

	TY 2006 Total Unit Costs (Dollars)	FY 2004 Mail Volume (Pieces)	Total Cost
Nonauto Basic	0.351	29,186	\$ 10,244
Nonauto 3/5 Digit	0.265	1,367,428	362,368
Auto Basic	0.347	167,112	57,988
Auto 3/5 Digit	0.261	<u>97,096,345</u>	<u>25,342,146</u>
 TOTAL		 98,660,071	 \$25,772,746

If you do not confirm, please provide the correct total cost and show how it was derived.

- b. Please refer to your response to POIR No. 1, Question 4.b.ii, Attachment 5, showing Appendix A, page 5 (revised), and confirm that the same volume of Standard Mail non-letters as shown above, when mailed at projected rates, would generate total revenue of \$24,925,667 for the Postal Service in FY2006. If you do not confirm, please provide the correct figure.
- c. Please confirm that if Bookspan were to mail the same volume of Standard Mail non-letters as shown above in FY 2006, then even after a projected rate increase of 5.4 percent, the Postal Service could expect to suffer a total out-of-pocket loss of \$847,079 on such mail, representing the difference between the revenues in preceding part b and the costs in preceding part a, and a unit loss of \$0.0086. Please explain fully any non-confirmation.

**RESPONSE:**

- a. – c. Please see my response to VP/USPS-T2-2.a. – c.

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**VP/USPS-T2-4.**

- a. Please refer to your Appendix A, page 6, and confirm that if Bookspan were to mail the same volume of Standard Mail ECR Basic non-letters in FY 2006 as it did in FY 2004, and if all of that volume were to be at the Basic non-letter rate category in FY 2006, the same as it was in FY 2004, then using USPS Test Year costs from Docket No. R2005-1, the total cost for such ECR non-letters would amount to \$6,440,399 computed as follows:

	TY 2006 Total Unit Cost (Dollars)	FY 2004 Mail Volume (Pieces)	Total Cost
Basic Non-letter	0.098	65,718,356	\$6,440,399

If you do not confirm, please provide the correct total and show how it was derived.

- b. Please refer to your Appendix A, page 5, and confirm that the same volume of ECR non-letters as shown above, when mailed at current rates, generated revenue of \$11,116,946 for the Postal Service in FY 2004. If you do not confirm, please provide the correct figure.
- c. Please confirm that if Bookspan were to mail the same volume of ECR non-letters as shown above in FY 2006, even with no rate increase the Postal Service could expect to realize a net gain in contribution of \$4,676,547, representing the difference between the revenues in preceding part b and the costs in preceding part a, and a unit contribution of \$0.0712. Please explain fully any non-confirmation.

**RESPONSE:**

- a. – c. Please see my response to VP/USPS-T2-2.a. – c.

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**VP/USPS-T2-5.**

- a. Please refer to your response to POIR No. 1, Question 4.b.ii, Attachment 5, showing Appendix A, page 6 (revised), and confirm that if Bookspan were to mail the same volume of Standard Mail ECR Basic non-letters in FY 2006 as it did in FY 2004, and if all of that volume were to be at the Basic non-letter rate category in FY 2006, the same as it was in FY 2004, using USPS Test Year costs from Docket No. R2005-1, the total cost for such ECR non-letters would amount to \$6,440,399 computed as follows:

	TY 2006 Total Unit Costs (Dollars)	FY 2004 Mail Volume (Pieces)	Total Cost
Basic Non-letter	0.098	65,718,356	\$6,440,399

If you do not confirm, please provide the correct total and show how it was derived.

- b. Please refer to your response to POIR No. 1, Question 4.b.ii, Attachment 5, showing Appendix A, page 5 (revised), and confirm that the same volume of ECR non-letters as shown above, when mailed at projected rates, would generate total revenue of \$11,717,261 for the Postal Service in FY 2006, and a unit revenue of \$0.178. If you do not confirm, please provide the correct figures.
- c. Please confirm that if Bookspan were to mail the same volume of ECR non-letters as shown above in FY 2006, even with no rate increase the Postal Service could expect to realize a gain of \$5,276,862 representing the difference between the revenues in preceding part b and the costs in preceding part a. Please explain fully any non-confirmation.
- d. Please confirm that the unit contribution from a Bookspan ECR non-letter at rates proposed in Docket No. R2005-1 is equal to \$0.080, derived by subtracting a unit cost of \$0.098 from a unit revenue of \$0.178. If you do not confirm, please provide the correct figures.

