

**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

REPLY BRIEF OF BOOKSPAN

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I. Introduction

In NSA proceedings, as distinguished from generic rate cases, the Commission must base its decision upon facts and principles within the realm of comprehension, control, and discourse of regular business people, who run regular, profit-oriented businesses. The evidence and analysis offered by the witnesses for Bookspan and the Postal Service in this proceeding constitute a legally sufficient and empirically sound basis for the Commission to recommend this agreement.

Bookspan has presented forecasts of its mail volume not on the basis of an theoretical model, but the way that it (and other businesses) operate: by taking its marketing budget for the test year, a budget figure that has been subject to considerable internal scrutiny, allocating these marketing resources according to its usual method (a method that has been described in testimony), and assessing how the resources that it allocates to direct mail can be expected to translate into incremental mail volumes if its postage costs were reduced. *Bookspan has not presented a theoretical demand model; it is not a theoretical customer.* As an ongoing business, it makes rational and efficient marketing decisions that ultimately determine its mail volume in the normal course of operations. Its own distinguished personnel are the source of the best available information regarding how those decisions are made, and as such, are the source of the best possible forecasts.

The Postal Service has properly taken a different approach to pricing with this NSA than it does in its omnibus rate proceedings. In omnibus rate proceedings, the Postal Service (and this Commission) generally applies theoretical economic models to price the various postal products at the subclass level. These models are clearly

necessary and highly effective for purposes of comprehensive, system-wide analysis of the relationship between postal prices and volumes. The models address the drivers of mail volume on a system-wide or subclass level. However, as a practical matter, they do not (because they cannot) adequately explain the individual customer mailing decisions that determine that customer's promotional mail volumes.

The Postal Service did not artificially model the customer-specific drivers of mail volume in this case. It and Bookspan did develop and test careful forecasts based on the available data. And, the Postal Service set the bar for obtaining the NSA discounts high enough to virtually eliminate any risk that it would be offering discounts on mail that would have been mailed "anyhow" at the prevailing rates, a bar that adjusts in succeeding years and is subject to a floor. The Postal Service has also established reasonable contractual safeguards that allow it to continuously monitor the deal and walk away from it at any time if, despite best efforts, the deal proves fruitless or harmful. The record bears no room for doubt that this NSA is in the public interest because it is reasonably calibrated to yield measurable benefits to the Postal Service without serious risk of harm.

The OCA, Valpak, the Newspaper Associations and APWU, by divergent and sometimes internally inconsistent routes, urge the Commission not to recommend this NSA. We deal with the substantive arguments of these parties in the succeeding sections of this brief. It is, however, appropriate to point out that there are certain aspects of these oppositions that go well beyond the record of this proceeding in order to achieve ends which are not properly within the scope of this Commission's power or, for that matter, of the Postal Service and the Board of Governors. To the extent that the opposing parties are categorically opposed to NSAs that involve Standard Mail, the proper recourse is not

to this Commission, but to Congress. See Association of American Publishers v. Board of Governors, 485 F.2d 768, 775 (D.C. Cir. 1973). The Commission should not entertain such arguments, no matter how carefully they are disguised.

The Commission must also take care not to be swayed by arguments masquerading as fact. Conjecture, speculation and hyperbole are not proof. Not one of the opposing parties elected to introduce direct or rebuttal testimony in this case, and the testimony adduced by Bookspan with respect to the multiplier effect was not even cross examined. That has not prevented the opposing parties from using their briefs to develop forms of “analysis” that are evidentiary in character and that have never been subjected to discovery or cross examination.

In formal terms, these testimonial submissions on briefs are properly subject to a motion to strike. Bookspan does not ask the Commission to take this step at this late stage in the proceeding. These evidentiary submissions on brief are in any event baseless, as we will show. Bookspan does urge the Commission to keep in mind that, in NSA proceedings as in generic rate cases, the occurrence of future outcomes cannot be predicted with absolute certainty or mathematical precision. This NSA deserves the Commission’s approval if the record shows by a preponderance of empirical evidence a reasonable probability that the outcomes claimed by proponents will occur and that there are adequate protections against non-occurrences. Bookspan is confident that, viewing the record and the arguments objectively and fairly, the Commission will find that the proponents of the NSA have met their burden of showing that the Bookspan NSA comports with the ratemaking standards, is perfectly lawful, and should be recommended without qualification.

II. The OCA's Analysis Completely Ignores the Evidence Supporting Mr. Epp's Forecasts

The OCA seems to believe - in contradiction to all business reality - that there is a simple "model or spreadsheet" where the input of marketing budgets, media purchases, and profitability projections will provide a mailing quantity, and that Bookspan intentionally failed to produce this model. OCA I.B. at 11-12. There is no such model. As Mr. Epp has explained, his business does not plan mail volumes, it plans promotional campaigns. See Tr. 3/379-83. Mr. Epp clearly and openly explained the process he used to provide his "best estimates" of Bookspan's mail volumes over the three years of this NSA. Tr. 3/384-85. He has fully explained the factors that influence Bookspan's forecasted mail volumes before and after this NSA. Tr. 3/385-86. His historic figures have been fully reconciled with Postal Service permit figures, and these figures form the starting point of his estimates. In a word, he anticipates reallocation of Bookspan's marketing resources as a result of the discount, and fully explains the factors that drive this reallocation. Tr. 3/441-42. Given his role at Bookspan, Tr. 3/375, he is undoubtedly the most qualified individual to provide these forecasts. The record shows absolutely no basis to question his credibility, and the OCA's brief points to nothing in the record that provides a basis for doubt. Bookspan's forecasts cannot and should not be rejected on the basis of wholly unfounded suspicions about missing models on the basis of misplaced economic theory.

