

BUSINESS MAILERS REVIEW

Incorporating Postal World

Monitoring the Postal Service, Private Carriers and Suppliers

Published by Sedgwick Publishing Co.

Volume 27, Number 2

January 16, 2006

Volume Growth Per Household In Decline

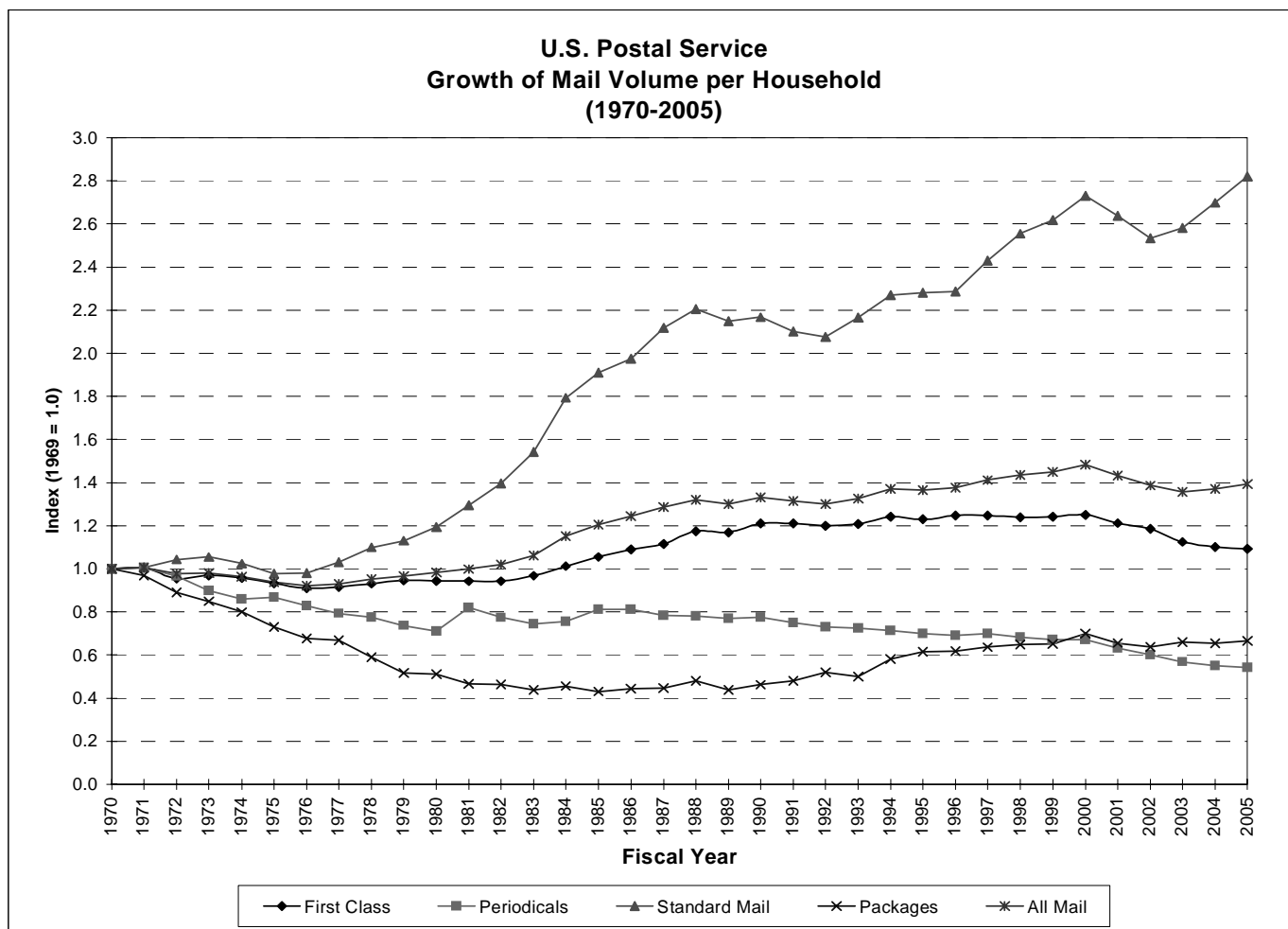
Total volume grew in absolute terms in 2005 and by about 0.8% annually over the first five years of the century, but household mail volume is down about 0.7% annually over that same five year period.

