Postal Regulatory Commission
Submitted 5/29/2008 3:51:56 PM
Filing ID: 60020
Accepted 5/29/2008

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before:

Chairman Blair,
Vice Chairman Acton,
and Commissioners
Goldway and Hammond

Rate and Service Changes to Implement Baseline Negotiated Service Agreement With Life Line Screening

Docket No. MC2007-5

OPINION AND RECOMMENDED DECISION

Washington, DC 20268-0001
May 29, 2008

Table of Contents

I. INTRODUCTION AND SUMMARY

The Postal Regulatory Commission recommends approval of the proposed Negotiated Service Agreement (NSA) with Life Line Screening. This is the ninth Negotiated Service Agreement reviewed by the Commission. Although the Commission found flaws with many of these agreements, it believes well-structured customer-specific agreements can be successfully used to take advantage of special situations in the market.

Initially, the NSAs submitted to the Commission focused on cost reduction incentives; volume incentives in those NSAs were ancillary. More recently, the NSAs submitted to the Commission have focused entirely on volume incentives with no associated cost savings incentives. The 2007 Annual Compliance Determination shows that those NSAs based on volume incentives have been markedly less successful than those more focused on cost reduction incentives. This case does not appear likely to be an exception to that unfortunate trend.

The Commission finds the independent analysis of market conditions and likely company mail use performed by the Postal Service regarding this NSA to be superficial and inadequate. The Postal Service, once again, relies on demonstratedly unreliable volume projections provided by the prospective NSA partner to estimate the benefits of this agreement.

Given this situation, as a default, the Commission applied the analysis it introduced in Docket No. MC2004-3 that uses subclass average proxies. On that basis, the Commission finds that this agreement supports a favorable recommendation, although the benefits are likely to be far less than the Postal Service estimates. The Postal Service appears to have done this same analysis on its own, but chose not to discuss or directly use the results of this analysis or attempt to reconcile it with other analyses showing significantly different results in its submission.

This is the last case in which the Commission will make recommendations pursuant to the Postal Reorganization Act of 1970 (PRA). Going forward under the Postal Accountability and Enhancement Act of 2006 (PAEA), the Commission's role in evaluating NSAs, while still significant, is altered. In most cases, review will be after the fact. Absent the introduction of better, more accurate methodologies for analyzing the benefits of agreements, the Commission expects to use the Docket No. MC2004-3 analysis to review NSAs in this after the fact context.

Under the PAEA, NSAs are expected to be a useful pricing tool. The Commission believes that it is imperative that the Postal Service become far more proficient at independently analyzing potential future agreements and negotiating favorable terms as it implements an increasing number of NSAs. Failure to do so could result in significant economic losses, and undermine a potentially beneficial program.

II. PROCEDURAL HISTORY

On August 8, 2007, the United States Postal Service filed a formal request with the Postal Regulatory Commission seeking a recommended decision approving a mail classification and related rates predicated on a Negotiated Service Agreement with Life Line Screening (Agreement).[1] The Negotiated Service Agreement was proffered as a new baseline agreement.

The Postal Service identified Life Line Screening (Life Line), along with itself, as parties to the Negotiated Service Agreement. Thus, Life Line has been considered a co-proponent, procedurally and substantively, of the Postal Service's Request during the Commission's review.

The Request, which includes six attachments,[2] was filed pursuant to chapter 36 of the Postal Reorganization Act, 39 U.S.C. § 3601 *et seq*.[3] In support of the Request, the Postal Service filed Direct Testimony of Michelle K. Yorgey on Behalf of the United States Postal Service, August 8, 2007 (USPS-T-1) and library reference USPS-LR-L-1, MC2004-3 Opinion and Further Recommended Decision Analysis for the Life Line Screening NSA. Life Line separately filed Direct Testimony of Eric Greenberg on Behalf

[1] Request of the United States Postal Service for a Recommended Decision on Classifications and Rates to Implement a Baseline Negotiated Service Agreement with Life Line Screening, August 8, 2007 (Request).

[2] Attachments A and B to the Request contain proposed changes to the Domestic Mail Classification Schedule and associated rate schedules; Attachment C is a certification required by Commission rule 193(i) specifying that the cost statements and supporting data submitted by the Postal Service, which purport to reflect the books of the Postal Service, accurately set forth the results shown by such books; Attachment D is an index of testimony and exhibits; Attachment E is a compliance statement addressing satisfaction of various filing requirements; and Attachment F is a copy of the Negotiated Service Agreement.

[3] The procedures of the former Postal Rate Commission apply to this request under 39 U.S.C. § 3622(f) as established by the Postal Accountability and Enhancement Act, Pub. L. No. 109-435, 120 Stat. 3198 (2006) (PAEA). Section 3622(f) specifies, for the mail categories which are the subject of this Request, that: "[p]roceedings initiated to consider a request for a recommended decision filed by the Postal Service during that 1-year [transition] period shall be completed in accordance with subchapter II of chapter 36 of this title and implementing regulations, as in effect before the date of enactment of this section."

of Life Line, August 8, 2007 (LLS-T-1). In a contemporaneous filing, the Postal Service submitted a proposal for limitation of issues in this docket.[4]

The Commission issued Order No. 25 to announce the filing of the Request; docket the Request; designate the acting director of the Commission's Office of the Consumer Advocate (OCA) as the representative of the interests of the general public; establish the deadline for intervention; establish the deadline for responding to the Postal Service's proposal to limit issues; and set the date and agenda for a prehearing conference.[5]

The prehearing conference was held on September 10, 2007 to identify issues in this docket and to solicit information necessary to establish a procedural schedule. The Commission subsequently issued an initial procedural schedule and ruled on the Postal Service's proposal to limit issues.[6] October 9, 2007 was set as the deadline for participants to file statements as to whether a hearing would be necessary. *Id.* at 4.

The Commission issued a Commission Information Request to clarify certain aspects of the record.[7]

[4] United States Postal Service Proposal for Limitation of Issues, August 8, 2007.

[5] PRC Order No. 25, Notice and Order on Filing of Request Seeking Recommendation of Baseline Negotiated Service Agreement, August 10, 2007 (Order No. 25).

[6] PRC Order No. 35, Order Regarding Limitation of Issues and Establishing Procedural Schedule, September 14, 2007.

[7] Commission Information Request No. 1, September 21, 2007.

The Commission also issued several procedural orders related to Life Line and the Postal Service's concerns relating to the release of data under protective conditions. The Commission appreciates the efforts and willingness of Life Line and the Postal Service to publicly provide the Commission with as much information as possible. Many difficult procedural issues relating to information placed under seal were avoided due to the participants' cooperation.

The Office of the Consumer Advocate (OCA) filed a motion for extension of time to request a hearing pending receipt of clarifying information through follow-up interrogatories.[8] The Commission granted the extension; however, no participant requested a hearing. The record was closed on January 25, 2008.[9]

Initial briefs were filed on February 4, 2008 by Life Line, the Postal Service, the American Postal Workers Union, AFL-CIO (APWU), and the OCA.[10] Reply briefs were filed on February 11, 2008 by Life Line and the Postal Service.[11]

[8] Office of the Consumer Advocate Motion for Extension of Time to Request a Hearing, October 10, 2007.

[9] PRC Order No. 54, Order Establishing Procedural Schedule, January 4, 2008 at 2 (Order No. 54).

[10] Initial Brief of Life Line Screening (Life Line Brief); Initial Brief of the United States Postal Service (Postal Service Brief); Initial Brief of the American Postal Workers Union, AFL-CIO (APWU Brief); and Initial Brief of the Office of the Consumer Advocate (OCA Brief), all filed on February 4, 2008.

[11] Reply Brief of Life Line Screening (Life Line Reply Brief); Reply Brief of the United States Postal Service (Postal Service Reply Brief), both filed on February 11, 2008.

III. SUMMARY OF PROPOSAL

A. Witness Greenberg's Testimony

Life Line witness Greenberg is the Vice President of Marketing at Life Line Screening. He describes Life Line's history, business model, and major growth drivers. He also details Life Line's approach to marketing and how marketing decisions are made. Additionally, he outlines Life Line's mailing history, volume forecasts, and address hygiene practices.

Witness Greenberg asserts that Life Line is the country's largest provider of direct to consumer preventive health screenings which provide early detection for risk of stroke, abdominal aortic aneurysms, peripheral arterial disease, and osteoporosis. He explains that Life Line has 87 ultrasound teams based in cities around the country, and each team travels in a 2-3 hour radius to pre-arranged sites on a daily basis to conduct screenings in more than 20,000 community locations around the country. He notes that part of the company's mission is education given the fact that cardiovascular disease is the number one killer of men and women in the U.S., and most Americans are unaware of the need for, and availability of, vascular screenings. He attributes Life Line's success largely to national direct marketing efforts and community outreach programs which increase awareness and fuel the daily operations of the teams. He states that their customers are typically baby boomers and senior citizens, and accordingly believes that direct mail is an excellent channel for Life Line to communicate its message.

Witness Greenberg describes two factors that are key drivers to the growth of Life Line's business. They are:

1. *Domestic ultrasound team growth*. Over the last 10 years, Life Line has grown from an organization based in Ohio with a handful of ultrasound teams to one with national coverage. As Life Line added dozens of new teams across the country

over the last few years, its direct mail growth increased dramatically. However, now that national coverage has been achieved, domestic team growth is no longer a major growth driver and incremental mail will no longer be needed in those new introductory markets given that Life Line has territorial coverage in "all the places we [Life Line] need to be in." LLS-T-1 at 3. Accordingly, growth is no longer a major direct mail factor. Instead, other variables like direct mail cost become much more important drivers of growth in the use of direct mail.

