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

Regulations Establishing System of Ratemaking	)))	Docket No. RM2007-1

DIRECT MARKETING ASSOCIATION, INC.
REPLY COMMENTS
PURSUANT TO PRC ORDER NO. 15
(July 3, 2007)

The Direct Marketing Association, Inc. ("DMA") respectfully submits these Reply Comments in response to the Second Advance Notice of Proposed Rulemaking on Regulations Establishing a System of Ratemaking issued by the Commission on May 17, 2007,[1] on the subject of the characteristics of a "modern system for regulating rates and classes," as defined in the Postal Accountability and Enhancement Act ("PAEA").[2] These Reply Comments will be limited to the issues raised by the Commission in Question 2 of the Second Advance Notice, and, more specifically, to the response to Question 2 made by the Postal Service in its Comments filed on June 18, 2007 ("USPS Comments").

I. The "Fixed Volume Weights" to be used in Confirming CPI-Cap Compliance should be Determined with Reference to an Historical Twelve-Month Period that May Contain Projected Data as well as Actual Data.

For purposes of convenience in the discussion that follows, DMA will use the term "Base Year" to refer to the twelve-month period on the basis of which the CPI cap will be tested and the term "Test Year" to refer to the twelve-month period immediately following the Base Year. Thus, in order to comply with the CPI cap, the average revenue per piece for a given class in the Test Year must be no larger than (1 + CPI) times the average revenue per piece for that class in the Base Year.

DMA strongly believes that the calculation of the average revenue per piece for the Base Year must use volume data for the same twelve-month period as the rate data used to calculate average

[1] PRC Order No. 15 ("Second Advance Notice").

[2] Public Law 109-435.

revenue per piece. Thus, the CPI limitation, expressed mathematically, for a market-dominant class is as follows:

(1) $(P12Q11+P22Q21+\ldots Pn2Qn1)/(P11Q11+P21Q21+\ldots Pn1Qn1) \quad 1+CPI$

where P and Q are prices and quantities and the first index on each denotes the service (rate element) and the second index denotes the year. Note that, as advocated in our first comments, we have continued to use an index based on Base Year volumes and not on projected Test Year volumes; in other words, we advocate using a “Laspeyres” index.

Also note that, although formula (1) has been written in terms of total revenue by class and not in terms of average revenue (AR) per piece, the left hand side of the inequality is simplified and could be rewritten in terms of average revenue per piece since:

(2) $AR = (P1Q1+P2Q2+\ldots PnQn)/(Q1+Q2+\ldots Qn)$

There are two different approaches that could be used to satisfy the requirement that the average revenue per piece in the Test Year does not exceed average revenue per piece in the Base Year by more than is allowed under the rate cap. Under the first approach, one could decide that the annual limitation must be calculated on the basis of a twelve-month Base Year thatcontains only actual, historic data. Under this approach, new rates could not be implemented at the start of the Test Year. Since the Test Year (as defined above) starts as soon as the Base Year is over, since actual Base Year data will not be available until several weeks after the close of the Base Year, and since the statute requires a 45-day review period by the PRC, implementation of new rates could not occur until roughly 90 days from the beginning of the Test Year, at the earliest.[3]

In its response to Commission Question 2, the Postal Service discusses a problem that would exist if this approach were used.[4] If the rate design for a particular class were changed when the rates were most recently adjusted, the billing determinants for the most recent twelve-month period for which actual data was available would include information that would be out-of date, *i.e.*, it would

[3] In other words, if new rates were to begin on May 1, 2009, one could choose a Base Year for which the most recent actual data were available (say, the twelve months ending February 1, 2009). One would then apply the new rates to the billing determinants in that Base Year for purposes of calculating the CPI cap.

[4] USPS Comments at 5-6.

include at least several months of data based on the rate design that pre-dated the rates in effect since the most recent adjustment.[5] As the Postal Service states,

> "Because the revenue per piece would be, in part, "locked in" by the previous . . . price structure, pricing decisions and movements to more preferable rate structures would be further delayed."[6]

The second approach to applying a Laspeyres index, which DMA respectfully commends to the Commission for serious consideration, would use as the Base Year the twelve months that immediately precede the date when new rates would become effective. This approach would have the significant advantage of using the actual rates in effect for the entire Base Year (*i.e.*, the "P" figures in the formulas stated above) and would avoid the "lock in" problem identified by the Postal Service. Of course, actual billing determinant information for the last several months of the Base Year would not be available. However, it should not be difficult for the Postal Service to provide reasonably reliable estimates of this information. The Postal Service would have actual "prior year" data for the pre-Base-Year months in question; it would have data reflecting actual experience under the rate structure in effect during the earlier months of the Base Year, and it would have current information relating to macro-economic trends and other relevant inputs.

In DMA's view, the chances are quite small that the Postal Service estimates for the last few months of the Base Year would be substantially in error. Moreover, even if they turned out to be incorrect to a significant extent, their impact on the figures for the overall Base Year average revenues per piece would be limited because the period being estimated is relatively short compared to the Base Year as a whole. Finally, any major errors could be identified (and adjustments made) during the annual compliance review.

For the foregoing reasons, DMA respectfully suggests that the Commission adopt procedures pursuant to which the CPI cap is calculated using as a base the twelve months immediately preceding

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[5] For example, assume that new rates are scheduled to take effect on May 1, 2009, and that on May 1, 2008, rate design changes were implemented for Class X. Assume further that the Postal Service makes its filing with the Commission for the new adjustments on March 1, 2009. Under those circumstances, the most recent actual annual data available to the Postal Service at that time it was preparing to make its filing would be through February 1 (or perhaps January 1), 2009. However, that data would include the months of February, March and April of 2008, and would not reflect the rate design changes that went into effect on May 1, 2008.

[6] USPS Comments at 6.

the anticipated effectiveness of new rates and that the Postal Service be directed to estimate any data for that period for which it does not have actual results.

Respectfully submitted,

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