First Class volume, which actually enjoyed a slight increase in 2005, was down 0.9% on a per household basis, with an average of 863 pieces per household compared with 871 pieces in 2004. First Class volume saw a 2.1% average annual decline on

a per household basis in the 2000-2005 period.

Similarly, Priority mail (which is not shown as a distinct category in the chart below) saw a 6.2% average annual decline on a per household basis over the past five years, although it surged 3.5% last year, with the average household receiving 7.8 pieces, compared with 7.5 pieces in 2004.

Standard mail continues to drive volume growth. Standard mail surged over the 35 years covered by this analysis, with average annual



Source: Postal Rate Commission

growth of 2.9% per household. The average household received 315 pieces of Standard mail in 1969 and 888 last year. Over the past five years, household receipt of Standard mail increased an average of 1.2% annually.

The analysis of household volume trends was prepared by the Postal Rate Commission, using volume data from the USPS Revenue, Pieces and Weight report and dividing it by data on numbers of households from the U.S. Census Bureau.

The analysis suggests that while overall mail volume is growing, that growth is due to

expansion of the population rather than changes in consumer habits.

And the findings illustrate that mail, particularly First Class, Periodicals and Packages, are feeling the impact of competition from sources such as electronic alternatives and private carrier services.

For copies of all the data tables that accompany this chart, including total volume and volume per household and volume per capita, broken down by class and year, contact editor Beth McConnell at lshearl@aol.com and we will forward them.

Short Takes

As *BMR* went to press, the Postal Service was slated to file a request to extend the one-year experiment with repositionable notes (RPNs) that began April 3, 2005. USPS says the RPNs have proven to be a popular item, especially for catalogs and flats and the extension is to make sure there is no disruption in service to customers planning spring mailings using RPNs. The agency is aware of the white paper release to the Postal Rate Commission last week (*see story, page 7*) and plans to respond to concerns or questions in a second PRC filing if necessary. The latest figures on RPNs (through November) show they were used on a total of 75,551,797 pieces of mail.

Personalized postage was a big attraction this holiday season with about five million impressions attached to holiday cards under the year-long market test that is allowing companies like Stamps.com and a Pitney Bowes/Zazzle collaboration to act as custom postage vendors for a one-time fee of \$250,000. Legislation signed by President Bush Jan. 5, as part of a large federal spending bill, clarified that "issuance of 'personal' postage by private vendors, under agreement with the Postal Service, will not be a violation of federal law under Title 18, which prohibits imitations of U.S. obligations or securities. The Postal Service says the law change does not give immediate permission for advertising images to be included on customized postage. The

existing agreement with customized postage vendors specifically prohibits images that consist of notices or advertisements. The change in the law essentially opens the door for USPS to authorize customized postage vendors to include advertising images. The Postal Service says it is evaluating the current test and analyzing how it wants to move forward.

President Bush has selected John Gardner to fill one of the vacancies on the Postal Board of Governors. The appointment was made during the congressional recess and so did not require confirmation by the Senate. Gardner, who attended his first board meeting Jan. 9, previously serviced as general counsel of the U.S. Agency for International Development, as deputy assistant to the president and deputy staff secretary at the White House for President George W. Bush, in similar offices for former President Bush from 1989 until 1992 and in positions at the Health and Human Services Dept. and the Federal Trade Commission. He also has been in private legal practice in New York, was employed as a researcher for Schwab Capital Markets and was formerly vice president for government affairs with AT&T Corp. With the Gardner appointment the board has one more member than the absolute minimum required for purposes of a quorum to in order to vote on key postal business.