2. *Development of new marketing channels.* Life Line uses a variety of marketing channels for soliciting both new and repeat customers. It has expanded into the web, e-mail, radio and other channels. Life Line submits that it will continue to test these channels to expand its customer base and find a higher return on investment. It selects marketing channels screening event by screening event and is driven by return on investment.

Witness Greenberg explains how Life Line acquires new customers through marketing. He states that direct mail (primarily Standard Mail letters), newspaper inserts, national and local radio, television, e-mail, web and other channels are used to generate sales. He discusses how the percentage that each media represents in Life Line's overall marketing portfolio shifts depending on cost and effectiveness. He notes that while direct mail costs much more per person than other channels, Life Line is more able to target its audience by mail and its target demographic group responds well to direct mail solicitations. He points out, however, that the cost of direct mail has risen significantly over the last two years, which has led Life Line to actively pursue alternative channels. He explains that all else being equal, as costs rise in a channel, it becomes less attractive. He states that Life Line wants to continue to use the mail, but needs an NSA to drive "continued growth." *Id.* at 6.

Witness Greenberg explains Life Line's multiplier effect as follows:

Once a customer is acquired, a series of further communications is delivered by e-mail and/or direct mail (as specified), including:

- screening results (month 1 by First-Class Mail);
- satisfaction survey (month 1 by e-mail);
- thank you letter (month 2 by Standard Mail);
- 1-2 new product offerings (3-9 months by Standard Mail); and
- 3 additional Standard Mail solicitations to repeat preventive health screenings (12-18 months) already completed.

He notes that currently, e-mail is used to supplement direct mail. He cautions that in the absence of an NSA, e-mail communications are expected to increase.

Witness Greenberg next explains Life Line's direct mail planning process and historical volumes. He reports that over the past three calendar years, Life Line's volumes have been as follows:

Table III.A.1

Calendar Year	Volumes
2004	51 million Standard Mail letters
2005	79 million Standard Mail letters
2006	93 million Standard Mail letters

Source: LLS-T-1 at 6.

In 2007, Life Line claims it has mailed approximately 52 million pieces through the end of June. *Id.* During the discovery phase of this case, Life Line provided actual Standard Mail solicitation letter volumes for the entire FY 2007. The actual volume was 106 million pieces. Tr. 2/40. Life Line attributed this surge to the addition of "its largest ever business development client" which caused an increase in mail volumes for August and September 2007. *Id.* At this time, it was also learned that Life Line was planning to discontinue the operations of six vans in early 2008 "which will correspond to a decrease of roughly six to seven million mail pieces in 2008." *Id.*

Witness Greenberg believes that the size and growth rate of Life Line's direct mail business is affected by the following factors:

1. *Domestic ultrasound team growth*. He explains that over the years, Life Line has "nearly completed" its national expansion of ultrasound teams, and has every major U.S. market covered by its screening events. Put simply, he says, more events mean more marketing and more mail. As new teams were formed, Life Line marketed the new team's events to its targeted demographics and mail volume grew significantly. In 2007, the number of screening events continued to grow over 2006 as new teams in new locations were added, according to witness Greenberg. However, he expects very little growth in screening events in 2008 and beyond because Life Line will already have teams in all 48 continental U.S. states. He does not believe that direct mail growth will be driven by introducing more ultrasound teams and more events because it will already have teams in all 48 continental U.S. states. Thus, he does not anticipate volume growth in the absence of the NSA. Instead, in the absence of the NSA, he expects mail volumes per event to decline as customer preference and return on investment changes. However, he believes that the NSA would allow Life Line to send more direct mail to advertise each existing screening event because an NSA would lower marginal cost and increase potential return on investment for marginal prospect lists. *Id*. at 6-7.

2. *Response rates.* Witness Greenberg explains that Life Line uses many direct mail lists, and the profitability of each list is measured for each marketing campaign that is executed. He points out that a higher response rate means that Life Line can mail deeper into its mail files and expand the number of lists and still generate profitability. He notes that when response rates fall or costs rise, fewer lists make the cutoff required to mail profitably. *Id.* at 7-8.

3. *Mail costs.* Witness Greenberg notes that postage costs represent Life Line's single largest marketing expense, and postage costs have risen substantially over the last two years. He believes that even a small increase or decrease in cost can have a significant impact on volume and profitability. He predicts that in 2007, even though Life Line's mail volume will continue to grow and the number of screening events will increase, the volume of mail per screening event is expected to decline by 7 percent in part due to postage cost increases. He believes that a price incentive, like that offered in the NSA, will increase both the absolute and relative dollars spent on direct mail. *Id.* at 8.

4. *Growth in affinity partners.* Witness Greenberg notes that a large number of third-party organizations partner with Life Line, requesting Life Line to offer screenings to their customers. Witness Greenberg admits that this is a growth business for Life Line, but it is difficult for them to forecast the volume growth in this area. *Id.*

5. *Alternative media channels.* Witness Greenberg explains that direct mail was introduced as a marketing channel in 2003. According to witness Greenberg, as Life Line learned more and its modeling techniques became more sophisticated, the direct mail growth was substantial over the following two years. However, he also notes that as direct mail became less profitable and other new marketing channels have tested well, Life Line has invested substantially in those other channels — including radio, e-commerce, e-mail, and print media. *Id.* at 8-9.

6. *Changing target demographics.* Witness Greenberg believes that as the population continues to age, the use of technology will become more prevalent meaning e-mail and the Internet will have a stronger return on investment for communicating with existing customers than other means of communication. He notes that Life Line's tests show that in some cases these other media have a higher return on investment than direct mail today. *Id.* at 9.

Witness Greenberg cautions that the above factors are subject to change on a monthly basis. Life Line's ability to accurately forecast revenues, costs, and volumes beyond the near term is always a challenge. *Id.* However, for purposes of this NSA, he attempts to provide the best estimate of Life Line's Standard Mail volumes for the next four fiscal years (with and without an NSA) based on the factors discussed above.

With the proposed NSA, witness Greenberg notes that there are significant incentives to increase mail volume beyond the current and minimum threshold levels. He believes that volume in excess of the minimum threshold would be mailed at the equivalent of pre-2007 rates allowing Life Line to mail additional volume that might not otherwise meet Life Line's target profitability criteria. *Id.* at 11.

Witness Greenberg explains that Life Line pays strong attention to address quality, and there was no opportunity for the Postal Service to impose cost savings related obligations as a condition of this NSA. He notes that Life Line engages Knowledge Base Marketing (KBM) as an external vender for address hygiene. He points out that KBM applies the latest in Postal Service certified address correction and standardization service to ensure the deliverability of Life Line's mailings. *Id.*

Witness Greenberg states that Life Line intends to continue using these services because they enhance Life Line's return on its investment. *Id.* at 13.

B. Witness Yorgey's Testimony

Postal Service witness Yorgey is a marketing specialist in the Pricing Strategy Group of the United States Postal Service. Her testimony (1) presents the specific terms and conditions of the NSA that the Postal Service has negotiated with Life Line; (2) describes the analytical support used to develop the NSA; (3) explains the financial implications of the proposed NSA; (4) describes the provisions that are intended to minimize the risk associated with forecasting volumes for a single mailer; and (5) explains the steps the Postal Service has taken to understand the market in which Life Line operates.

Witness Yorgey reviews the major elements of the Life Line NSA: the solicitation incentives and the multiplier effect; declining block rates with volume commitments; an annual adjustment mechanism for volume commitments; and termination clauses. She describes the incentives that are based upon the volumes of Standard Mail solicitation letters sent by Life Line. She believes that these incentives will encourage Life Line to mail additional solicitation letters, increasing its customer base. On the other hand, without such incentives, she believes that Life Line's marketing volumes can be expected to decline due to sensitivity to direct mail cost increases, alternative marketing channels, and certain business conditions that are inherent to Life Line's operations. She argues that the Postal Service will benefit from the additional contribution generated by an increased volume of Standard Mail solicitations ($5.4 million over the three-year period of the NSA). She also explains that the Postal Service is expected to benefit from the additional revenue generated by increased volume for each new screening event in the form of First-Class Mail correspondence. USPS-T-1 at 1-2.

Witness Yorgey explains the volume commitment levels in the proposed NSA. Before the discounts at a negotiated volume level are payable, Life Line must first meet a higher volume commitment. She believes that these commitments mitigate the risk of underestimation of before-rates volume.

Table III.B.1

Declining Block Rate Structure
Standard Mail Letters

Year 1 Structure			
Letter Volume Blocks			**Incremental Discount**
0	to	90,000,000	0.0 cents
90,000,001	to	100,000,000	1.0 cents
100,000,001	to	110,000,000	2.0 cents
110,000,001	to	118,000,000	3.0 cents
Before-Rates Volume Forecast: 90,000,000			
Volume Commitment: 95,000,000			

Table III.B.1 (cont'd)			
Year 2 Structure			
Letter Volume Blocks			**Incremental Discount**
0	to	88,000,000	0.0 cents
88,000,001	to	98,000,000	1.0 cents
98,000,001	to	108,000,000	2.0 cents
108,000,001	to	116,000,000	3.0 cents
Before-Rates Volume Forecast: 87,000,000			
Volume Commitment: 93,000,000			
Year 3 Structure			
Letter Volume Blocks			**Incremental Discount**
0	to	88,000,000	0.0 cents
88,000,001	to	98,000,000	1.0 cents
98,000,001	to	108,000,000	2.0 cents
108,000,001	to	116,000,000	3.0 cents
Before-Rates Volume Forecast: 87,000,000			
Volume Commitment: 93,000,000			
Source: USPS-T-1 at 3-4.			