**RESPONSE:**

- a. – c. Please see my response to VP/USPS-T2-2.a. – c.
- d. The calculations appear to be correct, but, again, these are averages rather than Bookspan-specific costs.

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**VP/USPS-T2-6.**

- a. Please compare your response to VP/USPS-T2-2(c) with your response to VP/USPS-T2-4(c) and explain why the Postal Service has been incurring a loss of \$0.0205 per piece and a total annual loss of \$2,020,173 on Bookspan's Standard Mail Regular non-letters, while making \$0.0712 per piece and a total annual contribution to overhead of \$4,676,547 on Bookspan's ECR non-letters, both at current rates. If you do not confirm the figures shown here and in the referenced interrogatories, please base your comparison and explanation here on the figures that you provided in your response to the above-referenced interrogatories.
- b. Please compare your response to VP/USPS-T2-3(c) with your response to VP/USPS-T2-5(c) and explain why -- after a rate increase of 5.4 percent -- the Postal Service would incur a loss of \$0.0086 per piece and a total loss of \$847,080 on Bookspan's Standard Mail Regular non-letters, while making a \$0.080 contribution per piece and a total contribution of \$5,276,862 on ECR non-letters, both computed at rates proposed in Docket No. R2005-1. If you do not confirm the figures shown here and in the referenced interrogatories, please base your comparison and explanation here on the figures that you provided in your response to the above-referenced interrogatories.

**RESPONSE:**

- a. Please see my response to VP/USPS-T2-2.a.
- b. The calculations appear to be correct. Please see my response to VP/USPS-T2-2.c.

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**VP/USPS-T2-7.**

- a. Please refer to your Appendix A, page 2, and confirm that the forecasted change in total volume from before rates to after rates is as shown here.

	FY 2006	FY 2007	FY 2008
After Rates	225,000,000	215,000,000	217,000,000
Before Rates	<u>215,000,000</u>	<u>204,000,000</u>	<u>205,000,000</u>
Change in volume	10,000,000	11,000,000	12,000,000

If you do not confirm, please provide the correct figure for the annual change in volume.

- b. Please refer to your Appendix A, page 2, and confirm that the forecasted increase in letter volume from before rates to after rates is as shown here.

	FY 2006	FY 2007	FY 2008
Net increase in volume (all ltrs)	10,000,000	11,000,000	12,000,000
Flats converted to letters	<u>17,000,000</u>	<u>19,000,000</u>	<u>20,000,000</u>
Total increase in letter volume	27,000,000	30,000,000	32,000,000

If you do not confirm, please provide the correct figure for the annual change in forecasted volume for each of the years shown.

- c. Please refer to your response to VP/USPS-T2-5(d) and confirm that if all Bookspan flats that converted to letters, as shown in the second row of preceding part b, were ECR Basic flats, then the Postal Service would forego a unit contribution of \$0.080 per piece and suffer the following total reduction in contribution, before taking into account either the increase in contribution from letters or any discount that might be earned.

	FY 2006	FY 2007	FY 2008
Reduction in contribution from ECR flats converting to letters	\$1,360,000	\$1,520,000	\$1,600,000

If you do not confirm, then for each year shown please provide the correct figure for the reduction in contribution on the assumption that all converting flats are ECR flats.

- d. Please refer to your response to POIR No. 1, Question 4.b.ii, Attachment 5, showing Appendix A, page 9 (revised), row 2, and for the years shown in that

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- attachment provide the contribution on the assumption that all conversion is from ECR non-letter mail to ECR letter mail.
- e. Since Bookspan's volume of FY 2004 high contribution ECR non-letters was slightly over 65 million, and the projected volume of flats converting to letters is only 17 million to 20 million, what assurance, if any, does the Postal Service have that the flats which Bookspan converts to letters will be mostly Standard Mail Regular flats with a low or negative unit contribution, and not a disproportionate share of ECR flats, which have a high unit contribution?