A. The Record Shows There Are No “Anyhow” Mail Volumes

The OCA’s claim of “anyhow” mail is completely illogical. First, concerns about “anyhow” volumes are generated in cases where the Before-NSA forecast is in doubt.¹ Here, that is not the case. In this case, even the OCA characterizes Witness Epp’s No Rate Increase/No NSA 80-million piece estimate of new member letter mail solicitations for 2006 as “eminently reasonable”, and accepts the two million piece difference in volume anticipated as a result of differing assumptions regarding the 5.4% rate increase. OCA I.B. at n. 3 and accompanying text (at 3). This endorsement necessarily implies a conclusion that Mr. Epp’s Before-NSA forecasts are equally “reasonable.” Indeed, they are: the forecast for Before-NSA new member letter solicitations is barely 1.5 million pieces less than the actual results achieved for FY 2005, and consistent with Bookspan’s mailing history. *Cf.* Tr. 2/88 *and* Tr. 2/250.

Reviewing the provisions for the first year of the agreement (which the OCA completely ignores), Bookspan does not become eligible for discounts under the NSA until it mails a minimum of 94 million qualifying pieces, and then, discounts are applied only to volumes above a minimum of 87 million qualifying pieces. Both of these thresholds are well above Bookspan’s “eminently reasonable” Before-NSA forecast (of 78 million qualifying pieces) and FY 2005 results (of 79.4 million qualifying pieces). *Id.* By definition, then, there can be no “anyhow” mail.²

¹ See PRC Docket No. MC2002-2 Opin. and Rec. Decision (“Capital One”) at 98-111 (The Commission’s concerns about “leakage” from discounts paid on anyhow volume in that case centered on the accuracy of Capital One’s before rates volume projections.)

² *Id.* at 53 (describing “anyhow volume” as the “before rates volume . . . or the volume that Capital One would mail absent the NSA”).

B. Strategic Partner Inserts Are Not A Source of “Anyhow” Mail Volumes

The OCA offers no evidence to support its position that strategic partner inserts are a source of “anyhow” volume. OCA I.B. at 34-7. Rather, the evidence shows that Bookspan mailed only 350,000 inserts in its new member mailings this year, that this was the first year it has included inserts in its new member mailings, and that it anticipates including only a “nominal” number of inserts in its new member mailings for each year of the NSA. Tr. 2/159. The idea that Bookspan intends to pursue an “insert” business is simply unrealistic: it is in no way supported by any real numbers, in terms of revenue Bookspan receives from inserts vs. expected decline in response rates to Bookspan's solicitation. *See* Tr. 4/487-8 (explaining that third party inserts diminishes response rates and it is response to Bookspan’s offer that is “the most important thing for us”). Bookspan has shown no intention of becoming another Val-Pak: rather, the record suggests that Bookspan wants permission to include inserts in its new member solicitations simply to allow it to continue its market tests without jeopardizing the eligibility of these volumes for the prospective discount. Tr. 3/465. Thus, the OCA’s claim that six million new letters represent “anyhow” volume (OCA I.B. at 3) is not only completely illogical and entirely unsupported by the evidence, but is not even supported by a reasonable theory.³

³ The OCA’s fear concerning the possibility that Bookspan’s strategic partner insert mail would supplant other direct mail is also unfounded. It is general industry knowledge that the cost per one thousand pieces of direct mail (including production and postage) runs four to five times as much as the cost of the same number of inserts. *See, e.g.*, http://www.directmag.com/directtips/Stein_insert_media/ So inserts are not likely to be substitutes for stand-alone direct mail campaigns; inserts more likely represent advertising that would not otherwise have been sent by mail but for inclusion in another mailpiece.

III. Neither Economic Principles, Nor the Record in this Case Support the OCA's Economic 'Analysis'

A. The OCA's Demand Curve Is Unsound and Unfounded

First, the OCA, argues that because the volume-price ratio changes when the price changes Bookspan's forecasts are implausible. OCA I.B. at 2. There is nothing "bizarre" about this circumstance whatsoever. A basic Managerial Economics coursebook informs they normally, both proportional relationship between price and quantity vary, and the rate at which quantity changes as price changes also varies along a curvilinear demand curve.⁴ In other words, elasticity is rarely constant. Even in theory, there is no general rule about the relation between price and elasticity.⁵ Thus, there is no theoretical basis for the OCA's expectations of a proportionate response to a discount as to a rate increase.

Second, the OCA presents so-called "demand curve[s]", but applies incorrect prices at the volume points graphed.⁶ Thus these curves paint a highly inaccurate picture. The OCA assumes that average revenue per piece is representative of price along the demand curve, and applies a price of \$0.194 to the point graphed at the 105 million piece volume level of qualifying mail. However, the Postal Service's average revenue per piece is not a reasonable proxy for "price" at or around that volume level: Bookspan's decision to pay for an additional unit is driven by the actual price of incremental units, not an average price. And the incremental price that will apply to new member letter

⁴ See S. Charles Maurice and Christopher R. Thomas, *Managerial Economics 6th Ed.*(McGraw Hill Companies, Inc.1999) at p. 92.