Witness Yorgey then reviews the annual adjustment mechanism for the volume commitments. If at the end of any agreement year the actual volumes are 12 percent or more above that year's commitment, the next year's commitment will be recalculated as the mean of the current year's actual volume and the original volume commitment for the next year. However, if at the end of any agreement year the actual volumes are 5 percent or more below the year's volume commitment, then the next year's volume commitment will be decreased by the percentage difference between actual volume and that year's volume commitment. *Id.* at 5. In the event that the volume commitment falls below the starting threshold in any year, the starting threshold will then equal the adjusted volume commitment. She believes that this mechanism will mitigate both the risks associated with forecasting errors and the effects that future rate increases will have on volumes.

Witness Yorgey explains that the NSA includes two termination clauses that provide substantial protection to both parties. The first provides an unconditional right to terminate the contract without penalty on 30 days' written notice. The second provides that the Agreement automatically terminates, and all discounts cease, if Life Line mails more than 10 million pieces above the top tier in any year. *Id.* at 6.

Financial analysis. Witness Yorgey provides the financial analysis the Postal Service used to evaluate the NSA. She bases net contribution calculations on Life Line's projected volume forecasts for new Standard Mail letters and obtains a new contribution of approximately $6.3 million. She then subtracts the expected discount exposure. She believes that the expected discount exposure is zero because the declining block rates were designed to only apply to volumes that are above before-rates forecasted volume (after rounding the thresholds to the nearest million pieces). The final financial impact that she calculates is the amount of the total incremental discounts. She calculates this at $0.9 million. Accordingly, the financial impact on the Postal Service, according to witness Yorgey, is a net benefit to the Postal Service of $5.4 million. She also notes that the multiplier effect should produce a "second stream of value" for the Postal Service, but she does not quantify this effect. *Id.* at 7.

Evaluation of Life Line's volume forecasts. Witness Yorgey uses several tools to evaluate Life Line's before-rates volume forecasts and the potential for growth in its use of mail as a marketing medium. She believes that her analysis is comparable to that used in evaluating previous NSAs, which includes company-specific research, volume trend analysis, and the analysis of the market environment.

She reviews company-specific information on Life Line, noting that Life Line is a mobile health screening service provider headquartered in Cleveland, Ohio. She notes that Life Line was founded in 1996 and currently has more than 1,000 employees. It is among more than 90 companies supported by Polaris Ventures Partners in the technology, healthcare, manufacturing, media, communications, and business services sectors.

Witness Yorgey does a volume trend analysis of Life Line's Standard Mail letter volumes for calendar years 2004 through 2006. She notes that the data show that Life Line's letter-size Standard Mail volume from 2004 has trended substantially upward. *Id*.

However, she points out that Life Line has projected a decline of this volume within the next three years due to (1) an increase in Standard Mail rates in 2006 and 2007; (2) a decrease in the pace of geographic expansion of Life Line's business; and (3) movement to non-direct mail marketing channels. She believes that these factors will affect volumes in the manner forecasted by witness Greenberg. *Id.* at 8.

She identifies solicitation mail as a significant means for Life Line to acquire new customers and promote health screening events to existing customers. She surmises that the projected volume decline could result in diminished customers attending health screening events for Life Line and a further reduction in the volumes of First-Class Mail correspondence and follow-up solicitations in the form of a multiplier effect to the Postal Service. She expects the decline to level off at the new, lower level estimated in the absence of an incentive to increase solicitation of health screening events.

Witness Yorgey also analyzes Life Line's market environment. She notes that the health care industry is the nation's largest industry representing 13.5 million jobs, and that health care for the elderly is projected to change dramatically as the population in the United States over the age of 65 is expected to double in the next 25 years. She explains that the 85 and older age group is now the fastest growing segment of the United States population. She points out that in 2005, the number of Americans without health insurance rose to 46.6 million (15.9 percent) compared to 45.3 million (15.6 percent) in 2004. She believes that based on these findings, mobile preventive health care screenings, provided by companies such as Life Line, may address the need to prevent complications of stroke and vascular disease in our society.

With respect to Life Line's after-rates volume forecasts, witness Yorgey explains that Life Line is in the best position to present its future plans. She believes that these plans are reasonable and will encourage Life Line to increase its use of the mail. She infers that the risks of misestimating the before and after-rates volumes are addressed by the risk mitigation contractual mechanisms discussed above. *Id.* at 8-9.

Witness Yorgey also presents the sensitivity analysis that the Postal Service undertook in this case. *Id.* at Appendix C. She believes that analysis shows that a net loss could only occur under "extreme mis-estimation or erroneous assumptions." *Id.* at 10.

Impact on competitors and other mail users. Witness Yorgey believes that Life Line is unique among its competitors in its use of the mail as an important means of marketing. She notes that while competitors make some use of the mail for marketing, their reliance on mail is not comparable to that of Life Line. She also points out that a competitor that intends to increase its use of mail as a marketing medium may negotiate a comparable agreement to the proposed NSA. Thus, she does not expect the effect of the NSA on Life Line's competitors to be significant, and may bring increased competition to the marketplace. *Id.* at 10-11.

With respect to competitors of the Postal Service, she believes that they are not affected by this Agreement. She notes that Life Line relies on the mail as a marketing channel because of its broad reach and targeting abilities. Further, she believes that the response rates and secondary effects of other media are different than mail and accordingly are imperfect substitutes for Life Line. She points out that the incentives in the Agreement are intended to allow Life Line to use the mail and to market to more potential customers than it otherwise would have found profitable. With respect to other mail users, witness Yorgey does not believe the small $5.4 million contribution increase from this NSA will measurably affect other mailers. *Id.* at 11-12.

IV. FINDINGS AND CONCLUSIONS

A. Overview

The Commission's analysis of this Agreement is predicated on the general requirements for NSAs first set out in the Commission's Opinion in Docket No. MC2002-2. Sections B and C of the Commission's Findings and Conclusions address the accuracy of the cost and volume estimates submitted by Life Line and the Postal Service in connection with this proposed three-year NSA with Life Line. In section D, the Commission analyzes the financial impact of the Agreement. Section E focuses on whether the Agreement comports with the applicable legal requirements. Section F discusses changes to Domestic Mail Classification Schedule (DMCS) provisions, and section G addresses the proposed Data Collection Plan.

B. Accuracy of Cost Estimates

To calculate the cost savings and determine the unit contribution for mailpieces sent under this Agreement, the Postal Service used Commission library reference 22 (PRC-LR-22) from the last completed rate case under the PRA, Docket No. R2006-1. *See* Docket No. R2006-1, PRC-LR-22 (April 27, 2007). In prior NSA cases, the Postal Service has used previous versions of library reference Docket No. R2006-1, PRC-LR-15 to calculate cost savings and contribution.

In Docket No. MC2007-4 (Bradford), the American Catalog Mailers Association (ACMA) argued that the Postal Service erred in using PRC-LR-22 to calculate contribution instead of using PRC-LR-15. In that case, ACMA asked the Commission to indicate that the Postal Service's use of PRC-LR-22 did not create a "binding precedent," and that its use may not be appropriate for certain future NSAs involving different mail profiles. Docket No. MC2007-4, ACMA Brief at 2. ACMA asserted that the Postal Service's use of PRC-LR-22 was inappropriate because it does not include the same level of detail as PRC-LR-15, aggregates costs differently, and could result in inaccurate contribution calculations when applied to different NSAs. *Id.* It also asserted that the use of PRC-LR-15 inflated certain costs, inappropriately decreases estimated contribution, and consequently depresses future NSA discounts. *Id.* at 2, 3, and 5.

As discussed in more detail in the Bradford Opinion, based on ACMA's arguments in that case, the Commission changed the Postal Service's costs to be used in calculating Life Line's mailer-specific unit cost to reflect past precedent. PRC Op. MC2007-4 at 20-22. In past NSA cases, the Commission has used mail processing and delivery unit costs from the last completed rate case under the PRA as a starting point for calculating mailer-specific costs. The Commission then adjusted those costs to reflect the additional costs captured in the Cost and Revenue Analysis (CRA). The Commission follows that practice here which results in lower unit costs than those estimated by the Postal Service.

C. Accuracy of Volume Estimates

In this case, it is necessary to examine the estimates that have been presented regarding Life Line's proposed solicitation mail volumes with and without the NSA. The purpose of the Agreement is to increase the volume of Standard Mail letters which will generate additional contribution to the Postal Service. The Commission is particularly concerned with the potential scenario where the before-rates estimates are too low. Discounts would then be paid on mail that would have been mailed without the discount, and the NSA will not only fail to add to the Postal Service's net revenue, it could reduce contribution because some of that volume would have been mailed at the non-discounted rate.

1. Derivation of Volume Estimates

In this case, the overall reliability and accuracy of the volume estimates is extremely important. The Life Line NSA depends heavily on the accuracy of the point estimates of volume devised by the potential NSA partner in the first instance. With NSAs designed under this point estimate model, there are two main issues. The first is the underlying reliability of those point estimates. The second is the Postal Service's due diligence in verifying those volume estimates.

2. Life Line's Estimates

Witness Greenberg provides Life Line's historic volumes. LLS-T-1 at 6. He also explains that Life Line can not forecast its total number of mailpieces independently from the following: domestic ultrasound team growth, response rates, mail costs, growth in affinity partners, alternative media channels, and changing target demographics. *Id*. at 6-9. Witness Greenberg testifies that because "each of the above factors is subject to change on a monthly basis, our ability to accurately forecast revenues, costs and volumes beyond the near term is always a challenge." *Id.* at 9. Nonetheless, to support this Agreement, he develops the best possible three-year before-rates and after-rates mail volume forecasts based on information Life Line presently possesses. These numbers are as follows:

Table IV.C.1

Life Line Screening Forecasted Solicitation Volumes

	FY 2007	FY 2008	FY 2009	FY 2010
Est. Volume Before-Rates				
Standard Mail letters	96,000,000	90,000,000	87,000,000	87,000,000
Est. Volume After-Rates				
Standard Mail letters	100,000,000	104,000,000	110,000,000	110,000,000
Source: LLS-T-1 at 10.				