The Board of Governors last week voted to re-elect James Miller as chairman and Alan Kessler as vice chairman.

Dell Hold For Pickup Deal On Hold

USPS and Dell Computers are rethinking the Hold for Pickup service launched this fall and Dell is currently not providing it as an alternative to UPS delivery of computers to homes.

Hold for Pickup was touted when first announced as a natural way to take advantage of the large U.S. post office network around the country and extended hours of operation, including evenings and weekends, to provide consumers with a safe, inexpensive way to have Dell computers shipped to them when they aren't at home during the day.

USPS is saying the "controlled launch" that went out for four weeks in November and December has led USPS and Dell to rethink the process of how customers are notified that their

computers are being held at local post offices. Jim Cochrane, head of Package Services, said testing with Dell will resume when the issue is fully resolved so the Postal Service is assured that customer needs are being fully met.

He said the program is still in development and while Dell is the only customer for Hold for Pickup right now, he continues to talk with other interested companies and organizations about the service.

Dell spokesperson Jennifer Davis said the company is running the data on the "test" and is analyzing customer feedback on Hold for Pickup. She said the company isn't saying when it will decide whether to go forward with the service.

Rewards, Penalties Urged to Encourage Address Hygiene

The Postal Service should consider a stick approach to encourage improved quality of addresses in the commercial mailing industry, according to postal consultant Cary Baer.

In an interview with BMR, Baer said that so long as incorrectly addressed First Class mail is forwarded without an additional fee, there's insufficient incentive for mailers to invest in the best possible address hygiene. He certainly recognizes that businesses understand they will benefit from getting their message, advertisement or bill to the recipient in the fastest possible time, but argues that's not good enough. There should be a charge that is specific to those commercial mailers who don't invest in opportunities to clean and update mailing lists, Baer said.

This could be developed as part of the computerized forwarding system, so that sources of mail to be forwarded are identified and charged some sort of fee to contribute to the cost of handling undeliverable-as-addressed (UAA) mail.

While some might balk at the idea, Baer suspects that a relatively small percentage of the industry is causing a disproportionate part of what the Postal Service estimates is a \$2 billion problem. Dramatically reducing the cost to the Postal Service and ratepayers of incorrectly addressed mail will benefit everyone, he noted. "Capitalism would rear its head and come up with a way to improve address quality" as a

result, Baer said.

Although Baer applauds the goal in the transformation plan to reduce UAA mail by 50% by 2010, but he thinks that the Postal Service approach, which he argues is too oriented toward following regulations and not sufficiently focused on results, won't get the industry to that goal.

For example, Baer said USPS should be encouraging individuals to change their addresses electronically, rather than by going to a post office and filling out a card, because the information can get through the system more quickly. But in fact the Postal website requires a valid credit card to be entered to help verify identity and prevent fraud. Baer has no problem with this but does object to the \$1 fee charged to the credit card as part of the verification system. The Postal Service should be encouraging address correction, not discouraging it, Baer said. He thinks at a minimum the USPS could offer \$1 worth of stamps to compensate for the credit card charge for a task that is ultimately saving the Postal Service money.

Baer thinks services such as the new catalog forwarding component of electronic change of address are an excellent idea, but that USPS has lost sight of the fact that the objective should be to save money through more accurate addressing, not through additional products and services.

Ban on Remailing in Canada Gains Ground

The Canadian Supreme Court late last month declined to overturn an appellate court decision finding that Canada Post has exclusive privilege to collect, transmit and deliver all letter mail (up to 500 grams) including mail sent internationally.

To Canada Post, this decision is national in scope and bans remailers from collecting large quantities of mail in Canada and inducting it into foreign postal systems – a practice Canada Post says costs it between \$48 million and \$80 million in lost revenue each year (see BMR 10/24/05 p. 6).