⁵ Id. (citing one exception to this comment to address a special mathematical circumstance not relevant for purposes of this discussion).

⁶ OCA I.B. at 14 describes the graph presented at 19 as a "nonsensical demand curve". (The comment is accurate, but not for the reason stated.)

solicitation pieces at levels of volume above the discount threshold is the discounted price of \$0.178, not \$0.194. In fact, the only elasticities of demand that actually appear in the record in this proceeding were calculated using the discount price of \$0.178. Tr. 5/580-83. Not only do the charts on page 19 and 21 of the OCA's Initial Brief have no foundation in the record, but they are misleading. Were one to plot a curve based on correct price and quantity points (as reflected in the Postal Service's response to OCA/USPS-T2-24), an unremarkable, downward sloping, curvilinear demand curve readily emerges.

Third, as Bookspan said in its Initial Brief (at 19-20) Bookspan maintains that, in general, plotting a demand curve in this case is not a meaningful exercise because such an exercise must necessarily use a point that was developed based on an unrealistic assumption. *See* Tr. 5/524. That position is not the result of back-pedaling, but the direct result of changes in factual circumstances. (These circumstances were that the 5.4% rate increase was expected to be, and eventually was approved.) The OCA's attempt at constructing a demand curve is misguided. Witness Epp suggests that he does not think in terms of mail volumes he intends to purchase; his testimony suggests that the "price" of postage is more readily viewed as a *cost* to Bookspan. Postage is just one variable in Bookspan's marginal cost of production. Viewed in that framework, the increase in volume that Bookspan anticipates in response to the discount is hardly unusual. The discount only affects a small portion of Bookspan's mail volume; and, as a direct and indirect result of that discount, the marginal cost of mailpieces produced at that volume is

significantly lower (due to reduced postage and other costs), resulting in increased volume.⁷

Fourth, there is nothing implausible about the differences in Bookspan's pre-NSA and post-NSA postage expenditures, or any reason to believe, as the OCA suggests (at OCA I.B. p. 18), that Bookspan's incremental expenditures would be limited by the value of the discounts it receives. As Bookspan has explained, decisions about how much more Bookspan will spend on postage for the duration of the NSA are by no means limited by the value of the discounts it receives, but by the expected profitability of its mail campaigns relative to campaigns in other media. Bookspan I.B. at 18-19. If additional direct mail campaigns are selected as a result of the discount, Bookspan will spend more on direct mail generally (at the expense of print ads or Internet marketing, for example). Postage is one component of that. A simple review of the FY2006 budget figures shows there is ample room to reallocate these resources.

The OCA also suggests that the Postal Service should show preference to publicly traded companies over privately held companies when selecting NSA candidates. The OCA's position that publicly traded companies provide better and more information with regards to their marketing plans is unrealistic. A review of a 10-K for a publicly traded company demonstrates that this position is completely unfounded. For example, Amazon's 10-K provides very little information about how it intends to allocate its substantial marketing budget across its various marketing channels.⁸ Leaving aside the

⁷ In economic terms, the impact of the NSA can be viewed as a downward shift of Bookspan's marginal cost curve as a combined result of a drop in postage, and the further consequential drop in list rental and other costs. Assuming a typical, downward sloping marginal revenue curve and upward sloping marginal cost curve, it is not the least bit surprising that intersection of these curves shifts outward when the marginal cost curve shifts down, indicating additional mail volumes will be produced.

⁸ See <http://www.sec.gov/Archives/edgar/data/1018724/000119312505047032/d10k.htm>

discriminatory character of a policy that limits NSA's to publicly traded companies the assumption that SEC reports would provide any insight into details of marketing plans is unrealistic and inaccurate.⁹ Ironically, the Amazon 10-K does confirm that Amazon views direct mail marketers as competition, independently confirming yet another of Mr. Epp's observations about Bookspan's market.¹⁰

B. The OCA's Critique of Ms. Yorgey's Analysis is Entirely Unsupported

The OCA criticizes Ms. Yorgey's assessment of Bookspan's market, arguing that she offers no support for her assertion that merchandisers and retailers may continue to increase market share at the expense of mail-order clubs. OCA I.B. at 23. Disputing witness Yorgey's assessment, but having chosen not to present its own direct testimony, the OCA then launches into a discussion of that market, completely unsubstantiated by either the record or research. The Commission should simply disregard that discussion as entirely unfounded.

The OCA also criticizes the Postal Service for accepting Bookspan's forecasts over the forecasts of a simple Excel net trend function. OCA I.B. at 25-27. That criticism is also unfounded. An Excel Net trend function simply returns values along a linear trend. While it is not unreasonable for a businessperson to run such a function the Commission should readily recognize that such a function is based purely on the data in the spreadsheet, the historic volumes. It does not consider factors such as the effects of the rate increase, the effects of the NSA, the shift between flats and letters, or, of course,

⁹ Reasonable real world forecasts under clear contractual safeguards are entirely sufficient to support a conclusion that this NSA is in the public interest.