To arrive at these estimates, witness Greenberg uses marketing results for prior years, Life Line's current cost and response rate experience, and applied its best estimate of future profitability to arrive at mail volume over the next few years. *Id.* at 10.

He believes that without an NSA, Life Line's mail volumes per screening will continually decline since postage costs will continue to rise and make other marketing channels more attractive. Witness Greenberg expects that the completion of the roll-outs of Life Line's screening teams will occur in 2007. Therefore, he expects mail volumes to increase by 3 percent in 2007 versus 2006. He believes that increases in Life Line's affinity programs will be partially offset by reductions in mail volume per screening. Further, in 2008 and 2009, he forecasts a 6 percent and 3 percent decline in Standard Mail volume, respectively, as the postage increases are fully realized and statistical suppression models are implemented to reduce unprofitable mail volumes. He also anticipates more of the company's marketing budget to be transferred to alternative channels. For 2010, he expects no change in mail volume over 2009 since no domestic team growth is anticipated. *Id.* at 10-11.

There is nothing in the record to contradict these estimates or assertions. Indeed, it would be very difficult for a participant to argue for different estimates since that would imply that it understood Life Line's business better than Life Line did. As the Commission pointed out in connection with the Bookspan and Bradford NSA cases,[12] the Postal Service must exercise due diligence in independently analyzing Life Line's point estimates to alleviate the underlying inherent problems with "unquestioning reliance" on point estimates derived by the potential NSA partner as justification for the Agreement. *Id.* ¶ 4072.

[12] *See,* PRC Op. MC2005-3, ¶¶ 4072-73; PRC Op. MC2007-4 at 23-24.

3. Postal Service's Independent Analysis

The Postal Service claims to attempt to independently analyze Life Line's before- and after-rates volume forecasts to determine their reliability. The primary methods used by the Postal Service in this case are: company-specific research, volume trend analysis, and an analysis of the market environment. USPS-T-1 at 7-12. Based on its analysis in these areas, the Postal Service accepts, without modification, the point volume estimates of Life Line witness Greenberg.[13] The Commission analyzes each element of the Postal Service's independent review of Life Line's estimates in turn and then discusses further difficulties with the Postal Service's independent analysis.

a. Company-Specific Research

The Postal Service offers that Life Line is a mobile health screening service provider headquartered in Cleveland, Ohio. It notes that Life Line was founded in 1996 and currently has more than 1,000 employees. As discussed in the Bradford Opinion, a thorough independent analysis would require research beyond materials prepared for the sole purpose of persuading parties that this Agreement is in the Postal Service's best interest. The Postal Service claim that company-specific research that was conducted is of limited value. Noting the size and location of the company does not help predict its mailing habits.

b. Volume Trend Analysis

The Postal Service found that Life Line's Standard Mail letter volume for calendar year 2004 through 2006 trended substantially upward. USPS-T-1 at 7. It does not appear that the Postal Service performed any analysis of Life Line's mail. Witness

[13] *Compare* LLS-T-2 at 9-11 *with* USPS-T-1, Appendix A, at 2.

Yorgey concludes that "[t]his decline expects to level off at the new lower level in the absence of an incentive to increase solicitation of health screening events." *Id.* at 8.

The Commission has difficulty understanding how witness Yorgey's upward trend line supports a conclusion that "[t]his decline expects to level off at the new lower level." *Id.* The trend line is above both the before- and after-rates volume forecasts for all three years of the Agreement. *See* PRC-LR-2. Witness Yorgey appears to have parroted witness Greenberg's conclusion without any independent analysis.

c. Market Environment

Witness Yorgey suggests Life Line's market may "double in size within the next 25 years." *Id.* Yet, rather than finding Life Line likely to continue to increase its business and advertising due to the increased market size, witness Yorgey concludes that its mail volumes will level off. While this conclusion might be supportable, witness Yorgey's market environment analysis does not explain or examine this seemingly counterintuitive result. Merely reciting the market environment without analyzing the ways by which the market environment could affect the volume projections in a proposed NSA is of limited value.

d. Further Difficulties

The Commission's review in this case also uncovered several additional areas that the Postal Service should have explored further before deciding to enter into this Agreement. The proposed Domestic Mail Classification Schedule (DMCS) language to implement this NSA defines eligible Standard Mail as "pieces sent by Life Line Screening for the purpose of soliciting prospective customers and clients of Life Line Screening, *as well as advertising to existing Life Line Screening clients.*" This raises an issue with respect to the probability that the Postal Service will provide discounted postage on mailpieces that would have been sent in the absence of the NSA.

If Life Line has already obtained a customer, there is an increased likelihood that Life Line will send additional marketing mail to that existing customer in the absence of the NSA. *See, e.g.,* LLS-T-1 at 5-6 (stating that letters are sent to existing customers about new product offerings and repeat preventive health screenings via Standard Mail). Life Line's current business model encourages Life Line to continue sending Standard Mail solicitation mailpieces to current customers due to their ongoing relationship, rather than due to the NSA discount. It is difficult to believe that existing customers would not have been sent solicitation mail in the absence of the proposed NSA given Life Line's current business model. The Postal Service should have explored this issue and submitted its analysis with the filing of the NSA with the Commission as part of its due diligence.

The Postal Service also should have calculated the price elasticity of demand implicit in the Agreement based upon the NSA's discounted rates and Life Line's before- and after-rates point volume estimates. This would have allowed the Postal Service to prepare and present analysis to help determine if Life Line's before- and after-rates volume estimates are in the realm of reasonableness.

The Commission also has concerns with the Postal Service's due diligence regarding changes to Life Line's business operations during the pendency of this case. Life Line's actual Standard Mail letter volume for FY 2007 was almost 11 percent above original estimates, and very close to the trend line. Nonetheless, there is no evidence on the record that the Postal Service did any evaluation of the impact of this significant new data, and no changes were made to the proposed Agreement despite the fact that this increase could continue to have an impact on the FY 2008 volumes. *See* Tr. 2/40; APWU Brief at 4. The Postal Service also learned during the pendency of this case that Life Line planned to discontinue the operations of six vans in early 2008. Again, there is no evidence on the record showing the Postal Service evaluated the effects of the discontinuance of those vans on the NSA. Tr. 2/40. On brief, the Postal Service seems to make the argument that the effects of these two exogenous factors are offsetting.

Postal Service Reply Brief at 8. This misses the point. The Postal Service needs to systematically undertake critical analysis to evaluate the impact of events on NSAs. Contract provisions allowing for alteration or cancellation of agreements are meaningless if no effort is ever made to determine whether each specific NSA remains worthwhile.

4. OCA's Evaluation of the Postal Service's Financial Model/Sensitivity Analysis

The Postal Service provides a sensitivity analysis of the Agreement. *See* USPS-T-1, Appendix C. The Postal Service believes the analysis shows that a net loss could only occur under extreme mis-estimation or erroneous assumptions. *Id.* at 10.

OCA argues that the Postal Service's sensitivity analysis model can not be used to show that the Life Line NSA will improve the financial position of the Postal Service because the financial model fails to take into account the effects of non-price exogenous factors. OCA Brief at 4-10. In particular, OCA asserts the Postal Service's financial model assumes that the NSA price incentives are solely responsible for any increase in Life Line's mail volumes that exceed the before-rates volume forecast. *Id.* at 5-6. Without an elasticity of demand specific to Life Line, a reasonable estimate of the effect of the NSA on the Postal Service's net contribution can not be obtained. *Id.*

The Postal Service and Life Line respond that the record indicates that any own price elasticity specific to Life Line would produce an unreliable estimate and that OCA has not provided a better estimate on the record. *See* Postal Service Reply Brief at 4-6; Life Line Reply Brief at 7-8.

Even if the Postal Service can not construct an own price elasticity specific to Life Line, the Postal Service should consider attempting to verify data presented by a potential NSA partner through an industry elasticity of demand or even using the subclass elasticity of demand. While a mailer-specific own price elasticity is not required for approval of an NSA, its absence means that the Postal Service should more thoroughly exercise due diligence in negotiating and evaluating proposed NSAs.

The Commission finds that while a sensitivity analysis like the one provided by the Postal Service may provide some useful information, it can not be relied upon to assess the relative desirability of a given NSA. The analysis presented by the Postal Service does not provide any explanation for the volume change assumptions. Therefore, it is difficult to assess whether the volume scenarios are representative. In addition, the implicit elasticity differs at each point of the analysis. The Commission finds this problematic. In the Commission's opinion, an analysis of the before-rates volumes and corresponding after-rates volumes based on a constant elasticity of demand would be more useful. Such an analysis could be further enhanced to show the effects of a range of plausible elasticity assumptions.

5. Findings

APWU argues that the reliability of the estimated before-rates volumes provided by Life Line as a basis for determining the value of the NSA to the Postal Service is of concern. APWU Brief at 1. As APWU points out, if the current trend continues, the volumes will go beyond the automatic termination point. *Id.* at 4. Life Line candidly acknowledges that its volume estimates are unreliable beyond the near term. Although the Commission finds that those offered by Life Line in this case were made in good faith, because the accuracy of the point volume estimates are so important in the way this Agreement was structured, the Commission can not accept its admittedly unreliable estimates as accurate enough to support the Agreement. The Postal Service's due diligence attempts at independently reviewing Life Line's estimates are also inadequate and do not justify reliance on Life Line's estimates. Neither the Postal Service's sensitivity analysis nor OCA's recharacterization of that analysis can be relied upon to allow the Commission to recommend adoption of the Agreement.

