

**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

INITIAL BRIEF OF BOOKSPAN

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December 6, 2005

TABLE OF CONTENTS

STATEMENT OF THE CASE	3
STATEMENT OF FACTS	5
A. Description Of Bookspan	5
B. Description Of The NSA	7
C. Commission Proceedings	9
ARGUMENT	
I. The Bookspan NSA Meets the Requirements of the PRA	9
A. General Standards	9
B. The NSA Is Not Unduly Discriminatory	11
C. Volume-Based Discounts Are Legal, Even In The Absence Of Cost-Saving Provisions	12
II. The Bookspan NSA Serves the Public Interest	15
A. The Evidence Compelling Approval of this NSA Cannot Be Overcome By Speculation and Surmise	15
B. The NSA Is Overwhelmingly Likely To Have A Favorable Financial Impact On The Postal Service, To The Benefit Of All Postal Customers	17
1. Mr. Epp's Before And After NSA Volume Forecasts Are Reliable And Consistent With The Company's Mailing History	17
2. Ms. Yorgey's Estimates Of The Financial Benefits To The Postal Service Are Reliable	20
3. The Parties' Expectations Of Flats Conversion Volumes Are Reasonable; In Any Event, Any Deviations From These Expectations Do Not Affect the Value of the Deal	21

4.	The Multiplier Effect Of The Deal Provides Additional Value To The Postal Service	22
5.	The Terms Of The Agreement Adequately Protect The Postal Service From Any Forecast Exposure	23
III.	The Terms Of The NSA Are Sufficiently Definite And Reasonable, And The Commission Should Not Second Guess The Deal Reached By The Parties	25
IV.	Rules Providing For Expedition Of Proceedings For Functionally Equivalent NSAs Were Intended To Reduce Burdens On Subsequent NSA Proponents, Not Impose Burdens On Innovators	27
	CONCLUSION	28

STATEMENT OF THE CASE

This Negotiated Service Agreement (NSA) represents the first time the Postal Service and a customer have reached a customized service agreement concerning Standard Mail postal rates. Like the four First Class NSAs that the Commission has previously reviewed, this NSA complies with all of the applicable provisions of the Postal Reorganization Act ("PRA"). The Commission should recommend its adoption without qualification, for the following reasons.

The primary feature that distinguishes this baseline customized service agreement from the four earlier NSAs is that the incentives provided to Bookspan under the agreement derive exclusively from the commitments that Bookspan has made to increase its volume of promotional letter mail. There is no cost saving commitment by Bookspan, because its mail hygiene practices already meet and exceed established standards. This distinction between this case and the four preceding cases is, however, without substantive significance: The Postal Service and Bookspan have established beyond questions that the agreement (i) meets the ratemaking and classification criteria of the PRA, (ii) is not discriminatory, and (iii) is in the public interest.

The first of the legal tests of a valid NSA is not open to dispute in this case. It has not been claimed that the Bookspan mail eligible for NSA discounts will fail to cover their Attributable Costs or will fail to make an increased contribution to the Postal Service's Institutional Costs, nor can any such claim be made.

The NSA under consideration equally satisfies the anti-discrimination provisions of the PRA. While in the past the Commission expressed reservations about a customized agreement that is based solely on the provision of incentives to generate additional mail

volume, the NSA and the record in this case plainly address such concerns the Commission may have had regarding volume discounts in the abstract. The Agreement embodies safeguards that assure that it will not provide Bookspan with any undue preference at the expense of competitors or other mailers. The volume commitments exceed the historic volumes of promotional letter mail that Bookspan has experienced, and are adjustable (subject to a floor that is not lower than historic volumes) based on actual experience. The agreement is terminable if volumes exceed a specified level. The prospect of a windfall benefit to Bookspan is thus eliminated. Precedent in the postal context and in other network industries plainly establishes that customized volume based incentive arrangements are not discriminatory *per se*; that precedent applies with particular force in the context of this agreement with its special safeguards.

Last, and by no means least, the agreement will plainly benefit the Postal Service and thereby all users of the system. It is therefore in the public interest. The agreement furthers the fundamental purposes of the PRA because it will enable the Postal to capture volume of promotional mail that would not have been entered by Bookspan but for the incentive offered under the NSA and, as a result of Bookspan's unique status as a negative option book club enterprise, the discounted promotional mail will generate additional undiscounted First Class, Standard and parcel mail volumes. The before- and after-NSA forecasts of volume presented by Bookspan are not open to factual or analytic challenge. Mere speculation or conjecture about the possibility that actual results may differ from the forecast is not sufficient to discredit or rebut the conservatively estimated benefits that will flow to the Postal Service and derivatively to the public from this agreement. The Postal Service's analyses confirm that the benefits to the Postal Service

far outweigh the cost (in terms of risk of revenue leakage), that the Postal Service will experience, even allowing for imprecision inherent in any forecast of future events. The terms of the agreement are unambiguous and readily administrable and the duration of the agreement comports with Commission rule and is economically rational.

For these reasons, as detailed more fully in this Brief, Bookspan urges the Commission to favorably and unqualifiedly recommend implementation of the Bookspan NSA.