¹⁰ *Supra* at n. 8 (Amazon 10-K ending December, 31 2005, at p. 6).

any of the other factors Mr. Epp described as influencing mail volumes. The results of this function place undue emphasis on the then most recent, higher 2004 volumes; but the evidence establishes that the higher results in that year were aberrational due to the discontinuance of outbound telemarketing. Tr.3/384. To suggest that the Postal Service should have relied on this function over Bookspan's informed forecasts ignores economic reality.

In the attempt to undermine Witness Yorgey's financial analysis, the OCA also states that "changes in price are not paramount in determining mail volume." OCA I.B. at 22-23. Whether changes in price are "paramount," or directly or indirectly effect mail volume is immaterial. It cannot be disputed that the discount will increase Bookspan's mail volume, and provide favorable financial benefits to the Postal Service under any outcome that may reasonably be expected.

IV. The OCA Completely Ignores the Practical And Contractual Limitations of the Agreement

The OCA makes much of the fact that a forecast is, just that, a forecast. OCA I.B. at 8-11. Of course actual results are unknowable. Any successful business will readjust its marketing plans based on new information, including year-to-date actual results. Mr. Epp's forthright discussion of this process in testimony and upon cross-examination of Bookspan's marketing planning process and the resulting impact on mail volumes lends further credence to his mail volume forecasts. There is some uncertainty involved in any business decision. But uncertainty is not a reason to forego business opportunities, it is a reason to protect one's position through contractual safeguards.

Because the Before-NSA forecasts are so close to the volumes that Bookspan has mailed and reconciled with the Postal Service data in its most recent Fiscal Year, it may

be claimed that there is greater uncertainty with respect to Bookspan's After-NSA forecasts, than with respect to Bookspan's Before-NSA forecasts. But as we have already explained, this NSA places the risk of After-NSA forecast error entirely on Bookspan. Bookspan I.B. at 9. The OCA's Initial Brief conveniently ignores the contractual safeguards that the Postal Service insisted upon and that Bookspan accepted.

To virtually eliminate uncertainty with respect to the Before-NSA forecasts, the Postal Service set the thresholds for discount eligibility well-above Bookspan's historic volumes, and adjusts the annual thresholds based on actual results. To virtually eliminate uncertainty with respect to the After-NSA forecasts, the agreement establishes both a floor and a cap. If Bookspan's actual after-NSA volumes in the first year are below a floor of 73 million, Bookspan compensates the Postal Service for its transaction costs. If Bookspan's actual after-NSA volumes are above 150 million, the deal terminates, and Bookspan obtains no benefit. And over the three years, the discount thresholds themselves adjust based on actual results achieved in the preceding years. Together, these provisions set reasonable and impenetrable boundaries for uncertainty and risk to the Postal Service. This Commission should not insist upon Bookspan's mathematic exactitude in judging Bookspan's After-NSA volume forecasts since it is clear the Postal Service has dealt by contract with the inevitable risk of forecast error and uncertainty.

V. The Claims of Discrimination Or Undue Preference Are Baseless

The Bookspan NSA – whether characterized as a “pure volume discount” (as NAA/NNA and OCA and would have it) or as a ‘pure declining block discount’ (as Valpak claims) – plainly does not involve any element of additional cost savings to the Postal Service resulting from increased worksharing. There is a simple and unassailable

reason for that: Bookspan's business model already demands rigorous attention to address and mail preparation quality and there was no opportunity for substantial additional postal savings. Bookspan I.B. at 8.

The opposing parties nonetheless contend that any NSA which does not include additional worksharing violates Section 403(c) of the Act. Valpak I.B. ("VP I.B.") at 34-40; Newspaper Association I.B. ("NAA I.B.") at 6-9. In other words, the opposing parties insist that NSAs can lawfully only be made available to inefficient mailers – those who are not employing the most sophisticated address hygiene and mail preparation techniques, and therefore able to provide additional cost savings to the Postal Service if given an incentive to do so.

That position is manifestly untenable as both a legal and policy matter. It is true that the four NSAs the Commission has favorably recommended before this one did, in varying degrees, involve increased cost savings to the Postal Service. There is, however, nothing in those decisions that holds or even implies that an NSA embodying declining block discounts (as each of the four predecessor cases did) with no cost saving is violative of section 403(c) of the Act. In its opinion in the Capital One NSA, the Commission did indeed distinguish the Postal Service's earlier efforts to propose unqualified volume discounts in Express Mail. PRC Docket No. MC 2002-2 Op. and Rec. Dec. at ¶ 3031. See VP I.B. at 38. The very passage invoked by Valpak from the Capital One decision makes absolutely clear the Commission's view that cost savings are not the sole grounds on which an NSA involving volume discounts is justified: the Commission said that it had rejected the Express Mail volume discounts because they were "...unsupported by any measurable cost difference ... or *other empirical*

justification.” Opinion and Recommended Decision in Docket MC2002-2 at para. 3031 (emphasis added).¹¹

The “empirical justification” of the Bookspan NSA is plain. It is an indisputable fact that Bookspan operates in a sector of the publishing industry that is flat-to-declining, and that its use of the mails for the recruitment of new club members has been in decline. A central purpose of the discounts in this case is not merely to stem the erosion of Bookspan’s use of the Postal Service to recruit new club members, but, in fact, to buck the declining trends and increase the volume of promotional letter mail that Bookspan sends.¹² Bookspan I.B. at 4.