D. Financial Impact

Under the PRA, the Commission must be reasonably certain that this Agreement will not result in a lower net contribution than would occur in the absence of this NSA before it can recommend approval. The admittedly unreliable volume estimates provided by Life Line would not allow the Commission to recommend approval. Consequently, the Commission must explore other areas of the Agreement to determine if the risk of the Postal Service losing net contribution due to this NSA is at an acceptable level. In this section, the Commission reviews the Agreement's multiplier effect, and the Agreement's procedural safeguards. It also applies the Docket No. MC2004-3 Analysis to this Agreement and analyzes the financial impact over the range of possible after-rates volumes.

1. Multiplier Effect

The Postal Service believes that it will additionally benefit from implementation of the Agreement through a "second stream of value" known as the multiplier effect. This multiplier effect generates additional revenue through increased volume for each new Life Line customer in the form of First-Class Mail and Standard Mail correspondence and additional solicitations. USPS-T-1 at 2; LLS-T-1 at 4-5. The Postal Service does not quantify these perceived additional benefits in its evaluation of the financial impact of this NSA, and considers it an "unintended benefit." USPS-T-1 at 2. Witness Greenberg explains the benefits of the multiplier effect and concludes that it results in up to seven additional mailpieces for each acquired customer. LLS-T-1 at 4. Five of these pieces are further Standard Mail solicitation letters for repeat screenings or other offerings. *Id.* at 4. Thus, approximately 70 percent of the mail that is considered part of Life Line's multiplier effect is eligible for a discount under the terms of the NSA. This means that Life Line's multiplier effect is not as remunerative as Life Line and the Postal

Service might argue since the contribution from approximately 70 percent of the multiplier effect mail could be reduced up to 3 cents per piece.

While it is easy to conclude that a lower benefit is still a benefit, the fact that this issue was not explored by the Postal Service and discussed in its presentation to the Commission, is unfortunate. The Postal Service needs to review a proposed agreement from all angles and determine how changes from one agreement to another affect the various benefits to the Postal Service. The Postal Service must improve its financial analysis when negotiating these agreements to assure that each particular agreement is in the Postal Service's best interest.

2. Contractual Protective Mechanisms

a. Overview

The Postal Service and Life Line argue that the terms of the Agreement itself also help protect the Postal Service from any potential errors in the before- and after-rates volume forecasts. *See*, *e.g.*, Postal Service Brief at 6-8; Life Line Brief at 14-16. They point out that these contract terms are similar to those recommended by the Commission in connection with the Bookspan NSA with the addition of a discount cap provision. Postal Service Brief at 6; Life Line Brief at 15-16.

The protective mechanisms in this proposal are designed to prevent net contribution from decreasing. Each risk reduction mechanism is addressed in turn below.

b. Volume Commitments

As in the Bookspan NSA, the proposed Life Line NSA has a contractual provision which allows Life Line to earn discounts for Standard Mail letter volumes that exceed specific volume thresholds, but the discounts do not become payable until Life Line reaches a higher volume level. This volume commitment will help protect the Postal Service by reducing the risk of discount leakage from variations from before-rates forecasts by helping minimize the potential that discounts will be paid on mail that would have been sent if there was no NSA.

c. Volume Commitment Adjustments

To further protect the Postal Service against discount leakage, there is a volume commitment adjustment mechanism in the Life Line NSA. The volume commitment adjustments provide that if at the end of either the first or second years, the actual volume is 12 percent or more above the prior year's actual volume, the following year's commitment will be revised to be the average of the prior year's actual volume and the following year's original commitment. USPS-T-1 at 5. This mechanism reduces the risk of discount leakage from more significant variations in forecasted volumes or an acquisition or merger that increases Life Line's mail volumes. If Life Line fails to reach the adjusted volume commitment level, it will not be paid any discounts for that year of the Agreement.

d. Discount Cap

This contractual provision ends Life Line's ability to earn discounts on otherwise eligible mail sent that exceeds certain volume thresholds for Standard Mail letters. This may limit the Postal Service's discount exposure in case unexpected non-price exogenous factors significantly boost Life Line's Standard Mail volumes.[14] *Id.* at 6.

[14] However, volumes in excess of the discount cap can be viewed as an indication that the incentive to mail is not due to the discount. This raises issues with proper application of the Docket No. MC2004-3 Analysis at volumes in excess of the discount cap.

e. Automatic Termination

This contractual provision automatically terminates the Agreement and all discounts cease if Life Line's Standard Mail letter volume exceeds 10 million pieces above the discount cap. This provision essentially operates as a protection against changed circumstances since it is very unlikely that a very large increase in volume would occur due to the price incentives, but rather to other factors that may cause sharp changes in volume.

f. Unconditional Withdrawal

This contractual provision gives both parties the unconditional right to terminate the Agreement without penalty upon 30 days' notice. *Id*. It allows the Postal Service to terminate the Agreement if it later determines that circumstances have changed in a way such that the Agreement is no longer in the Postal Service's best interest. This provision allows the Postal Service some protection from unanticipated major complications. The Commission finds the unconditional withdrawal contractual protection to be appropriate and desirable for this NSA.

g. Issues and Findings

OCA contends that these protective mechanisms are not as useful as they seem since the Postal Service can not determine after the fact whether any increase in volume is due to the NSA or non-price exogenous factors. OCA Brief at 8-12. The Postal Service and Life Line argue that the contractual protective mechanisms protect against mis-estimation of volumes. *See, e.g.*, Postal Service Brief at 6-8.

The protective mechanisms, while beneficial, do not significantly mitigate the risk of over- or under-estimation of volumes in agreements predicated on the volume point estimate model. Since the parties can not determine with any degree of certainty whether any increase in volume is due to the NSA or due to other factors, it makes it extremely difficult for the Postal Service to know whether or not its net contribution increased due to the discounts. Currently, the NSA design mechanism discussed in the Bank One reconsideration opinion is the only demonstrated method that allows meaningful insight into the distinction between after-rates volume increases that occur in response to the NSA and volume increases caused by other exogenous factors.

3. Docket No. MC2004-3 Analysis

Under the PRA, the Commission must be satisfied there is "reasonable assurance that the Postal Service will not lose money on this NSA." *See* PRC Op. MC2002-2, ¶ 8013. The analysis introduced by the Commission in the Bank One reconsideration is a way to quantify the additional contribution generated by an individual NSA using the average subclass elasticity to determine plausible before-rates volumes. It was first applied by the Commission to a pending case with respect to the Bookspan NSA. It was also applied by the Commission in the Bradford NSA case. This analysis is rooted in the Commission's first NSA Opinion and Recommended Decision in Capital One. In that case, the Commission found, based in part on the testimony of witness Panzar, that "[t]he impact of the tariff on postal net revenue has two parts." PRC Op. MC2002-2, ¶ 5012. The first is the increase in net revenue that results from the increase in volume. This is the increase from new mail volume, or "new contribution." The second part of the impact is a decrease in net revenue. This decrease in net revenue constitutes discounts on volume that the potential NSA partner would have mailed at the higher rate if there were no discounts. If the new contribution produced by the response to the lower block rate exceeds the loss of net revenue, the Postal Service's overall net revenue will increase at that after-rates volume. *See id.* ¶ 5013. If not, then the Postal Service will lose net revenue at that after-rates volume.

The Commission's Docket No. MC2004-3 Analysis is most useful in monitoring the success of a given NSA that is already in place as it can be performed using actual after-rates volumes and working backwards to determine plausible before-rates volumes.[15] When using the test to design NSAs, it is important to introduce penalties to the mailer for overly optimistic estimates of response to the discounts. As originally designed, the Commission's test would require a significant penalty at the point where the Postal Service's gain in contribution equaled zero.[16] The Postal Service did not employ such a tactic here.

The Postal Service attempted to apply the Commission's Docket No. MC2004-3 Analysis to this Agreement.[17] *See* USPS-LR-L-1. This could have provided additional independent analysis and information as to the relative value of the Agreement to the Postal Service on a more objective basis than several of the other independent methods used by the Postal Service in exercising its due diligence in this case. However, the Postal Service did not discuss or directly use the results of this analysis in any fashion. For example, the analysis done by the Postal Service shows that the Agreement would be worth approximately $250,000 for the first year of the Agreement at the forecasted volume as opposed to the Postal Service's estimate of $5.4 million. *Compare id. with* USPS-T-1, Appendix A, at 7. No attempt was made to reconcile this substantial difference, nor was the difference analyzed in the Postal Service's review. These differences appear to arise from assumptions relating to the appropriate before-rates volume. The Postal Service assumes that the mailer's forecasted before-rates volume is correct and calculates the increase in contribution as the contribution generated at the forecasted after-rates volume less the contribution generated at the forecasted before-rates volume. In contrast, the Commission's analysis was designed to lessen the reliance on mailers' forecasts. The analysis begins with the forecasted after-rates

[15] An after-the-fact analysis of the currently effective NSAs was presented in chapter X of the Commission's FY 2007 Annual Compliance Determination.

[16] The purpose of this penalty is to shift some sort of meaningful risk of loss to the NSA partner in order to ensure that the range of volumes estimated by the mailer is accurate. *Cf.* PRC Op., MC2004-3, ¶¶ 5012, 5018 (stating that if the mailer's actual volume fell outside the agreed-upon range of after-rates volumes, the agreement would be void).