But to remailers, such as Key Mail Canada, Inc., which was the object of the initial lawsuit, and Spring Canada, a subsidiary of international mailing giant Spring, the matter is far from settled. First, because the case was brought in Ontario and upheld by an Ontario appellate court and then the nation's highest court did not rule specifically on the merits, they argue the decision is not a national one. They are also arguing other legal issues including raising the appropriateness of a government entity suing in civil court. Still Brendan Van Niegenhuis, an attorney with Spring Canada who

worked on the Key Mail case as well, acknowledged the lack of action by the Supreme Court is a great disappointment to everyone in the international mailing industry.

Canada Post has taken Spring Canada to court and is seeking an injunction against that company. Meanwhile Spring Canada, Key Mail and others in the remailing community have formed a group, the Canadian International Mailing Assn., to fight Canada Post's interpretation. Key Mail Finance Director Gwyneth Howell said their fundamental argument is that this practice has been going on for several decades without any intervention by Canada Post and for the post to clamp down now after businesses have been permitted to invest and develop is "abusive and monopolistic."

While legal action continues, the association and its members are going to try to apply some political pressure on the Canadian Legislature. But those efforts are complicated by the fact that the national government is somewhat in flux right now.

Unbundling Offered as Way to Modernize Mail

Most people agree that the Postal Service needs some adjustments in order to thrive and continue its universal service mandate in the face of a changing competitive landscape. But with postal reform bills stalled, at least for the moment, two postal regulatory experts argue it's time to think of things in a new way.

Postal economist John Haldi and postal legal expert William Olson think the postal industry should take a cue from industries that were formerly vertically integrated, such as telecommunications and electricity, and unbundle the functions of the Postal Service. The idea is to retain the "natural monopoly" through the portion of the postal network that provides daily universal delivery service and enjoys large economies of scale and scope and to separate the mail processing, transportation and acceptance functions of USPS, which do not have such monopolistic barriers to entry, and subject them to competition.

In a paper on the subject first presented at an international postal conference in Antwerp, Belgium, the authors suggest USPS could be unbundled by separating it into two distinct units with the unit

responsible for mail processing and transportation, called the United States Mail Service, subject to full market competition and required to set rates so that they cover the full cost of these functions. The other entity, the United States Delivery Service, would continue to fulfill the universal service mission of the current Postal Service.

"Over time, full competition should reduce cost and improve quality of mail processing and transportation services. This would help to maintain – or even to increase – the total volume of mail delivered by the USDS," Haldi and Olson write.

The unbundling idea can be seen as an extension of the worksharing discounts that correspond to prices for upstream services. But worksharing discount prices "can differ significantly from those likely to result from complete unbundling and full competition," the authors say.

One of the major transitional issues in moving to unbundled service involves facilities with multiple functions, such as facilities that process

originating, outgoing mail and also sort destinating, incoming mail. The authors suggest that either the USDS could contract with the USMS to use facilities and employees for destination mail or it could lease the facilities and conduct delivery functions during late night or early morning hours. But the USMS would need to be in complete control of use of facilities in order to keep facility decisions as separate from political considerations as they are for companies such as FedEx, United Parcel Service or DHL.

“Unbundling would maximize downstream access opportunities while preserving the [universal service obligation]. After unbundling, existing delivery, retail and collection networks would

function uninterrupted, daily universal delivery service would continue unchanged, and single-piece letters would continue to be charged a uniform rate.”

Haldi also pointed out to BMR that unbundled mail service could resolve the current controversy before the Postal Rate Commission in which proponents of the Bookspan negotiated service agreement proposal want a special discount while critics say a government agency with a delivery monopoly should not be allowed to set discriminatory rates. Under unbundling, the privatized upstream provider could make whatever deals it sees fit while the downstream provider, the USDS would continue under regulatory constraints.