The “empirical justification” and structure of this NSA equally serves to distinguish this case from the Express Mail decisions upon which Valpak and the Newspaper Associations entirely rely. The Express Mail cases involved volume discount proposals that were unconditional and that, therefore, virtually guaranteed that some large mailers already above the discount levels would derive windfall benefits from the rate structure proposed; that is, the very design of the Express Mail discount provided no checks against “anyhow mail.” That is not the case here. (See discussion of the contractual safeguards at 14, *supra*; Bookspan Brief at 23-25).

Accordingly, there is no basis for the Commission to conclude that this NSA is prohibited by section 403(c) of the Act. The Commission can reach the result that the OCA,

¹¹ Indeed, this is precisely why the Commission, in its 2002 Report to Congress dealing explicitly with NSAs, stopped well short of the holding for which the opposing parties now contend. The Commission did not say the volume based discounts without cost savings were illegal per se. It merely said that, in the abstract, such an arrangement might be “problematic.” The Commission’s Report to Congress no more than the Express Mail cases can be relied upon to support the proposition that an NSA, like the Bookspan NSA, is categorically impermissible under section 403(c) of the Act.

¹² It is also “empirically justified” by the amount of expected increase in contributions to institutional costs.

Valpak and the Newspaper Associations seek only by holding that NSAs without cost savings are unlawful *per se*. In order to reach that result, the Commission would have to ignore the decisions of other regulatory agencies interpreting statutes that are indistinguishable from section 403(c) and its own precedent.¹³ Bookspan I.B. at 12-14. The discrimination arguments advanced by the opponents of the NSA must therefore be rejected.

VI. The Arguments Concerning the Effect on Net Contribution Resulting From Conversion of Flats to Letters Ignore the Record, Are Speculative, And Are Nothing More Than A Collateral Attack Upon Commission Decision

Three fundamental characteristics of this NSA have been unmistakably clear from the very outset of this proceeding and the efforts of the opposing parties to obfuscate them should be summarily rejected. First, the discounts in this case apply to and only to letter shaped promotional mail. Flat shaped promotional pieces pay undiscounted rates. Second, the NSA takes, and is integrated into, the otherwise applicable rate and classification schedule as it exists at any time during the life of the agreement; that is, mail otherwise eligible for the NSA discount must meet all of the otherwise applicable terms and conditions for entry into a rate category within either of the “Standard Mail” subclasses and the discount is applied against the rate for that category then in effect.¹⁴

¹³ Nor can the experience of other regulated industries be distinguished on grounds of the Postal Service’s “monopoly” as the opposing parties suggest. That monopoly applies to the delivery of mail. The Postal Service has no monopoly over the way in which Bookspan elects to allocate its marketing budgets.

¹⁴ Valpak’s claim that there was ambiguity as to whether the NSA discounts applied to letter shaped ECR mail cannot be credited. There is nothing “ambiguous” (VP I.B. at 9) about the term “Standard Mail.” Indeed, Valpak understood perfectly at the time of its cross-examination of witness Yorgey that, to the extent Bookspan can qualify some of its letter shaped promotional mail for the basic ECR rate, that mail would be NSA eligible: the entirety of Valpak’s argument concerning net contribution rests on the assumption of migration of basic ECR non letters to some other letter category within ECR or Regular Standard. The Newspaper Association made a similar argument in response to the Presiding Officer’s Notice of Inquiry No. 1. See Comments of the Newspaper Association of America on Notice of Inquiry No. 1 at 4, filed Nov. 14, 2005. The Newspaper Association has apparently thought the better of it, for it makes no mention of this so-called “ambiguity” in its brief.

Third, the proponents made plain from the outset that the migration of flats to letters had begun and would likely continue without regard to the NSA, that proponents expect increased migration as a result of the structure of the NSA, but that there is no reason to anticipate complete conversion of Bookspan's new member flat solicitation to letters for a simple reason: flat shaped mail pieces yield higher response rates when marketing to external lists. Tr 3/386. Bookspan Brief at 22. Recognizing the reality of the situation, the Postal Service properly took the conversion phenomena into account in its forecast of net contribution it will derive from the NSA. The Newspaper Associations take these unassailable facts and turn them on their head.

A. The Claims Concerning Net Contribution Are Purely Speculative And Ignore the Evidence

The Newspaper Associations argue that the Postal Service will not realize \$5 million in additional net contribution from conversion because "Bookspan is under no obligation to convert flats to letters under the terms of the NSA." NAA I.B. at 19. The Newspaper Associations' argument amounts to a claim that Bookspan may stop converting flats to letters. This ignores the record. If anything is "obvious" (NAA I.B. at 19), it is that migration of promotional flats to letters was occurring before the NSA was conceived, that the Before-NSA forecast contemplated continued conversion and that, if anything, the application of the discount only to letter solicitation mail would result in increased conversion. Exh. USPS-T-2 at 11. The Newspaper Associations' argument is precisely the sort of conjecture and disregard of the record that should be dismissed out of hand.

Valpak takes entirely the opposite approach to the question of migration. It points out that converted letters might fall into a category that yields a lower net contribution

than the flats from which they were converted. In that “scenario,” the expected contribution from conversion may not occur, or so Valpak contends. VP I.B. at 27. This is simply another, albeit more convoluted exercise in conjecture and surmise. .