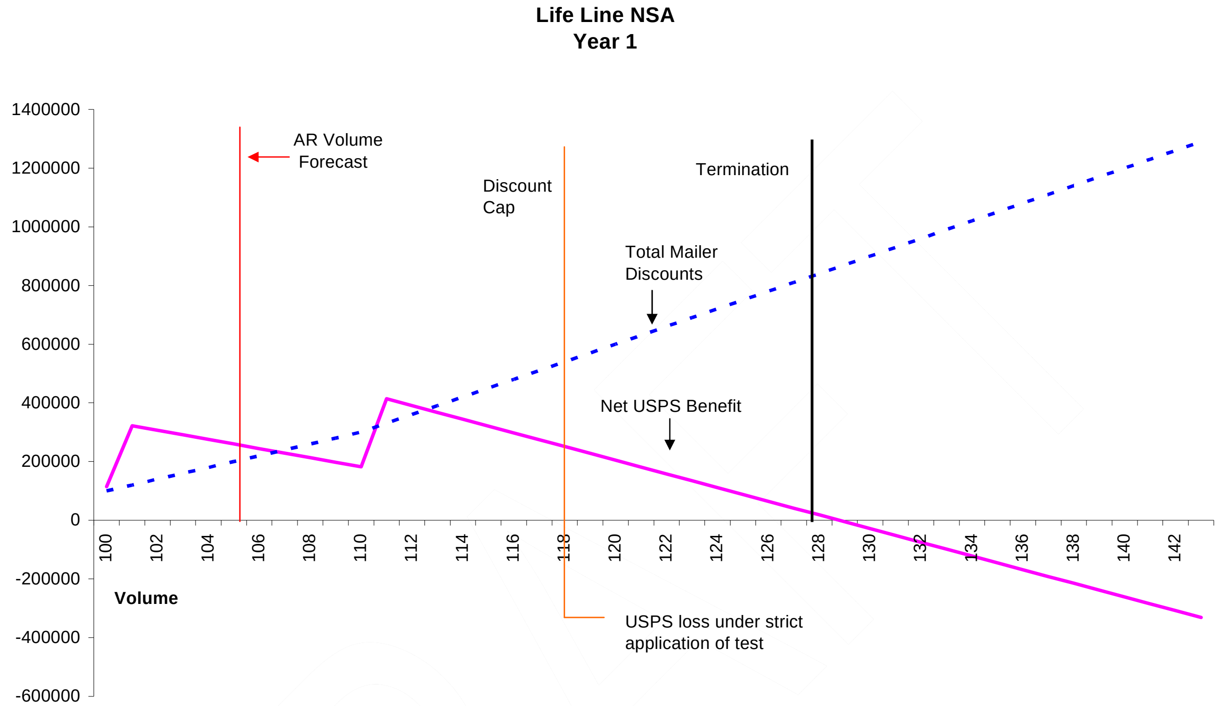
[17] *See* PRC Op. and Further Recommended Decision, MC2004-3, ¶¶ 5001-38.

volume, but uses the subclass average elasticity[18] to calculate the before-rates volume. Using this method, the calculated before-rates volume is higher than the mailers' forecasted before-rates volume. Thus, the increase in contribution is lower.

The Commission's application of its Docket No. MC2004-3 Analysis to the three years of the proposed agreement are reproduced and discussed below. The analyses incorporate the Commission's estimate of the mailer-specific unit contribution for letters. In addition, the Commission relaxed the strict interpretation of the test results that would indicate a loss in net contribution when volume exceeds the discount cap.

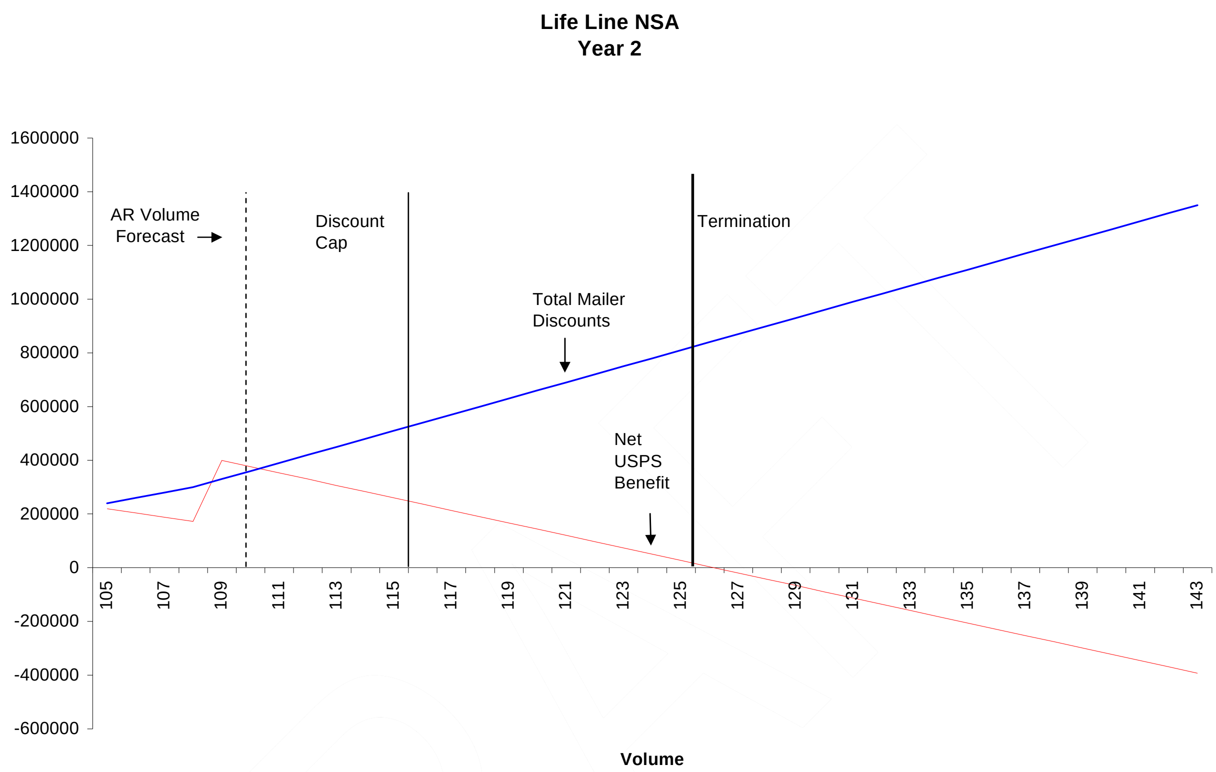
[18] The Commission believes that the most appropriate elasticity available should be used. In this case, the subclass average elasticity is the best available estimate.

Chart IV-D-1



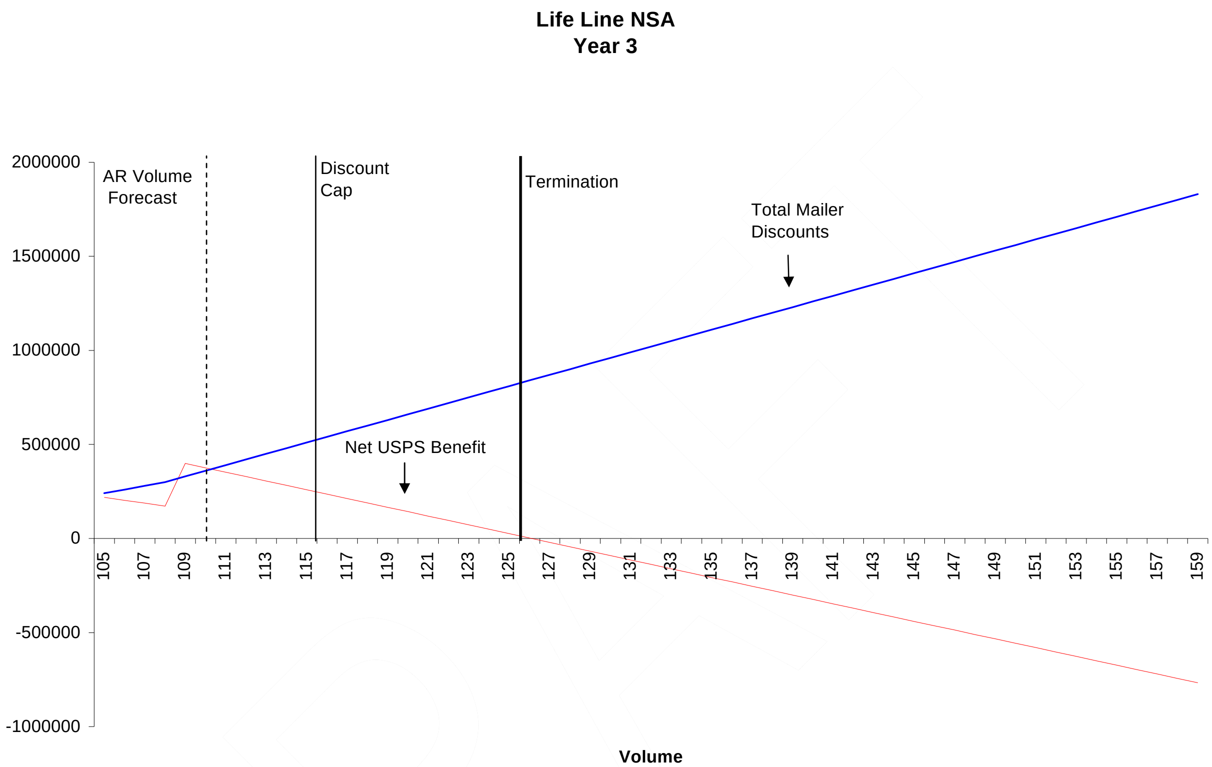
For Year 1 of the Agreement, if the total Standard Mail letter solicitations mailed by Life Line are below the automatic termination level, the test demonstrates that the Postal Service will not lose Standard Mail contribution on the NSA for that year. Moreover, below the automatic termination level, the Agreement is expected to increase net contribution as shown in PRC-MC2007-5-LR-2.