Regulation

PRC Defines Postal Service to Include Electronic Services

The Postal Rate Commission (PRC), in a Jan. 4 order, rejected efforts of the Postal Service to narrowly define what a postal service is and instead stuck largely to its previously proposed solution that makes clear it can regulate electronic services as well as hard copy mail.

The ruling is the latest example of the growing tension between the two entities. The House and Senate postal reform bills would expand the PRC’s role in regulating USPS, and that expansion has been one of the Postal Service’s biggest objections to the legislation.

The new definition, effective 30 days after publication in the Federal Register, declares: “Postal Service means the receipt, transmission, or delivery by the Postal Service of correspondence, including, but not limited to, letters, printed matter, and like materials; mailable packages; or other services incidental thereto.” Postal officials had strongly objected to the PRC’s two-year-long effort to define the term, arguing that commission lacked authority to define the scope of its own jurisdiction. The commission said that USPS contended that it should rely simply on “prevailing law as the Postal Service would define it.”

The commission rejected that argument as “both contrived and myopic.” It said the public needs to know the parameters of what USPS is offering and that, as a government agency, the Postal Service must give the public a chance to review what services it proposes to offer. That’s something USPS has rarely done in recent years, offering a wide range of services with very

little public say in whether they are good or bad proposals.

The first action USPS must take as a result of the definition is to file by June 1 a request for a review of “each current unreviewed service (or product) that fairly falls within the meaning of” the new rule. USPS also must ask permission to establish the service as either a permanent or an experimental service.

In addition it is required to give a list of each unreviewed service that “in its opinion, falls outside the meaning of the final rule.” In a 2004 order, the commission cited 14 services that the Postal Service contended were outside the regulatory review authority of the PRC. Many of the services were linked to the Internet and have since been discontinued or repackaged.

The 14 services were identified by the commission as Liberty Cash, Sure Money, eBillPay, Pay@Delivery, USPS Send Money, ePayments, NetPost Card Store, Net Post Certified Mail, Electronic Postmark, Unisite Antenna Program, Returns@Ease, Mall Package Shipment Program, First Class Phone Cards and retail merchandise. The commission said it assumes USPS will comply with the request and provide information on all the services. It is possible USPS could challenge the PRC ruling in the courts.

The commission noted in announcing its new rule that nothing it had proposed would stop USPS from offering new services. The PRC insisted, however, it has been accorded “due deference” by the Supreme Court in determining matters related to rate and classification issues.

Economist Questions Value Pricing

Pricing goods and services based on their “value” to the customer rather than the cost to the Postal Service could benefit USPS and the mailing community, but the first foray into this approach, a market test of charging for sticky notes on envelopes, won’t provide enough information on how to set the price points, says an economist charged by the Postal Rate Commission (PRC) to look at the idea.

The PRC commissioned the white paper to try to get more information on the controversial idea of value pricing while the Postal Service conducts its 12-month test of allowing the use of repositionable notes (RPN) on envelopes. Mailers are being charge 0.5¢ for RPN use on First-Class mail and 1.5¢ per piece for Standard mail and Periodicals even though there is no added cost to the Postal Service to process these mailpieces.

But Frank Wolak of the Economics Dept. at Stanford University wrote that this pricing approach doesn’t benefit the consumer. Rather, consumers could benefit if there was a discount for mailings without the RPN at the same time the RPN premium is charged, he said.

Wolak suggested that USPS would get better information about whether value pricing benefits the service and consumers if the test were extended over a period when prices change. For example, continuing the testing for another year now that the Jan. 8 rate increase has gone into effect, “would be significantly more likely to identify rates that would increase both postal revenue and consumer welfare.”

While mailers want to encourage innovative use of envelopes in a way that adds value to the mail many are critical of the RPN experiment in which the Postal Service has arbitrarily set a price for a design feature of the envelope that costs it nothing to process.