STATEMENT OF FACTS

A. Description of Bookspan

Bookspan's business originated in the 1920's. The business has a long and distinguished history of reaching America's book readers by direct mail, beginning with its well-known Book-of-the-Month-Club and The Literary Guild. Tr. 3/449c. Bookspan operates a classic "negative option" business: existing club customers members regularly (16-19 times per year) receive the opportunity to express their preference regarding the book designated as the main selection for that period and to purchase other or additional books offered by their club. Tr. 3/379, 449e, 453. Bookspan's 'catalogs' offering these choices are sent at Standard Mail rates, and the books are shipped via the Postal Service. Bookspan's primary mission is to provide its book club members with a superior book buying and reading experience through targeted editorial selection, great savings, and exemplary customer service. Tr. 3/376.

Bookspan now has approximately thirty-five book clubs organized around readers' interests. Tr. 4/483. General interest clubs encompass a variety of fiction and

non-fiction topics, such as literature, biography, history, cooking, diet and exercise, reference, and children's books. Tr. 3/376. Special interest clubs offer books and related merchandise that are specific to certain genres, such as mystery, science fiction, religion, hunting and fishing, gardening, romance, and specific professional interests. *Id.*

The overall market for books is relatively flat, and the market segment of book club and mail order sales is declining. Tr. 3/377. Nevertheless, Bookspan's members continue to value the at-home selection and delivery of books provided by the company's original book club model. Tr. 3/449d. The vast majority of correspondence between Bookspan and its members takes place in writing, through the Postal Service. *Id.* Bookspan generates significant volumes of solicitation mail. In addition, when Bookspan successfully recruits a member, each new member generates anywhere from 50 – 60 pieces of First Class, Standard, and Bound Printed Matter mail per year. Tr. 3/449e.

Bookspan manages a portfolio of marketing channels and programs to promote its clubs, and it uses various media to reach prospective members, including direct mail, print advertising, inserts in newspapers, enclosures in third-party mailings and shipments, telemarketing, and Internet marketing. Tr. 3/380. Bookspan clearly prefers the use of direct mail solicitation, but the percentage that each marketing medium represents in Bookspan's overall marketing portfolio shifts in any year depending on the relative effectiveness and comparative cost of that medium. *Id.*

Bookspan's annual solicitation volumes display a downward trend. Exh. USPS-T-2 at 8; Tr. 3/383-4. This is unsurprising, considering Bookspan is operating in a relatively flat to declining market. Tr. 3/377. Bookspan's interest in this NSA -- an interest demonstrated by its perseverance in the face of "iterative" negotiations with the

Postal Service (Tr. 2/297-298) and the considerable regulatory obstacles of this proceeding -- indicates a strong motivation to buck the trends in the book club market segment and increase club membership. Given the emphasis of its business on the use of direct mail, Bookspan's motivation is consistent with the Postal Service's interest in growing its Standard Mail volumes, and in at least maintaining First Class and parcel volumes in the face of increasing competition.

B. Description of the NSA

In this NSA, the Postal Service provides Bookspan with a financial incentive to shift its marketing efforts more heavily to direct mail. In exchange, the Postal Service receives the direct benefit of the revenues from additional Standard Mail letters. The Postal Service also receives the benefit of revenues from additional First Class, Standard Mail and Bound Printed Matter "multiplier mail" that results from each new member successfully recruited through these incremental solicitations.

As explained in the Postal Service's Request for Decision and supporting testimony, the proposed NSA is the first new baseline NSA to be considered since the initial NSA with Capital One Services, Inc. Like the Capital One NSA and its functional equivalents, Bookspan's NSA includes a declining block rate discount structure, the purpose of which is to encourage the entry of larger volumes of mail. It is *not* a functionally equivalent NSA, however, because (1) it is the first NSA designed to encourage the entry of Standard Mail, and (2) it does not include an address correction element or other condition that produces savings to the Postal Service.

As to the first distinction, the Postal Service has good reason to encourage Standard Mail entry. As Bookspan's multiplier effect illustrates, for negative option

mailers, Standard Mail drives postal mail volume in all other mail classes. Tr. 3/449d. As to the second, the parties did not develop provisions in this agreement conditioning the discounts on upgrades in address hygiene because there was simply no opportunity for substantial additional postal savings. Tr. 3/449h.¹ Bookspan’s mail intensive business model already demanded rigorous attention to address quality. *Id.*

Like the earlier NSAs, however, the Bookspan NSA provides for annual volume block discounts. The discounts apply only after Bookspan reaches a specified annual threshold, and apply only to the incremental volumes within each volume block. Moreover, as the table below discloses, the volume commitments in the second and third year are subject to adjustment based on actual experience:

Year	Volume Discount Threshold	Volume Blocks		Incremental Discount
1	94,000,000	87,000,001	120,000,000	2.0¢
		120,000,001	150,000,000	3.0¢
2	95,000,000, subject to adjustment	85,000,001	110,000,000	2.0¢
		110,000,001	150,000,000	3.0¢
3	105,000,000, subject to adjustment	94,000,001	100,000,000	1.0¢
		100,000,001	120,000,000	2.0¢
		120,000,001	150,000,000	3.0¢

The agreement thus provides for safeguards that mitigate –virtually eliminate – any risk to the Postal Service. The Postal Service insisted on these safeguards, in part to address concerns that arose in previous NSA proceedings. *Request* at 2. Key safeguards include:

- an annual volume commitment which must be met before discounts are payable, that is set well above the before-rates forecast;

¹ See also, *Request of the United States Postal Service for a Recommended Decision on Classifications and Rates to Implement a Baseline Negotiated Service Agreement with Bookspan*, PRC Docket No. MC2005-3 (July 14, 2005) (hereinafter "Request").