The entirety of Valpak’s argument is rank speculation divorced from reality and the record. The argument itself is framed in the conditional: thus, it is “the *prospect* of *potentially* losing” unit contribution, a “scenario” that is “easy to envision”, that underlies Valpak’s claims. VP I.B. at 28. These kinds of speculations are simply insufficient to “rebut” or “discredit” the evidence that the Postal Service and Bookspan have adduced, so long as the methodology employed by the proponents to formulate the estimates is reasonable. It is clear from the record that the net contribution estimates derived by the Postal Service in this case are reasonable and consistent with methods for estimating contributions approved by the Commission in prior NSA proceedings

B. The Postal Service’s Estimate of Increased Net Contribution Is Grounded In the Record, Consistent With Precedent and Reasonable

As in prior NSA cases, witness Yorgey used the actual Bookspan revenues to calculate test year after rates from Bookspan mail volumes. This calculation was possible because the historic volumes, weights and point of entry were ascertainable from data that Bookspan was able to supply to the Postal Service.

As the witness further explained, she used the Postal Service’s average costs – as had been done in each of the four earlier NSA cases – “because of the lack of more detailed information which would indicate that adjustments to the postal averages were warranted.” See Response of United States Postal Service to POIR No. 1. Valpak makes the bold claim that past practice should not be followed here because “more detailed cost information is available and is used regularly ... to design rates for Standard Mail.” VP I.B. at 20. There is

no citation of authority for this proposition. It is simply false.¹⁵ Valpak’s claim – joined by the Newspaper Associations and APWU – that actual cost data could have been used amounts to nothing more than a thinly disguised attempt by Valpak to invent a new standard for the evaluation of NSAs, one that no NSA could possibly meet. *See* Opinion and Recommended Decision in Docket MC2002-2 at 199-20 (accepting the use of average costs where mailer specific costs were not presented).

Valpak seeks further to raise the evidentiary burden of proof by contending that, in calculating the aggregate net contribution, the Postal Service should have calculated the impact of the NSA on mail “from each postal product” and “compile the results to determine the combined impact.” VP I.B. at 26. In other words, Valpak maintains that Bookspan and the Postal Service must prove “which flats are most likely to migrate and the letter categories to which they are likely to migrate.” VP I.B. at 26n.26. What Valpak ignores is that, until this NSA is implemented, there is no means of determining precisely how much of Bookspan’s flat promotional mail will be converted; still less will there be a means of determining the letter categories to which they convert.

Once again, the opposing parties seek to expunge Mr. Epp’s testimony from this case. To repeat: the cost of postage is but one element of a much more sophisticated dynamic process, and the decision to use letter shaped promotional pieces rather than flats is never based on the type of detailed exegesis of the relative price of rate categories (or the imputed unit contribution that such categories may or may not yield to the Postal

¹⁵ The Valpak footnote which purports to support this proposition is insulting and should be regarded by the Commission as such. Valpak cites generically to docket no. C2004-1 which did not involve Standard Mail which has a rate and cost structure that differs markedly from the Periodical Subclass. Valpak goes on to observe that “mailer’s specific costs” are “possible” and that the Postal Service is in a position to “develop such estimates.” VP I.B. at 20n.21. Exactly how that is to be done in a class of mail with as complex a rate structure as exists within Standard Mail subclasses and at what cost is left utterly unanswered.

Service) for which ValPak now contends. Witness Epp made it plain that the existence of the NSA provides Bookspan with an incentive to increase its use of letter shaped promotional mail pieces, but that it will do so by reallocating marketing budgets that would otherwise be spent on other promotional channels to the testing of mailing lists that would not otherwise qualify for inclusion in the marketing plan because of response and contribution to overall profitability. Bookspan I.B. at 20.

Thus, the NSA will become a part of Bookspan's overall marketing plan, but the fundamental marketing process will not change. The proof of this is in witness Epp's undisputed statement that, *despite higher postage costs*, there will not be complete conversion because flat shaped mail pieces yield higher response rates when marketing to external lists. Tr. 3/386. It is lists, not rate categories, and the expected response rates and resultant expected profitability that drives Bookspan's marketing decisions.

There is nothing in the Commission's rules governing baseline cases or in its precedent in dealing with NSAs which requires or even suggests that, in order to qualify for an NSA, a business enterprise must either have the type of information concerning the conversion of flats to letters for which Valpak and the OCA contend or must convert its business model to generate that data.¹⁶ The Postal Service quite properly did not insist upon any such condition in its negotiations with Bookspan with respect to this NSA. Neither should this Commission.¹⁷

¹⁶ As we have noted, the OCA's theory that publicly traded companies would have such data is equally baseless.

¹⁷ A precise measure of the effects of the NSA on flats conversion will be available if the NSA is approved. The data collection plan requires the Postal Service to capture the volume of flats and letters by rate category. This, too, is ignored by the opposing parties.