**RESPONSE:**

- a. Confirmed.
- b. Confirmed.
- c. Please see my response to VP/USPS-T2-2.c.
- d. I did not make this calculation; however, the financial model that I filed with my testimony is designed to calculate various assumptions, including this one, using the electronic spreadsheet.
- e. Given that ECR flats tend to have a lower price already, they are the flats least likely to convert, all other things being equal.

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**VP/USPS-T2-8.**

Please refer to your responses to VP/USPS-T2-2(c) and VP/USPS-T2-5(d), and consider the unit contribution that the Postal Service would derive from the entire volume of Bookspan's non-letter mail after a 5.4 percent rate increase; *i.e.*, the unit contribution on Bookspan's 98.7 million Standard Mail Regular non-letters, and Bookspan's 65.7 million Standard Mail ECR non-letters.

- a. From a statistical perspective, would you agree that the unit contribution from these 164.4 million non-letters is a bi-modal distribution, with a large volume showing little or no unit contribution, and a large volume showing a substantial positive unit contribution? If you do not agree, please explain how you would describe the distribution of the unit contribution from all of Bookspan's non-letter mail.
- b. Would you agree that averages based on a bi-modal distribution may not be representative of the underlying data? If you disagree, please explain how you view averages that are taken over a bi-modal distribution.

**RESPONSE:**

- a. I have not undertaken a comprehensive analysis of the costs of Bookspan's various types of Standard Mail Regular non-letters. Given that Bookspan enters mail in many different rate categories and employs a number of different piece designs, it is reasonable to assume that – were it possible to measure Bookspan's Standard Mail Regular non-letter costs with the precision implied in this interrogatory - their pieces would exhibit a range of cost characteristics, and therefore that the net contribution of Bookspan's Standard Mail Regular non-letters is distributed along some type of continuum. However, I would not go so far as to infer that the distribution is bi-modal in the manner suggested here. Please also refer to the response to POIR 1, question. Please see my response to POIR No. 1, question 4(b)(ii) and attachment 5.
- b. Averages – or means - are representative by definition. The degree to which such representations are adequate depends in large part on the use for which such an

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average is employed. See also the response of witness Plunkett to VP/USPS-T2-  
9(e).

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**VP/USPS-T2-9.**

Please review your response to VP/USPS-T2-3 and respond to the following.

- a. Please, confirm that the projected negative difference between revenues and cost — *i.e.*, the out-of-pocket loss — for Bookspan's Standard Mail Regular non-letters is calculated using Postal Service volume variable costs. If you do not confirm, how would you characterize the costs which are used?
- b. Would not the Postal Service be financially better off if Bookspan did not mail any Standard Mail Regular non-letters? Please explain any negative response, and if you claim that considerations of the "multiplier effect" would offset the loss, please explain how high the multiplier effect would have to be in order to offset the out-of-pocket loss.
- c. In your view, are the unit costs shown in your Appendix A, page 6, for Standard Mail Regular non-letters representative of — or reasonable proxy for — the Postal Service's cost of handling Bookspan's Standard Mail Regular non-letters?
- d. If your response to preceding part c is anything other than an unqualified affirmative, please explain what you consider to be shortcomings in the estimated unit cost of Bookspan's Standard Mail Regular non-letters, and discuss what you would consider to be a better methodology, or proxy, for the estimated unit cost of Bookspan's Standard Mail Regular non-letters.

**RESPONSE:**

- a. Confirmed.
- b. No, the dropship profile for Bookspan is significantly different from the national average. This results in a slightly lower revenue per piece for Bookspan in comparison to the national average revenue unit. In contrast, the unit cost presented in the calculation does not represent the Bookspan's specific unit cost but rather the national average unit cost. My calculations were reasonable for the purpose of calculating the financial impact of this NSA, but are not intended to be used, and were not used in this case, to design rates.
- c.-d. Yes, they are a reasonable proxy. As I mentioned in my response to part b, these unit costs were used for a very limited purpose: to estimate the financial impact of expected migration of mail that is currently entered as flats to letters.

## **CERTIFICATE OF SERVICE**

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

Scott L. Reiter

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