- an annual adjustment mechanism for those volume commitments, based on actual experience (with an adjustment floor);

- an automatic termination clause if volumes exceed 150 million otherwise eligible pieces in any one year; and

- an unconditional right of cancellation for both parties with 30 days notice.

Thus, this NSA provides an opportunity for gain for all concerned—for Bookspan, the Postal Service, and postal ratepayers overall—with minimal, if any, risk of loss to any postal stakeholder.²

C. Commission Proceedings

Bookspan adopts the statement of the proceedings set forth in the brief of the Postal Service. We note that Bookspan supplied some competitively sensitive data under seal in accordance with the Commission’s established procedures. At the conclusion of the hearings – and on Bookspan’s motion – the transcript was unsealed with only a few references to sensitive data redacted. In all material respects, therefore, the proceedings were open to the public.

ARGUMENT

1. The Bookspan NSA Meets the Requirements of the PRA

A. General Standards

The legality of Negotiated Service Agreements has been firmly established, as evidenced by the Commission’s decisions in Dockets MC2002-2 (“Capital One”), MC2004-4 (“Discover”), MC2004-3 (“Bank One”), and MC2005-2 (“HSBC”). The Commission set out the general requirements for NSAs in 2002, explaining that the

² Indeed, if there is any risk, it falls entirely on Bookspan. See discussion *infra* at 17.

Postal Reorganization Act, 39 U.S.C. §101 *et seq.*, permits the Postal Service to contract with individual mailers if (1) the contract is subject to the usual review procedures for rate and classification changes, (2) the terms of the contract satisfy the general ratemaking standards of the PRA and benefit mailers as a whole, and (3) the rates and services of the mailers specified in the contract were offered “on the same terms to other potential users willing to meet the same conditions of service.”³ Rule 190 of the Commission’s Rules of Procedure states that “it shall be the policy of the Commission to recommend Negotiated Service Agreements that are consistent with the statutory criteria, and benefit the Postal Service, without causing unreasonable harm to the marketplace.” 39 C.F.R. § 3001.190.

The Commission has long recognized that more than one set of rates can satisfy the criteria of the Act. PRC Op. R87-1 ¶ 4001, cited at PRC Op. MC2002-2 at ¶ 8010. The Commission has also already determined that NSAs in general, and declining block rates in particular, do not conflict with the operative ratemaking and classification criteria of the Act. *See* PRC Op. MC2002-2 at ¶ 8010. Further, it is entirely clear (and basically undisputed) that this NSA satisfies the ratemaking and classification criteria of the Act. *See* 39 U.S.C. §§ 3622(b), and 3623(c)(5) (requiring the Commission to consider "the desirability of special classifications from the point of view of both the user and of the Postal Service" in recommending classification changes). Thus, the only cognizable legal question is whether the agreement provides an unreasonable preference to Bookspan, 39

³ *Authority of the United States Postal Service to Introduce New Products and Services and to Enter into Rate and Service Agreements with Individual Customers or Groups of Customers: A Report to the Congress by the Postal Rate Commission, February 11, 2002* (hereinafter “PRC Report to Congress”) at 1.

U.S.C. ¶ 403(c), and would therefore cause “unreasonable harm” to the market place.

There is no basis for such a conclusion in this case.

B. The NSA Is Not Unduly Discriminatory

The PRA prohibits only rates and classifications that *unreasonably* discriminate among postal customers. 39 USC § 403(c). The volume discounts in the Bookspan NSA are reasonably based on Bookspan’s unique business model and demand characteristics. They are designed to exploit these characteristics and encourage Bookspan to enter mail that it would not otherwise have sent; and the discounts will generate -- through the “multiplier effect” -- additional *undiscounted* volume across mail classes. In so doing, the discounts will result in increased contribution to the Postal Service’s system-wide institutional costs, benefiting the Postal Service and all of its customers.

The volume discounts contained in the Bookspan NSA, therefore, have a reasonable basis.⁴

Moreover, mailers similarly situated to Bookspan will be able to take advantage of these discounts by entering functionally equivalent agreements with the Postal Service. It is not necessary at this time to define precisely which mailers are “similarly situated”; mailers who believe they can demonstrate the requisite elements for a functionally equivalent agreement can present their case to the Postal Service. The Bookspan NSA discounts, therefore, are available to all similarly situated parties, as required by the PRA and the ratemaking principles described above.

⁴ Because Bookspan’s business is selling books, the Bookspan NSA will further the educational, cultural, scientific, and informational (ECSI) values promoted by the PRA. The discounts embodied in this NSA will allow Bookspan to solicit more customers and, ultimately, sell more books. Thus the Bookspan NSA will not only increase Bookspan’s profitability and provide additional contribution to the Postal Service’s institutional costs, but it will also promote literacy and the broad dissemination of knowledge.