The Postal Service's method for estimating the aggregate net contribution resulting from conversion of flats to letters is based on facts in the record. The only assumption embedded in witness Yorgey's calculation of net contribution and sensitivity analysis is that the rate relationships among and between the various letter and non-letter category within both Standard and ECR would remain relatively as they were at the time she performed her analysis; and the Board of Governors' acceptance of the Commission's Recommended Decision in Docket R2005-1 validates this assumption. In performing the estimation and sensitivity analysis, the witness relied upon historic data supplied by Bookspan itself showing the volumes of letters and flats that Bookspan had historically entered into the system and the distribution of those volumes. There being no reason – and Valpak certainly has offered none – to conclude otherwise, witness Yorgey forecast that the increased conversion of flats to letters resulting from the NSA would display the same distribution among the various letter categories as the before rates distribution. *See* Tr. 2/105, 2/131. Thus, using weighted averages – a practice that has been employed by this Commission and by the Postal Service in every rate and classification proceeding since the passage of the Postal Reorganization Act – witness Yorgey computed the expected contributions resulting from conversion.

Nor did she stop there. Recognizing that she was relying upon both historic and forecast data, Ms. Yorgey performed a sensitivity analysis with regard to the conversion percentage. Exh. USPS-T-2, App. D. The analysis tests the degree to which financial gains to the Postal Service may be in error if the Before-NSA volumes were severely over or underestimated. Not surprisingly, the sensitivity analysis is not even mentioned, by the opposing parties. It shows that under any scenario -- from a 0% to 100%

conversion rate of flats to letters -- the NSA will yield a significant net gain and contribution to the Postal Service. Bookspan I.B. at 21.

For these reasons, the contention that the proponents of this NSA have failed to carry their burden of showing that this NSA is in the public interest must be rejected. The record unmistakably establishes that -- whether the actual number is 7.7 million, or slightly higher or slightly lower -- the methods employed by the Postal Service to estimate net contribution resulting from conversion are entirely reasonable, and accord with established precedent and practices. Actual results will be available during the life of the NSA under the data collection plan and the contractual safeguards eliminate any serious prospect of risk. It is equally clear that the increased contribution the Postal Service will receive from new (that is, not converted) promotional mail induced by the NSA -- a subject not at all addressed by Valpak and lamely dismissed by the Newspaper Associations as "chump change" -- must also be credited.

C. Consideration of Changes to the Structure and Rate Levels of Standard Mail Are Beyond the Proper Scope of This Proceeding

The real issue underlying Valpak's and the APWU opposition to this proposal is not the forecast of net contribution resulting from flat to letter conversion. It is, rather, an indirect challenge to the rate structure of Standard Mail in general and to the basic ECR rate in particular. Valpak concedes as much: "The across-the-board rate increase in Docket R2005-1 has perpetuated [the] rate structure ..." on which this NSA is based. VP I.B. at 23 n.25.

Any doubt that it is the basic rate structure and not the NSA that Valpak is attempting to put into issue here is removed by an examination of the "scenario" under which, by Valpak's assessment, the Postal Service would actually lose money from this

NSA. That hypothetical scenario assumes that all 56 million pieces of mail expected to be converted from flats to letters over the life of this agreement will, in fact, convert from ECR flats to ECR basic letters. VP I.B. at 28. While the assertion is preposterous as a factual matter,¹⁸ it is also revealing: what Valpak seeks to put into play in this proceeding is what it perceives to be the “existing disparities” in “unit contributions of individual rate categories” within ECR, in particular and the relationship of ECR rates to Standard Regular rates more generally. This position is more than slightly evocative of the testimony which Valpak adduced in Docket R2005-1 (Testimony of Robert Mitchell, VP-T-1); and the claim of “current pricing anomalies” advanced here is literally on all fours with the argument advanced on brief by Valpak in that case.

Whatever the merits of the argument about the current rate structure -- and Bookspan takes no position on that subject -- the claim that the NSA must be rejected because of anomalies in the underlying rate structure is well beyond the scope of this proceeding. As with the four prior NSAs, this NSA takes the existing rate and classification schedule (the conditions of eligibility and mail preparation and the rate levels) as they stand or *as they may be changed* in an appropriate proceeding. Except for the introduction of the discounts, and then only with respect to the eligible category of mail, the NSA rests upon the predicate that rates classification requirements applicable to Standard Mail that are recommended by the Commission and approved by the Governors are lawful.

The Commission cannot as a matter of law, and should not as a matter of sound administrative procedure, entertain in this NSA proceeding a collateral attack upon rates

¹⁸ It assumes, in defiance of the record, that all of Bookspan’s flats are now entered at ECR rates and all would be converted to basic ECR letters.

and a rate structure it just approved. *See generally* Opinion and Recommended Decision in Docket R2005-1 (November 1, 2005). This is particularly true because the “disparities” in unit contributions of which Valpak and the APWU complain are not the result of accident or inadvertence.

In Docket R97-1, the Postal Service explicitly proposed the same rate for basic ECR letters and flats and it coupled this proposal with a downward adjustment to the five-digit automatic letter rate in Standard Mail precisely to encourage migration of letters from basic ECR to five-digit automation. R97-1 Opin & Rec. Dec. ¶ 5556 *et seq.* The Commission carefully considered this plan; it recommended the rate structure as proposed. *Id.* at ¶ 5560. This does not mean that the Commission is bound for all time to its analysis in Docket R97-1. It does mean, however, that the opponents of this NSA cannot be permitted to hold it hostage because of alleged unit contribution discrepancies within ECR and Standard Regular mail. If Valpak, APWU or the Newspaper Associations have legitimate grievances concerning the current rate structure and the resultant imputed unit contributions within Standard Mail, the proper forum to pursue these arguments is in a complaint case or, as the Commission itself has suggested “in future rate cases.” Decision in Docket R2005-1 at Para. 6075.