Chart IV-D-2



For Year 2 of the Agreement, if the total Standard Mail letter solicitations mailed by Life Line are below the automatic termination level, the test demonstrates that the Postal Service will not lose Standard Mail contribution on the NSA for that year. Moreover, below the automatic termination level, the Agreement is expected to increase net contribution as shown in PRC-MC2007-5-LR-L-2.

Chart IV-D-3



For Year 3 of the Agreement, if the total Standard Mail letter solicitations mailed by Life Line are below the automatic termination level, the test demonstrates that the Postal Service will not lose Standard Mail contribution on the NSA for that year. Moreover, below the automatic termination level, the Agreement is expected to increase net contribution as shown in PRC-MC2007-5-LR-L-2.

The Commission finds the automatic termination provision and its relationship to the Agreement a positive factor. In the Commission's Bank One reconsideration opinion, where the Commission set forth an alternative design mechanism, the Commission discussed voiding the agreement if the NSA partner's mail volumes were outside the agreed upon plausible range of mail volumes.[19] This measure was introduced as a means of offering an incentive for the mailer to provide the most accurate mail forecast possible. It was also intended to shift some of the risk of an overly conservative after-rates volume forecast from the Postal Service to the mailer.

Voiding the Agreement may not be the only sufficient mechanism to encourage accurate volume forecasts. Other meaningful and usable methods of shifting some of the NSA's risk of loss onto the mailer may exist.[20] The automatic termination provision may be on the right track, at least for the first year. If the mailer sends too many mailpieces in the first year, it will lose its right to participate in the Agreement in the second and third years.[21] The goal is to shift some sort of meaningful risk of loss or penalty to the NSA partner. Placing a meaningful risk of loss on the NSA partner provides a much needed incentive to develop a range of accurate after-rates volume estimates.

4. Findings

The Commission finds that, after the adjustments and revisions to the financial analysis noted above are taken into consideration, the financial risk of the Agreement is acceptable. The Commission improves the cost estimates to make them more accurate. This increases the potential benefits to the Postal Service. The Commission does not find the proponents' point volume estimates to be reliable and usable. The Commission has significant concerns with the fact that Life Line's actual FY 2007

[19] *See* Op. and Further Recommended Decision, MC2004-3, ¶ 5018 ("The agreement would stipulate that if the mailer's actual volume under the agreement fell outside the agreed-upon range, this would represent an unexpected major shift in the mailer's demand due to changes in non-price factors, thereby voiding the agreement.").

[20] In the proposed and all past NSAs, there is no downside for the mailer. That is, under the worst case scenario, the mailer would have to pay the tariff rate. However, under the worst case scenario for the Postal Service, it could lose several hundred thousand dollars per year in net contribution.

[21] The provision's effectiveness for this purpose in the second and third years of the Agreement is more questionable.

volumes were almost 11 percent above forecasts and very close to the trend line that the Postal Service argues is not reliable. However, based on the Commission's Docket No. MC2004-3 Analysis, there is a wide range of values where the NSA appears to result in increased contribution for letters. The Agreement also contains a number of safeguards designed to limit the Postal Service's exposure to risk. Taking all these factors into consideration, the Commission is satisfied that risk of loss from this agreement is acceptable.

E. Statutory Criteria

This case is filed under the provisions of the pre-PAEA, Postal Reorganization Act. 39 U.S.C., §§ 101 *et seq.*, *as in effect prior to amendment*, Pub. L. 109-435. Therefore, the Commission is required to evaluate how former sections 3622 and 3623 apply to the proposal. The Commission has reviewed each of the applicable factors and determined that, on balance, its recommended decision is consistent with the policies of the PRA.

The Commission first considers whether the proposed classification is consistent with the establishment and maintenance of a fair and equitable rate schedule and classification system for all mail. *See* former §§ 3622(b)(1) and 3623(c)(1). In every negotiated service agreement request, the Commission must consider the impact of the agreement on competitors to the Postal Service, on competitors to its NSA partner, and mail users in general. *See* rule 193(f). No record evidence has been presented indicating any adverse effect on competitors to the parties of the Agreement, nor has any evidence been presented that would indicate any likelihood that there would be any unreasonable harm to competition in the marketplace generated by recommending this Agreement. Moreover, any competitor who is similarly situated may seek to negotiate a functionally equivalent agreement with the Postal Service comparable to Life Line's proposed NSA.

The Commission estimates that the financial risk of the Agreement is acceptable at this time. The evidence shows that the mail sent under the Agreement will cover its attributable costs. *See* 39 U.S.C. § 3622(b)(3). The Agreement has a *de minimus* effect on the simplicity of the rate structure (§ 3622(b)(7)), the importance of classifications with high degrees of reliability and speed of delivery (§ 3622(c)(3)), and the importance of classifications which do not require high degrees of reliability and speed of delivery (§ 3622(c)(4)). Tariff rates remain available to all users of the mails. Thus, the Agreement does not affect the availability of alternative means of sending and receiving letters and other mail matter at reasonable costs (§ 3622(b)(5)).

The mail matter sent by Life Line is generally not considered to be “educational, cultural, scientific, or informational” as that term is used in § 3622(b)(8). Accordingly, that factor is not applicable here. Similarly, this NSA does not affect the degree of preparation required to enter mail into the postal system. Therefore, factor 3622(b)(6) is inapplicable.

NSAs allow the Postal Service to tailor its rates and services to the particular needs of individual mailers. Thus, as the Postal Service points out, by directly negotiating with a customer, rates may more accurately represent the value that the user places on the service. This results in an increase in the desirability and value of the service to both Life Line and the Postal Service. *See* former §§ 3622(b)(2) and 3623(c)(5).

The Commission finds the enactment of the PAEA to be an extremely important factor in considering whether to recommend this NSA since it provides a clear Congressional expression of public policy. *See* PRC Op. MC2007-1, ¶ 4059. The Commission concludes that the policies and objectives of the PAEA are relevant and should be given considerable weight under the PRA §§ 3622(b)(9) and 3623(c)(6). These provisions of the PRA specifically allow and encourage the Commission to apply “such other factors as the Commission deems appropriate.” *Id.*

OCA argues that if the Commission is going to take the PAEA's expression of public policy into account under former §§ 3622(b)(9) and 3623(c)(6), the Commission should also take into consideration the PAEA's specific instruction that the agreements for market dominant products must "improve the net financial position of the Postal Service through … increasing the overall contribution to institutional costs of the Postal Service." OCA Brief at 2. The Commission has also promulgated a regulation bearing on this factor. *See* 39 C.F.R. § 3010.40.

The Commission agrees with OCA that this factor is relevant in determining whether to recommend the Life Line NSA. Whether or not the Agreement improves the net financial position of the Postal Service is of considerable importance in evaluating an NSA — both from the point of view of the Postal Service when it negotiates the NSA, and the Commission and the Governors in evaluating the positives and negatives of the Agreement. Indeed, this is a factor that the Commission has consistently evaluated in every NSA case even prior to the passage of the PAEA; it is not a new criteria. *See, e.g.*, PRC Op. MC2005-3, ¶ 4089; PRC Op. MC2002-2, ¶ 8013. The Commission has taken this factor into account in its financial analysis of this Agreement and trusts that the Governors in their ultimate decision on this Agreement find the Commission's analysis helpful in that regard.

In addition to codifying that the likelihood that an NSA will result in a net benefit to the Postal Service is an important consideration for evaluating whether to enter into an NSA, the PAEA introduced an entirely new criterion for the Commission to consider in evaluating these agreements. This criterion was recently discussed in the Commission's Bank of America recommended decision. See PRC Op. MC2007-1, ¶¶ 4059-61. There, the Commission noted that:

> One goal of the PAEA is to provide the Postal Service with a level of flexibility to set rates and develop classifications, including the ability to enter into mailer-specific agreements that it finds beneficial. To provide this flexibility, it is necessary to shift the initial responsibility to review and to

> determine whether or not to proceed with mailer-specific agreements to the Governors of the Postal Service. The Commission provides this Opinion and Recommended Decision with its analysis of the BAC Agreement, both financial and statutory, to the Governors for consideration. Although the Commission's review is consistent with the legislation that predates the PAEA, the Commission is well aware that review under PAEA standards is soon to become the norm.

Id. ¶ 4060. The Commission believes that the same considerations are applicable here. Accordingly, the Commission provides its thorough analysis based on the record evidence to assist the Governors in making an informed determination, based on the financial and statutory factors of the PRA on whether to implement the proposed NSA.

F. DMCS Language

The Postal Service proposes to add a new DMCS section 640 to specify the general parameters of the Life Line NSA. *See* Request, Attachment A. The Commission recommends the DMCS language as proposed by the Postal Service with minor technical corrections that should have no effect on the intended meaning. The Commission also will develop similar language for incorporating into the draft Mail Classification Schedule. *See* C.F.R. part 3200, subpart A.

The Postal Service proposes the addition of three new rate schedules to the DMCS: 640A, 640B, and 640C. Rate schedule 640A specifies the volume block incremental discounts in Year 1 of the Agreement. Rate schedule 640B specifies the volume block incremental discounts in Year 2 of the Agreement. Rate schedule 640C specifies the volume block incremental discounts in Year 3 of the Agreement. *See* Request, Attachment B. The Commission recommends the addition of rate schedules 640A, 640B, and 640C as proposed by the Postal Service.