C. Volume-Based Discounts Are Legal, Even In The Absence Of Cost-Saving Provisions

The discounts contained in the Bookspan NSA are exclusively volume-based. While the Commission has expressed reluctance to approve volume-based NSA's without cost-savings provisions,⁵ it is clear that Bookspan's NSA is fundamentally different than the type of arrangement that the Commission hypothesized in that report. The Bookspan NSA contains three features that guard against the risk of a discount based exclusively on volume. First, the Bookspan NSA sets volume commitments that are well above the discount threshold and, in fact, above historic volumes. Second, the Bookspan NSA embodies adjustment provisions which will ratchet the volume commitments upward in the second and third years if the experiment proves – for whatever reason – more successful than the forecasts project. Third, the NSA embodies upper and lower bounds that further serve to guard against the possibility of unexpected developments in the marketplace that might affect the goodness of the deal.

Precedent in the postal and other network industries indicates that volume discounts are a legal and appropriate method of contracting with customers. In the postal industry, the federal courts have upheld International Customized Mail (“ICM”) agreements based solely on volume discounts. *See UPS Worldwide Forwarding, Inc. v. USPS*, 66 F.3d 621, 634 (3rd Cir. 1995). Although, as the court noted, this case dealt only with international mail, the principle behind its decision applies here as well. The court determined that allowing discounts for large volume mailers constituted “a reasonable business decision about the most effective means to solicit new customers.” *Id.* at 634. The court further concluded that such discounts were not unduly

⁵ *PRC Report to Congress* at 13.

discriminatory, and thus were in keeping with § 403(c) of the PRA, because the Postal Service published detailed information about the agreement and made the agreement available to similarly situated customers. The court in *UPS Worldwide* did distinguish, in dicta, the Postal Service's domestic operations from its international operations. *Id.* at 637. But, neither the language nor purpose of Section 403(c) form a basis for concluding that the Bookspan NSA, with its more stringent requirements, is discriminatory because it involves domestic mail. The principle articulated in *UPS Worldwide* plainly applies to the Bookspan NSA, especially in view of the added safeguards against discrimination.

Indeed, a contrary conclusion is foreclosed by precedent in other network industries where prices are regulated under a "just and reasonable," and without undue discrimination standard. Interstate Commerce Act ("ICA") § 1(5)(a) and 2. In rejecting contentions that the ICA did not allow common carriers to contract with customers, the D.C. Circuit explained that "[b]ecause shippers meeting these volume requirements are not similarly situated with other shippers tendering lower volumes of traffic, no discrimination results from differential pricing in these circumstances." *Sea-Land Service, Inc. v. ICC*, 738 F.2d 1311, 1317 (D.C. Circuit 1984). In other words, volume discounts are not *unduly* discriminatory when they differentiate between customers on a reasonable and economically rational basis. This reasoning is nearly identical to that used by the D.C. Circuit in upholding the volume-based discounts in the ICM's discussed in *UPS Worldwide*. See also, *Williams Pipe Line Company*, 58 FERC ¶ 63,004(1992).

Volume based discounts have also been approved by the Federal Energy Regulatory Commission ("FERC") for oil pipelines regulated under the ICA. FERC has held that if an oil pipeline files a volume incentive rate that is less than the applicable

ceiling rate, no further regulatory action will normally be required, so long as the ceiling rate is not exceeded. *See Explorer Pipeline Company*, 71 FERC ¶ 61,416 (1995); and *Williams Pipe Line Company*, 80 FERC ¶ 61,402 (1997). Accordingly, a pipeline may simply include such volume incentive provisions in its cost-based tariff for approval by FERC. The pipeline need not tie the volume incentives to cost savings initiatives.

FERC has approved volume discounts for natural gas pipelines as well. Natural gas pipelines provide volume discounts to their shippers via one of two mechanisms, both of which must be filed with and approved by FERC: (i) a generic volume discount set forth in the pro forma service agreements that are included in the pipeline's tariff, or (ii) a negotiated rate agreement either set forth in the pro forma service agreement, or filed separately from the pipeline's tariff. Whichever mechanism for providing such discounts is used, the principle that volume discounts are permissible as long as they are available to all similarly situated shippers is firmly established. *See, e.g., ANR Pipeline Co.*, 85 FERC ¶ 61,333 (1998) (approving the filing of a tariff that contained discounts for shippers that met certain volume requirements).

Since the ICA, the Natural Gas Act, and the PRA all prohibit undue discriminatory rates, the actions of the ICC and FERC should provide the Commission with confidence that an NSA based on volume discounts without cost saving features is not inherently discriminatory. These cases demonstrate that other industries have embraced the volume discount concept as a reaction to market conditions without regard to the utility's costs savings. The Bookspan NSA, which presents virtually no risk of loss to the Postal Service, is thus analytically on all fours with the decisions in these other

industries. This NSA is economically rational as a revenue-generating measure for the Postal Service, and, therefore, compliant with Section 403(c).

II. The Bookspan NSA Serves The Public Interest

A. The Evidence Compelling Approval of this NSA Cannot Be Overcome By Speculation and Surmise

The degree of proof required to carry the burden of persuasion in an on-the record adjudication under 5 U.S.C. §§ 556 and 557 is the preponderance of the evidence. *Steadman v. SEC*, 450 U.S. 91, 89-102 (1981). In *Steadman v. SEC*, 450 U.S. at 101, the Court noted, *citing* H.R. Rep. No. 1980, 79th Cong., 2nd Sess, 37 (1946) (emphasis added): “[Where] a party having the burden of proceeding has come forward with a *prima facie* and substantial case, he will prevail unless his evidence is discredited or rebutted”.