The Postal Service should be working with industry to add value to mail, rather than risking antagonizing mailers, several observers point out. Industry has less costly alternatives to the RPN, such as bang-tails, the detachable long flaps on the inside of envelopes that are used regularly by credit card companies and others as marketing devices.

Wolak appears to think the RPN experiment, if made permanent, would set a dangerous precedent, as there are “many other observable dimensions of postal products that do not impact the cost of delivering the mailpiece along which the Postal Service could price discriminate,” such as the color of the envelope stock, or of the ink, or whether a company logo is included. Over time, Wolak argued, if value pricing is increasingly used to charge for various design features the PRC would have little ability to determine the appropriate prices for new postal products and would be forced to rely on the Postal Service to establish the correct value.

The white paper, “Pricing Repositionable Notes for Use in Postal Delivery Service: An Economic Analysis,” is available on the PRC website under the Jan. 9 daily listings.

PRC: Bank One NSA Record Closed

The Postal Rate Commission’s (PRC) Jan. 6 decision not to allow fresh volume data to enter into its review of its Bank One Negotiated Service Agreement (NSA) decision is the latest in the regulator’s tussle with the Postal Service and many large mailers who don’t want to see caps on the volumes for which NSAs can get approved discounts.

The complicated case is important for several reasons. The Postal Service wants to have as much flexibility as possible to allow special discounts that will encourage companies to increase their volumes of First Class mail. In addition, proponents of the

NSA approach want it to be as streamlined as possible so that more entities will find NSAs an attractive option. Potential participants have complained that the regulatory hurdles to gaining volume discounts are just too-cumbersome relative to the potential benefit.

The Board of Governors has asked the PRC to revisit the issue of capping – an \$11.5 million stop-loss cap over the life of the agreement has been imposed on the Bank One NSA by the PRC despite USPS objections – and to explain under what circumstances an NSA might be approved without such a ceiling. The

Postal Rate Commission has imposed this cap because of continuing concern that companies could get volume discounts for mail that they would have mailed without the discount incentive.

In the latest ruling, posted Jan. 6 on the PRC's website, the regulatory agency declined the request of J.P. Morgan Chase & Co., which merged with Bank One in July 2004, to amend the current proceeding to include Chase and Bank One volumes and reflect a reported

volume surge.

The PRC said there are separate procedures by which Chase and the Postal Service can seek to modify the agreement to address technical defects, unforeseen circumstances or intervening events. Alternatively, the commission said, Chase can continue to mail under the agreement until the stop-loss cap is exhausted.

Chase argues it could reach the discount volume cap as early as mid-2006, just over a year into the three-year life of the NSA.

Marketing

Some Energy Bills Migrating to Electronic Payment

Between 2004 and 2005, the number of customers using the Internet to pay their energy utility bill doubled, with nearly 3 million customers opting to pay by Internet in 2005, according to the American Gas Assn. (AGA), which represents the energy utility industry.

The majority of customers – about 53 million of a total 56 million – still mail in their payments, AGA found.

AGA recently conducted a survey of its 197 members, which represent the majority of the natural gas delivered in the United States. The data analysis shows 85% of 80 energy utilities that responded to the survey said they offered Internet payment as an option in 2005, AGA Public Relations Director Daphne Magnuson told *BMR*.

The industry survey shows some siphoning off of utility bills from the mailstream although the vast majority of consumers obviously have not changed their bill-paying method. What's most interesting about the survey is the dramatic increase in electronic bill paying in a single year and the key question is whether this growth will continue.

Some utilities are encouraging it to, seeing cost savings in electronic bill presentment and payment. For example Philadelphia-based PECO electric and gas utility is urging customers to enroll in e-Bill or the company's Automated Bill Payment Plan, Bill Processing Manager Irene Johnson said. For the first time

ever, 30% of PECO customers did not use the Postal Service for utility payments in 2005.