VII. The Opposing Parties' Positions With Respect to the Role of the Multiplier Effect In This NSA Are Misguided And Unfounded

An important qualifying condition of this NSA is the fact that each new Bookspan club member produces incremental volume to the Postal Service. Witness Posch's uncontested testimony shows that, on average, a successfully recruited member will generate between 50 and 60 mail pieces over the course of one year. Tr. 3/449e. That incremental volume comes in the form of main selection catalogs (at Standard Mail), book shipments (at Bulk Bound Printed Matter and other parcel rates), and transactional correspondence (at First Class rates) between Bookspan and its book club members. There is thus an intimate and logical relationship between the incentives provided by the NSA, and the multiplier effect across all the classes of mail that ensues.

The opposing parties profoundly mischaracterize (or perhaps more charitably, misunderstand) the role of the multiplier effect in this NSA. Valpak asserts that the multiplier effect cannot be considered as a part of the expected increased contribution because the incremental volume cannot be quantified. VP I.B. at 33. The short answer to this claim is that the multiplier effect is *not* relied upon by Bookspan or the Postal Service as a part of its forecast of increased net contribution resulting from the NSA.¹⁹ As we pointed out in our initial brief, the financial analysis Ms. Yorgey performed does not reflect the fact that the Postal Service stands to benefit from the additional undiscounted mail volumes that are generated from new book club members acquired as a result of the increase in solicitation volumes mandated by the NSA. Bookspan I.B. at 21. Thus, the only point of interest in Valpak's argument is the tacit concession is that there is, indeed,

¹⁹ Bookspan will ignore the fact that, when the Postal Service offered evidence showing the contribution resulting from the multiplier, the opposing parties objected to the proffer. Tr. 2/207-11.

a multiplier effect that will add value to the Postal Service and, therefore, is of benefit to all users of the system.

The Newspaper Associations seemingly recognize that the multiplier effect embedded in the NSA and the Postal Service's revised DMCS language is a qualifying condition for functionally equivalent agreements and not a part of the calculated net increase in contribution. Its position is nonetheless baseless. On the one hand, the Newspaper Associations contend that the inclusion of the multiplier effect in the NSA and the DMCS is meant to so narrowly define similarly situated mailers as to limit future functionally equivalent NSAs built on the Bookspan model to very large mailers. NAA I.B. at 16-17. On the other hand, it argues that since "any mailers" (including presumably small mailers) could argue that they would increase mail volume if given a discount, the multiplier effect does not serve to effectively define mailers who are "similarly situated." *Id.* at 15. In either case, the Newspaper Associations' position seems to be that the failure to define precisely and in advance what types of mailers will be deemed similarly situated is discriminatory. The Newspaper Associations' position is wrong on all counts.

In the first instance, the limiting condition—proposed not by the Postal Service but by the Commission itself²⁰—is neither arbitrary nor is it so restrictive as to foreclose functionally equivalent NSAs. The threshold, six times per year, specified in the proposed DMCS is, in fact, one-third of the actual multiplier effect that Bookspan produces. Tr. 3/49e. There is certainly nothing in this very modest limitation that would preclude a small mailer with a multiplier effect from qualifying for a functionally

²⁰ Notice of Inquiry No. 1 in Regard to Domestic Mail Classification Schedule and Data Collection Plan Language at 7 (Nov. 3, 2005).

equivalent arrangement. Nor is there anything in either the original or proposed revised DMCS provision that limits the definition of similarly situated mailers to businesses which, like Bookspan, operate pursuant to the Federal Trade Commission's Negative Option Rules. There may well be other types of mailers – large or small – who can meet the limiting condition of having a multiplier effect. The condition proposed in the NOI is thus perfectly rational and reasonable.

At the same time, there are compelling reasons for the imposition of the multiplier effect as a limiting condition on functionally equivalent NSAs. Without such a defining condition, the discounts proposed here would be open to all users of Standard Mail and the contractual safeguards and added value built into this NSA would be impossible to establish, much less to enforce. In other words, without the limiting condition, there could be no safeguards; and without safeguards, the concerns underlying the Express Mail cases would again come into play. That may well be what the Newspaper Associations seek. But that is not what this case is about. The multiplier effect is logically connected to the NSA and a perfectly valid limiting condition on future functionally equivalent NSAs.

In the last analysis, the Newspaper Associations advance the – by now, shopworn – argument that since neither the Postal Service nor the Commission can determine precisely and in advance an identifiable postal customer who may qualify for a functionally equivalent NSA, this NSA should not be granted. The Newspaper Associations' position is profoundly illogical. If the Commission refuses to recommend this NSA on grounds that similarly situated mailers cannot be identified, then there will be no functionally equivalent NSAs ever to consider and, indeed, no other baseline case structured like the Bookspan NSA could be

filed. Plainly, these consequences were not intended by this Commission's rules governing the filing and review of NSA proposals. See PRC Order No. 1391 at 37.

Conclusion

For those reasons, the Commission should recommend the adoption of the Bookspan NSA without qualification. The Postal Service and Bookspan have established beyond question that the agreement meets the ratemaking and classification criteria of the PRA, that it is not discriminatory, and that it will yield both direct and indirect benefits to the Postal Service and thereby all users.

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