As we shall show, the Postal Service and Bookspan have met their burden of coming forward with a *prima facie* case to support the legality of the Bookspan NSA. The burden of rebutting the demonstration we have made on the record therefore falls upon those who oppose the NSA. They cannot discharge that task by conjecture or hypothesis. The Postal Service/Bookspan showing must be “discredited or rebutted.” It has not been, and cannot be, as we shall show.

In previous NSA proceedings, particularly Capital One, a prominent issue has been the reliability of volume estimates. In this proceeding, Bookspan has put forth projections of its before-rates and after-rates volumes. Tr. 3/385. No party has introduced evidence casting doubt on these estimates. No analyses have been prepared indicating that Bookspan will not generate the volume it projects; no facts have been addressed from

which a reasoned conclusion can be drawn that the volume commitments Bookspan has agreed to would be met even without the NSA. Indeed, the evidence shows that meeting those commitments will be a reach. *See* Tr. 4/504 at l. 10-23. Therefore, the risk falls almost entirely on Bookspan. The record is utterly devoid of any meaningful information that would rebut Bookspan's carefully prepared volume projections. Mere speculation is insufficient to rebut this showing.

As the Commission is well aware, it is bound by the record before it. The Commission's decision must be supported by "such 'relevant evidence as a reasonable mind might accept as adequate to support [the] conclusion.'" *Mail Order Association of America v. USPS*, 2 F.3d 408, 420 (D.C. Cir. 1993) (quoting *Consolidated Oil & Gas, Inc. v. FERC*, 806 F.2d 275, 279 (D.C. Cir. 1986) (quoting *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 477 (1951))). Further, "the evidence must be found 'within the record of closed-record proceedings to which it exclusively applies. The importance of that requirement should not be underestimated.'" *Id.* (quoting *Association of Data Processing Serv. Orgs. v. Board of Governors*, 745 F.2d 677, 684 (D.C. Cir. 1984)).

If, as we will show, the record in this case establishes the reasonable probability that this NSA will benefit the Postal Service (and, therefore, all users), as well as Bookspan, the Commission cannot legally, and surely should not, allow itself to be swayed by hypothetical or speculative concerns as to what might happen in some other case or circumstance if this NSA is granted. Nor should the Commission insist on absolute certainty so long as there are reasonable safeguards against harm, or countenance broad philosophical arguments it has previously and repeatedly rejected.

B. The NSA Is Overwhelmingly Likely To Have A Favorable Financial Impact On The Postal Service

The evidence in this case establishes that (1) this NSA will cause Bookspan to send more promotional letter mail, thereby providing financial benefits to the Postal Service, and (2) the risks to the Postal Service and other users of the postal system from this deal are minimal, at worst.

1. Mr. Epp's Before And After NSA Volume Forecasts Are Reliable And Consistent With The Company's Mailing History

In his testimony, Witness Epp sets forth the basis for the company's volume estimates. The historic volume figures presented in his testimony have been fully reconciled with the Postal Service's volumes. These numbers are indisputable. By simply looking at the totals that Mr. Epp presents in Table 1 of his testimony, Tr. 3/384, the Commission will independently observe, as Ms. Yorgey did, Exh. USPS-T-2 at 8, an average decline in total new membership solicitation volumes of almost 8% per year for the two years ending in FY2004. Furthermore, after the testimony was filed, FY 2005 ended and the actual solicitation mail volumes for that year were reconciled with Postal Service data and submitted under seal during the proceeding. These results evidence further decline in total new member solicitation volumes. Exh. OCA/Bookspan-T-2-1.⁶

The volume of new member solicitation letters sent in FY 2004 emerges as an exception to this general trend. This exception is caused by factors that Mr. Epp fully explained were related to changes in the regulation of telemarketing. Tr. at 3/384.

Bookspan made the decision late in 2004 to cut off funding its telemarketing campaigns

⁶ *Response of Witness Epp to Interrogatory of the Office of the Consumer Advocate (Under Seal)*, filed July 29, 2005 (showing FY2005 monthly actuals plus a partial forecast for remainder of FY2005) and *Supplemental Response of Witness Epp to Interrogatory of the Office of the Consumer Advocate, OCA/BOOKSPAN-T2-1(b and c) (Under Seal)*, filed October 19, 2005 (showing actual monthly volumes for remainder of FY2005).

and apply the remaining funds in that year to direct mail letter campaigns. Due to the changes in regulatory climate, Bookspan's telemarketing campaigns were behind in meeting their membership goals for the year.⁷ Bookspan therefore dedicated additional funds to letter campaigns, because the telemarketing campaigns that had been executed until that point were falling short of their membership goals. *Id.* As Mr. Epp explained, the deviation was not expected to have a materially lasting effect on Bookspan's Standard Mail new member letter solicitations. Tr. 3/384. And, the FY2005 new member letter solicitation volumes indisputably confirm both Mr. Epp's and Ms. Yorgey's conclusions regarding the exceptional nature of the 2004 figures. *See* Tr.2/159; Exh. OCA/Bookspan-T-2-1.

The modest decrease projected in the before-rates volume forecast over the three year period of the agreement is consistent with the declining trend in letter volumes observed in previous years. Exh. USPS-T-2 at 9. Furthermore, independent sources of information confirm that Bookspan is operating in a relatively flat to declining market for book sales. Tr. 3/377 (citing figures published in 2004 by the Association of American Publishers). It is no wonder that there is no record evidence challenging Bookspan's before-NSA volume forecasts.