In a recent background paper as part of a long-term Pitney Bowes research project on electronic substitution of mail, Fouad Nader of Adrenale Corp. said the Internet seems to have to date had little impact on the volume of utilities mail to households. The paper, which looked at energy utilities and telecommunications, said recent utility market research shows the adoption of paperless bills has not exceeded 1% of the customer base, whereas web payments have reached just 3% as of May 2005. Pay-by-phone has remained at about 2% annually since phone service payments were introduced. Nader said this could suggest electronic bill payment will stay in the single digits for many years.

Direct mail's share of total ad spending has been going up for the past 14 years from about 14% of total advertising in 1980 to 20% of ad expenditures in 2004. At the same time, "except for a temporary share decline in 2000 due to a spike in Internet advertising, electronic technology has not affected direct mail's share," Nader said.

Nader found the underlying drivers of utility and telecom industry mail growth are likely to remain – including 1% annual growth in households, gross domestic product growth of 2-3% and a 5% increase in annual ad spending.

"Therefore it is reasonable to assume the First Class and Standard (A) mail volumes in these industries will continue to grow as well," he said.

The report is available at www.postalinsight.com.

Briefs

The holiday mailing season – which runs from Thanksgiving through Christmas – was “sluggish” Postmaster General Jack Potter told the Board of Governors last week, even though Dec. 19 was a record day with mail cancellations at 282 million pieces, 5% higher than last year’s peak, and Click and Ship, with carrier pickup was up about 67% over the same period last year. Looking forward, Potter said this year USPS will deploy its widely anticipated automated package processing system to sort bundles of mail and Priority mail packages and in April USPS will install and test a prototype of the flats sorting sequence machine at the Indianapolis Mail Processing Annex. This technology is designed to sort non-letter or flat-size mail into delivery route sequence.

In his presentation to the Board of Governors last week, Postmaster General Jack Potter said the agency is looking at every opportunity to cut costs and improve service. “Our ever-evolving transportation and mail processing network is one area we are looking at closely. Let me stress that while nothing has been decided, and with the evolving nature of the mail mix, it is the right time to evaluate changes which will make mail processing more efficient. We are constantly reviewing our transportation network and we are committed to making changes that would move more mail on to ground transportation to increase reliability.”

This week the Postal Service – one of the nation’s largest employers of individuals with hearing challenges – says it plans to unveil its high-tech communication alternative for deaf and hard-of-hearing employees. Two types of video interpreting services are being added to postal facilities across the country, resulting in the largest deployment of this technology in the public or private sector.

Happy Birthday, Mr. Franklin! This month marks the 300th birthday of Benjamin Franklin. In 1775 the Continental Congress selected the founding father as postmaster general because of his experience as a colonial postmaster and directed him to organize a postal system. The Smithsonian’s National Postal Museum scheduled a birthday bash Jan. 14 to explore his accomplishments and inventive spirit.

Bank of America, NA, subsidiary BA Merchant Services, the nation’s second-largest bankcard merchant acquirer, has snapped up a contract to provide credit card processing and settlement services for more than 34,000 USPS sites, including post offices, automated postal centers and the online postal store at USPS.com. A Bank of America spokesperson would not disclose the size of the contract or the length, but service is expected to begin in March. This is the first time BA Merchant Services is providing these processing services to USPS.

BUSINESS MAILERS REVIEW (ISSN: 0739-3873) is published biweekly by Sedgwick Publishing Co., an independent newsletter firm. Subscriptions to **BUSINESS MAILERS REVIEW** are \$377/year in the U.S., Canada and Mexico; delivered airmail for \$392 elsewhere. Authorization to photocopy items for internal or personal use, or the internal or personal use of specific clients, is granted by Sedgwick Publishing Co. for libraries and other users upon request. **BUSINESS MAILERS REVIEW** is available electronically via e-mail. Contact the circulation department at 301-528-0011, or email to support@pnmsi.com. © 2006 by Sedgwick Publishing Co.

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