G. Data Collection Plan

The Postal Service has stated that it intends to follow the same data collection plan as recommended by the Commission in the Bookspan case, Docket No. MC2005-3. The complete data collection and reporting to be required during the term of the NSA are set out below:

1. The volume of solicitation Standard Mail letter-shaped pieces by rate category in eligible Life Line accounts and any other accounts in which Life Line sends its mail;

2. The discounts paid to Life Line Screening for letter-shaped solicitation Standard Mail by incremental volume block;

3. Monthly estimates of the amount of time spent on compliance and a description of the activities performed;

4. A comparison of the estimated mailer-specific costs and revenues with the actual mailer-specific costs and revenues;

5. An evaluation of the impact of the Agreement on contribution;

6. An evaluation of the effectiveness of the Agreement using the Docket No. MC2004-3 Analysis;

7. A narrative comparison of Life Line's actual volumes by rate category with:

- before-rates forecast;
- after-rates forecast;
- subclass totals; and

- relevant benchmarks based on research using available and/or commissioned sources where possible. This will include an analysis of any significant exogenous impacts.

8. The volume of solicitation Standard Mail letter-size mailpieces that included strategic business alliance inserts on a quarterly basis. This information shall be provided by rate category and by whether the mailpieces included one or two inserts.

An annual report of the data collected and the information analyzed are to be provided to the Commission yearly within 120 days of the NSA anniversary date. Items 1 and 3 are to be reported as monthly data for the previous year of the Agreement. Items 7 and 8 shall be provided every six months within 30 days of the ending of that six-month period. The Postal Service shall provide the data in a PC-available format.

H. Conclusion

The Commission has reviewed the evidentiary record pursuant to its statutory obligation under chapter 36 of title 39 of the U.S. Code. This includes an independent review of the evidentiary testimony of Postal Service witness Yorgey, the testimony of Life Line Screening witness Greenberg, the designated written cross-examination, the designated responses to Commission Information Request No. 1, and the briefs filed by the participants. This review leads to the conclusion that the record supports the proposed classification changes and the related discounts set out in the Request dated August 8, 2007, and that these changes are consistent with the policies of the Postal Reorganization Act. The Commission therefore recommends to the Governors of the Postal Service that the DMCS be amended as set forth in Appendices One and Two of the accompanying Recommended Decision.

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners: Dan G. Blair, Chairman;
Mark Acton, Vice Chairman;
Ruth Y. Goldway; and
Tony L. Hammond

Rate and Service Changes to Implement Baseline Negotiated Service Agreement With Life Line Screening — Docket No. MC2007-5

RECOMMENDED DECISION

(Issued May 29, 2008)

The Commission, having considered the Postal Service Request, has issued its Opinion thereon. Based on that Opinion, which is attached hereto and made a part hereof

IT IS ORDERED:

1. The Commission's Opinion and Recommended Decision shall be transmitted to the Governors of the Postal Service and the Governors shall thereby be advised that the proposed discounts (set forth in Appendix One) and the proposed amendments to the Domestic Mail Classification Schedule (set forth in Appendix Two) are in accordance with the policies of title 39 of the United States Code and the factors set forth in §§ 3622(b) and 3623(c) thereof, and they are hereby recommended to the Governors for approval.

2. Except to the extent granted or otherwise disposed of herein, all motions, exceptions, and other outstanding requests filed in Docket No. MC2007-5 hereby are denied.

By the Commission.

Steven W. Williams
Secretary

RECOMMENDED CHANGES IN RATE SCHEDULES

The following changes represent the rate schedule recommendations of the Postal Regulatory Commission in response to the Postal Service's Docket No. MC2007-5 Request. The changes require addition of three new rate schedules — 640A, 640B and 640C.

LIFE LINE SCREENING NSA

RATE SCHEDULE 640A

(First Year of Agreement)

Eligible Standard Mail Letters

Volume Block[1]	Incremental Discount
90,000,001 to 100,000,000	1.0¢
100,000,001 to 110,000,000	2.0¢
110,000,001 to 118,000,000	3.0¢

[1] Volume block beginning and ending thresholds are subject to adjustment in accordance with DMCS § 640.22 and DMCS § 640.24.

LIFE LINE SCREENING NSA

RATE SCHEDULE 640B

(Second Year of Agreement)

Eligible Standard Mail Letters

Volume Block[1]	Incremental Discount
88,000,001 to 98,000,000	1.0¢
98,000,001 to 108,000,000	2.0¢
110,000,001 to 116,000,000	3.0¢

[1] Volume block beginning and ending thresholds are subject to adjustment in accordance with DMCS § 640.22 and DMCS § 640.24.

LIFE LINE SCREENING NSA

RATE SCHEDULE 640C

(Third Year of Agreement)

Eligible Standard Mail Letters

Volume Block[1]	Incremental Discount
88,000,001 to 98,000,000	1.0¢
98,000,001 to 108,000,000	2.0¢
108,000,001 to 116,000,000	3.0¢

[1] Volume block beginning and ending thresholds are subject to adjustment in accordance with DMCS § 640.22 and DMCS § 640.24.

RECOMMENDED CHANGES IN
DOMESTIC MAIL CLASSIFICATION SCHEDULE

The following material represents changes to the Domestic Mail Classification Schedule recommended by the Postal Regulatory Commission in response to the Postal Service's Docket No. MC2007-5 Request. The underlined text signifies that the text is new, and shall appear in addition to all other Domestic Mail Classification Schedule text. Information to be added upon approval by the Board of Governors appears in brackets and is underlined.

NEGOTIATED SERVICE AGREEMENTS
CLASSIFICATION SCHEDULE

*****

640 LIFE LINE SCREENING NEGOTIATED SERVICE AGREEMENT

640.1 Eligible Standard Mail

640.11 **Life Line Screening.** Eligible Standard Mail under this section is defined as letter-shaped pieces sent by Life Line Screening for the purpose of soliciting prospective customers and clients of Life Line Screening, as well as advertising to existing Life Line Screening clients. Such letters may be sent by Life Line Screening, by entities in which Life Line Screening holds controlling shares, or by their vendors on their behalf. Such letters may also include up to two inserts promoting Life Line Screening's strategic business alliances.

640.2 Standard Mail Declining Block Rates

640.21 **Volume Commitments.** The following volume commitments for otherwise eligible letter-shaped Standard Mail pieces must be met before any discounts under this section are payable:

a. 95 million letter-shaped pieces for the first year of the Agreement;

b. 93 million letter-shaped pieces for the second year of the Agreement, subject to adjustment as specified below; and

c. 93 million letter-shaped pieces for the third year of the Agreement, subject to adjustment as specified below.

If Life Line Screening does not mail at least 75 million Standard Mail letter-shaped pieces during the first year of this Agreement, it will pay the Postal Service a one-time transaction fee of $200,000.

640.22 **Volume Commitment Adjustment Mechanism.** At the end of each year of the Agreement other than its final year, the volume commitment for the following year will be adjusted as follows.

a. If, at the end of the year, actual volume is 12 percent or more above that year's volume commitment, the following year's commitment will be revised to be the average of the completed year's actual volume and the original volume commitment for the following year.

b. If, at the end of the year, actual volume is 5 percent or more below that year's volume commitment, the following year's commitment will be decreased by the percentage difference between the completed year's original volume commitment and its actual volume, but in no case to lower than 80 million for the second year of the Agreement or 80 million for the third year of the Agreement. If the adjusted volume commitment falls below the following year's starting threshold, the starting threshold must then be adjusted to equal the adjusted volume commitment plus 5 million pieces for letters.

640.23 **Incremental Discounts.** Life Line Screening's eligible Standard Mail is subject to the otherwise applicable Standard Mail postage in Rate Schedules 321A or 321B, less the discounts shown in Rate Schedule 640A for the first year of the Agreement, in Rate Schedule 640B for the second year of the Agreement, and in Rate Schedule 640C for the third year of the Agreement, if Life Line Screening meets the applicable volume commitments specified in section 640.21, or as adjusted in accordance with section 640.22. Each incremental discount applies only to the incremental volume within each volume block.

640.24 **Volume Block Adjustments for Mergers and Acquisitions.** In the event that Life Line Screening merges with and/or acquires an entity or entities and/or purchases a portfolio with annual Standard Mail letters volume in excess of 10 million pieces, the volume blocks will be adjusted to add the volume of Standard Mail sent by the merged or acquired entity during the 12 months preceding the merger, acquisition, or purchase. The adjustment becomes effective for the succeeding fiscal quarter immediately following the date that mail volumes due to the merger, acquisition, or purchase begin to be mailed through the threshold permit accounts.

640.25 **Termination.** The Agreement automatically terminates and eligibility for all discounts under this section ceases if Life Line Screening's Standard Mail volume exceeds 10 million pieces above the maximum volume in the top tier of Rate Schedules 640A, 640B, or 640C, in any year of this

Agreement as may be adjusted in accordance with section 640.22, or if the Agreement is terminated by either party with 30 days' written notice to the other party.

640.3 Rates

The rates applicable to this Agreement are set forth in the following Rate Schedules: 640A, 640B and 640C.

640.4 Expiration

The provisions of section 640 expire on [insert date three years from implementation date set by the Board of Governors].

640.5 Precedence

To the extent any provision of section 640 is inconsistent with any other provision of the Domestic Mail Classification Schedule, the former shall control.

PARTICIPANTS AND COUNSEL

American Postal Workers Union, AFL-CIO
  Darryl J. Anderson
  Jennifer L. Wood

David B. Popkin*
  David B. Popkin

Life Line Screening
  Ian D. Volner
  Rita L. Brickman
  Matthew D. Field

Office of the Consumer Advocate
  Kenneth E. Richardson
  Emmett Rand Costich

Pitney Bowes Inc.*
  James Pierce Myers
  Michael F. Scanlon

United States Postal Service
  Daniel J. Foucheaux, Jr.
  Elizabeth A. Reed

Valpak Direct Marketing Systems, Inc.
  William J. Olson
  John S. Miles
  Jeremiah L. Morgan

Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc.
  William J. Olson
  John S. Miles
  Jeremiah L. Morgan

---

* Limited Participant