Neither is there any record evidence challenging Mr. Epp's after-NSA volumes. Mr. Epp's written testimony explains in detail how Bookspan makes marketing decisions, addressing fully the specific factors that motivate changes in Bookspan's mail volume. Tr. 3/376-383. Bookspan currently manages a large number of new member promotional campaigns each year, using various media including Standard Mail letters and flats, print

⁷ *Response Of Witness Epp To An Information Request Of The Office Of The Consumer Advocate At Closed Hearings (Under Seal)* (October 31, 2005).

advertising, inserts into newspapers, enclosures in third party mailings and shipments, telemarketing (historically), and through the Internet. Tr. 3/379-383, *see also* Tr. 4/483 (under seal). Mr. Epp explains that Bookspan's mail volume forecasts can only be produced in connection with the planning of all of its direct marketing campaigns across marketing media. In explaining his method of developing the forecasts, Mr. Epp cogently and specifically describes, in business terms, the elasticity factors that influence his direct mail letter volumes. Tr. 3/376-387. Among these factors are differences in postage, cost of paper, list costs and rental terms, and expected response rates.

At the margin, even small changes in postage rates can change whether direct mail campaigns or specific lists within direct mail campaigns go off or on Bookspan's list of executable campaigns. Incremental mail volume – book shipments, member catalogs and correspondence – is obviously generated when planned direct mail letter campaigns are successfully executed. Tr. 3/383; Tr. 4/483.

Questions were posed with a view towards assessing the Bookspan's own-price and cross-price elasticities on the basis of volume forecasts Mr. Epp provided in testimony and written responses. Tr. 3/424, OCA/USPS-T2-23 – 25. Mr. Epp originally offered two scenarios: before-NSA and after-NSA forecasts. Both of his original scenarios offered his "best estimates" of mail volumes assuming that the Postal Service's rates would be increased by 5.4% in FY2006. Tr. 3/384. In light of the Board of Governors' decision with respect to the rates this Commission recommended in R2005-1, that was a valid assumption. In response to a Presiding Officer's request, he offered a third scenario. Tr.3/424. In light of the Board of Governors' decision with respect to R2005-1, that scenario does not represent a plausible scenario (if it ever did). *Response*

Of Witness Epp To Presiding Officer's Information Request No. 3 (November 9, 2005).

Any reliance on this scenario to generate issues about Bookspan's elasticity is therefore misplaced.

Moreover, the Commission has already concluded that "there is nothing in economic demand theory . . . that requires the demand elasticity of any individual mailer to agree with the average of the aggregate." PRC Op. MC2002-2 at ¶ 5100. Nor is there anything in economic demand theory which suggests that a single firm should anticipate a response to a durable and specific relative price decrease that inexorably mirrors its anticipated response to a general change in price. Mr. Epp quite clearly explained that an NSA postage discount would create further cost savings and thus motivate changes in the firm's behavior not possible in response to a general change in postage rates. *Response Of Witness Epp To Presiding Officer's Information Request No. 3* (November 9, 2005). Single-firm elasticities are, quite simply, not meaningful for purposes of analysis of this NSA. *Response Of United States Postal Service To Presiding Officer's Information Request No. 3*, Question No. 1 (Witness Plunkett, November 9, 2005).

2. Ms. Yorgey's Estimates Of The Financial Benefits To The Postal Service Are Reliable

The Postal Service estimates it will benefit by \$7.7 million over the life of the Negotiated Service Agreement. This value is based on estimates of \$3.5 million in contribution gained due to additional volume for new Standard letter mail, \$5 million in contribution gained from converting Standard Mail solicitation flats to letters, less total incremental discounts of \$0.96 million. *Response Of United States Postal Service To Presiding Officer's Information Request No. 3*, Question No. 3, Att. 1 at 9 (Witness Yorgey, November 9, 2005). Ms. Yorgey describes in detail her methodology for

reaching these conclusions, and there is no record evidence contesting the validity of her analysis.

Like any forecasts, Mr. Epp's forecasts are estimates. Therefore Ms. Yorgey performed a sensitivity analysis of the volume forecasts for Year 1 of the Agreement. Exh. USPS-T-2, App. C. This analysis illustrates whether the financial gains or losses to the Postal Service if the before-NSA volumes were severely over- or under-estimated. The results of this analysis show that under any plausible scenario, the NSA will yield a net gain in contribution to the Postal Service. *Id.* Moreover, that analysis does not take into account the fact that the Postal Service's judicious exercise of its unconditional termination options would shield the Postal Service from unfavorable results. *Id.*

3. The Parties' Expectations Of Flats Conversion Volumes Are Reasonable; In Any Event, Any Deviation From These Expectations Do Not Affect the Value of the Deal

A significant portion of the contribution gained from this NSA is derived from the conversion of new member flat-shaped solicitations to new member letters. Historically, Bookspan has used Standard Mail flats for the majority of its new member solicitation mailings. In recent years, Bookspan's flat-shaped new member solicitation volumes have been declining at a faster rate than its total solicitation volumes. Exh. USPS-T-2 at 11 and App A at 2. Because the discount provided by this NSA pertains only to letter – shaped solicitations, the proponents expect increased migration. Tr. 3/386-387; Exh. USPS-T-2 at 11. However, despite the fact that the NSA discount is applicable to letters and not flats, Mr. Epp explains that he does not anticipate converting all of Bookspan's new member flat solicitations to letters under the NSA. His explanation was not and

cannot be discredited: flat-shaped mailpieces yield higher response rates when marketing to external lists. Tr. 3/386.

Ms. Yorgey's financial model reasonably assumed that conversion of flats to letters would continue to occur at annual rates of around 63%. *See* Exh. USPS-T-2 App. A at 1. Ms. Yorgey conducted a sensitivity analysis to assess the affect of different conversion percentages on the value of the NSA to the Postal Service. This analysis showed that increases in the conversion percentage modestly decrease the value of the NSA to the Postal Service. Exh. USPS-T-2 at 11-12. But regardless of the conversion percentage, the value of the NSA is expected to be overwhelmingly favorable to the Postal Service. Exh. USPS-T-2 App. D.

4. The Multiplier Effect Of The Deal Provides Additional Value To The Postal Service

As Mr. Posch explains, as a classic negative option marketer, Bookspan conducts its relationship with its members through the mails, so adding new members contributes in predictable ways to the mailstream. Tr. 3./449d-449f. A typical successfully recruited member can generate between 50 and 60 mailpieces over the course of one year. Tr. 3/449e, 454. The financial analysis Ms. Yorgey performed does not reflect the fact that the Postal Service stands to benefit from the additional mail volumes that are generated as a result of correspondence with and fulfillment of the orders of the new book club members that are acquired through the increases in solicitation volumes. Tr. 2/274. None of this additional volume is subject to discount. Therefore, the basis for the NSA – and its benefit to all mailers – is conservative in the sense that it is likely to understate the value of the deal to the Postal Service and its customers. Thus Ms. Yorgey reasonably

concluded that the financial benefits of the NSA to the Postal Service are actually likely to be even higher than the \$7.7 million anticipated.

5. The Terms Of The Agreement Adequately Protect The Postal Service From Any Forecast Exposure

Mr. Epp anticipated that Bookspan would mail approximately 78 million new member letter solicitations in FY 2006, and 75 million in FY 2007 and FY 2008; simple review of the actual FY 2005 letter mail solicitation volumes indicates that the FY2006 forecast represents only a very modest decline in these volumes from FY2005. *See* Tr. 2/159; Exh. OCA/Bookspan-T-2-1

Although there is no factual basis to doubt Bookspan's before-NSA forecasts, a key design feature of this agreement is that the threshold for discount eligibility, the volume commitment in each year, is set well above that forecast. It is set approximately at the highest historic letter mail solicitation volume that Bookspan has achieved since its formation as an entity. Tr. 3/384; Exh. OCA/Bookspan-T-2-6. Considering the clear downward trend exhibited by Bookspan's letter mail solicitation volumes, setting the first-year volume commitment at the highest level that Bookspan has achieved in the previous several years is highly conservative, and provides complete protection from risk of "anyhow" mail. In the first year of the agreement, Bookspan must send mail volumes of 94 million in order to obtain a discount on any mail. Absent the discount, Bookspan estimated it would expect to mail 78 million letters. In FY2004, a year which was inconsistent – because of the elimination of telemarketing as a marketing channel – with Bookspan's overall declining trend, Bookspan mailed approximately 94 million letters.

As Ms. Yorgey explains (Exh. USPS-T-2 at 5), the agreement offers similar protection in later years. In the second year of this Agreement, the base volume

commitment is 95,000,000 new member letter solicitations, and in the third year of this agreement, the base volume commitment is 105,000,000. These commitments adjust up or down depending on the actual volumes mailed in the preceding agreement year. Any downward adjustment is subject to a lower limit of 90,000,000, which is well above the FY2005 new member letter solicitation volumes actually realized by Bookspan. *See* Tr.2/159; Exh. OCA/Bookspan-T-2-1; *Request*, Att. F at 2.

In addition to the volume commitment/discount threshold, the agreement contains two termination provisions that were designed to address the advent of unforeseen circumstances. First, the agreement provides the parties with unconditional rights of cancellation with thirty-days notice. *Request*, Att. F at 7; USPS-T-2 at 6. Thus, if unforeseen circumstances arise that may cause this agreement to become unprofitable, or even just less favorable to the Postal Service than not having the agreement, the Postal Service may terminate the agreement with thirty-days notice.

Second, the agreement terminates automatically, and all discounts cease to be earned if Bookspan mails more than one hundred and fifty million (150,000,000) eligible letter mail solicitations. *Request*, Att. F at 7; USPS-T-2 at 6. Given both the historic and forecasted volumes in this case, this provision was included in an excess of caution. Such circumstances are highly unlikely to arise, and even if they did, the provision operates as a cap on the financial benefits that can accrue to both parties under the agreement. Nevertheless, the parties agreed to this provision because if Bookspan's letter mail solicitation actually did double in a two-year span, this would be indicative of fundamental change in Bookspan's market that would raise questions concerning the need for an incentive to achieve higher new member solicitation mail volumes. Tr. 2/242, 314.

Finally, because the first year volume commitment is above historic levels, the NSA deals with the possibility that Bookspan may not be able to produce enough new member solicitation mail during the first year of the agreement to substantially cover the Postal Service's transaction costs. To protect the Postal Service from this scenario, the NSA includes a penalty clause: if Bookspan does not mail at least 73 million eligible solicitations during the first year of the Agreement, it is required to pay the Postal Service \$200,000. *Request*, Att. F at 2 (¶II.A). This figure represents a reasonable proxy for transaction costs which has been accepted by Bookspan as part of the deal, and has not been challenged by any party.

These several aspects of the agreement (the volume commitments the two termination provisions, and the penalty clause) operate to virtually eliminate any forecast exposure that otherwise might have encumbered the Postal Service's reliance on Bookspan's before- and after-NSA forecasts.

III. The Terms Of The NSA Are Sufficiently Definite And Reasonable, And The Commission Should Not Second Guess The Deal Reached By The Parties

Bookspan has a long history in the direct mail business, Tr. 3/449c, and thus, has well-established solicitation practices. In the context of how Bookspan conducts its business, there was no ambiguity to the agreement and the originally proposed DMCS language. However, during the proceeding some issues were raised concerning the proposed eligibility provision of the DMCS language. *Request*, Att. A, § 620.11.

The relevant provision of the DMCS language clearly identifies what Bookspan mail is eligible for the discount. Only letter-shaped Standard Mail solicitations sent for the purpose of soliciting new book club memberships are eligible. *Request*, Att. A, §

620.11; Tr. 2/263-5; and Tr. 3/428-9. Contrary to the position of one intervenor,⁸ eligible solicitations include Standard Mail Enhanced Carrier Route (ECR) letters. The eligibility provision can only be read to apply to Standard Mail as a classification.⁹ The NSA discounts were not conditioned on the level of sortation or mail preparation performed by Bookspan. There was no reason to do so. Worksharing incentives and mail preparation requirements are built into existing rates, and the NSA discounts are simply applied to the rates that may be in effect from time to time.

Concern was expressed that the provision permitting Bookspan to insert promotions of its "strategic business alliances" in its eligible new member letter solicitations was too open-ended. E.g., Tr. 3/409, 410; Tr. 3/65. Despite assurances from Bookspan that adding bulk advertising/coupons to its new member letter promotional campaigns would dilute the response rates of these campaigns, *see* Tr. 3/461 and 4/495 it appeared to the proponents that the provision was likely to remain an issue of contention. Therefore, the Postal Service amended its request, proposing DMCS language limiting to *two inserts* the number of promotions of Bookspan's strategic business alliances that could be inserted into a new member solicitation. It is absolutely clear that it is not in Bookspan's interest to dilute its new member solicitations with multi-page third-party promotions Tr. 4/495; with the Postal Service's revision, there is no longer any reason for that issue to be in contention.

Finally, the parties have reasonably assessed that an agreement of at least three years duration is necessary to achieve the full effects of the incentives provided.

⁸ *See Comments of the Newspaper Association of America on Notice of Inquiry No. 1* (November 14, 2005).

⁹ *Comments Of Bookspan On Notice Of Inquiry No. 1 In Regard To Domestic Mail Classification Schedule And Data Collection Plan Language* (November 15, 2005); *Reply Comments Of Bookspan On Notice Of Inquiry No. 1* (November 21, 2005).

Response Of Witness Epp To Presiding Officer's Information Request No. 3, Question 1 (November 9, 2005). Mr. Epp made it very clear that the reallocation of Bookspan's resources to direct mail necessary to produce Bookspan's forecasted after-NSA mail volumes would not occur but for a durable favorable effect on Bookspan's postage costs that is provided by an NSA of three years duration. *Id.* The adjustable volume commitment and volume block levels represent the results of negotiations that elicited Bookspan's expected responses to a variety of incentive structures, and were designed to provide an acceptable range of benefits to both parties to the agreement. *See* Tr. 2/341-346.

In sum, there is no absolutely no basis in the record to recommend changes to the duration or structure of the incentives in this Agreement.

IV. Rules Providing For Expedition Of Proceedings For Functionally Equivalent NSAs Were Intended To Reduce Burdens On Subsequent NSA Proponents, Not Impose Them On Innovators

Following the first NSA proceeding, Commission established a process of reviewing functionally equivalent agreements to expedite review of such agreements. As a direct result, much effort has been expended in this proceeding to try to define the scope of these potential, but as yet non-existent functionally equivalent agreements. *See generally*, Tr. 2/29-31, 209, 218, 222-3, 238, 246, 254-5, 269-78, 284-5, 316-17, 323-338. Given the rules, some consideration of this issue in the context of a unique NSA may be reasonable. But the Commission should not impose an unreasonably high burden on Bookspan and the Postal Service to completely and perfectly define the scope and nature of such agreements with heretofore unidentified postal customers. Those

agreements can and should be evaluated, if they materialize, on their own merits. There is no evidence and no claim can be made that this NSA unfairly burdens Bookspan's competition. To impose an impractical burden on the proponents of a first-of-its-kind NSA is to stifle innovation. Surely that was not the intent of this Commission's rules governing the filing and review of NSA proposals. 39 C.F.R. 3001.190-198.¹⁰

CONCLUSION

For the reasons provided above, the Commission should recommend the adoption of the proposed NSA and implementing DMCS rate schedules.

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¹⁰ *See also*, PRC Order No. 1391 at 37 (“While the Commission considers it a requirement that similarly situated mailers have the opportunity to obtain functionally equivalent Negotiated Service Agreements, dissecting an agreement for the purpose of developing and promoting future agreements is beyond what the Commission requires. It also is beyond what is necessary to evaluate the merits of any one Postal Service request.”)