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Potter Says USPS Won't Break Price Cap

Postmaster General Jack Potter last week looked to reassure mailers that the Postal Service won't try to break the CPI-based cap on annual rate increases despite the fact that it will likely be looking at more than a billion dollar loss for the fiscal year.

The law that established the annual cap offers an escape hatch – an exigency clause that permits UPSP to exceed the cap in the face of emergency circumstances. Potter said some in Congress have urged him to use the current economic situation, which is driving USPS's financial problems, as the special circumstance justifying raising rates above inflation. "This is not a time for the Postal Service to put further hurt on people in the mailing industry," Potter told the Mailers' Technical Advisory Committee (MTAC) Aug. 6.

He said raising rates beyond the annual inflation-based cap would contribute to "the spiral into the ground."

"If we raise rates it will drive people further from the mail and exacerbate the problem," he said.

Potter said he knows that the industry must be hurting because there is less mail in the system. The economic slowdown and inflation in fuel and other areas is hitting the Postal Service hard (*see story, page 5*). But Potter said the agency is positioning itself "so when the

economy comes back we're there for you and grow with you."

The package industry is going to grow with the Internet and "we want our fair share of it," Potter said. That's why he has restructured the organization with Robert Bernstock, with 30 years of private sector experience heading companies such as Campbell Soup, as the new president for the newly organized shipping and mailing services division.

He's joined by David Shoenfeld, former senior vice president for worldwide marketing at Federal Express, who is the new senior vice president for mailing services, and Stephen Kearney, who is the new senior vice president for customer relations (*see BMR 07/14/08, p. 1*).

In brief remarks to the MTAC group Bernstock said that the group is planning to focus on doing fewer things better. "Fewer, bigger, better is going to work for us," he said. Bernstock seemed more optimistic about future growth in shipping services than in mailing services. "Mailing is a greater challenge in terms of what's happening in the marketplace," Bernstock said. He added that the Postal Service needs to work with the industry to grow together. At his suggestion, MTAC is creating a new track on growth and the mail to pursue this goal.

Financial Incentive for IMB Migration Delayed

Mailers were taken aback last week by the announcement that no discount pricing differential will be offered for the Intelligent Mail Barcode for May of 2009

Postal officials insisted they will be ready with the infrastructure for the full-service IMB by May of 2009, if not several months earlier. But they said Postnet, which was supposed to be phased out by May of 2009, will still qualify for automation prices until at least May 2011.

And Postmaster General Jack Potter told the

Mailers' Technical Advisory Committee (MTAC) last week that there will be no price incentives for using the full-service IMB in May of 2009. The Postnet, full-service and basic service IMBs will all have the same automation discounts, he said. Potter said mailers made it clear in their comments in response to *Federal Register* notices on the IMB that they needed more time

Thomas Day, senior vice president for intelligent mail and address quality, qualified that a

(continued on page 3)

Short Takes

Now that the Postal Service is most likely postponing provision of financial incentives for implementation of the Intelligent Mail Barcode (IMB) it's expected to cause a delay in the number of business mailers who adopt the IMB (*see story page 1*). So how is this delay going to impact the Postal Service's ability to measure its performance and report those results to the Postal Regulatory Commission and Congress? The system it has designed relies heavily on use of the IMB to measure how well it meets its new performance standards for First Class and Standard mail. Tom Day, senior vice president for intelligent mail and address quality, doesn't think that volume of IMB mail will be a problem in getting statistically valid sampling regardless of how industry responds to the implementation delay. He said that even in piloting of measurement systems the issue was geographic dispersion. Day said there's enough volume for the 80 district reports and for the destinations of mail but the number of entry points is a concern because of the need for a broad array of entry points. As a result, Day said that in the next few years the agency may not reach the level of statistical precision it's ultimately aiming for. But he thinks there will be enough IMB mail for solid measurements that satisfy the requirements.

In a sign that it's looking for ways to improve communication with mailers the Postal Service is considering setting up blogs for members of the Mailers' Technical Advisory Committee, the Postal Customer Councils and other groups. Testing of the blog concept will begin internally with the IT group of the organization to see what kind of issues arise such as how to define the universe of participants, what the standards might be as well as how to ensure appropriate topics. There's no time frame for putting the blogs in place.

New procedures to improve the delivery of Standard mail are nearing completion,

with eight of the 10 areas having received training on how to treat the color coding procedures in a new environment. Chris Oronzio, manager of processing center operations, said that USPS isn't changing the color codes used to meet customer commitments but is requiring that the coding, which indicates when a mailpiece should be shipped, cannot be changed by the facilities. This way customers will be sure USPS meets delivery commitments, he said. Beginning Aug. 29 USPS will start auditing the field so that by Oct. 1 "we'll be pretty confident that the field understands the policy," Oronzio told the Mailers' Technical Advisory Committee last week. Oronzio said USPS is coming to understand that delivering too early can be just as problematic as delivering too late. He said mailers need to make sure their drop standards are synchronized with the color code system. One tool to achieve this will be a feature in FAST so when mailers create an appointment the system will state whether the drop date is too early or too late for the inhome delivery date. This will also guard against the Postal Service being a warehouse for mail that is dropped too early, Oronzio told MTAC. The procedures are for Standard letters and flats. The Postal Service is still looking into a procedure for Standard parcels.

USPS is rejecting the claims of North American environmental group ForestEthics, a leader in driving the "Do Not Mail Registry" effort that has issued a report claiming unsolicited mail makes a contribution to climate change that equals more than nine million cars or emissions generated by heating nearly 13 million homes for the winter. "They are dead wrong," said Mike Fanning, manager of environmental policy and programs with the Postal Service. "Their numbers on the impact of Standard mail are three times higher than we think they are. All we can do is rely on data. And we have really good data," Fanning said. But Fanning conceded, "We need to do a better job of telling our story because we have the facts."

IMB (continued from page 1)

bit saying that on today's facts there would be no pricing incentive. But "we're not taking the option off the table." The definitive word on this will be in February of 2009, when the annual price adjustments are announced.

This decision surprised mailers who have been assuming they would receive a price advantage for implementing the full-service IMB, which involves placing the IMB on mailpieces as well as containers and trays.

Mailers who have already invested in establishing an infrastructure for the full-service IMB say they are frustrated because they can't justify implementing it without the pricing information. On the other hand, companies that have yet to gear up have no more information than they did before with which to decide whether to adopt the full service IMB rather than basic service. So last week's announcement puts them at a standstill.

Day said that while there was a push from industry for the financial investment in the IMB to hinge on what incentive USPS might offer, "We disagree."

The Postal Service plans to provide a tool that mailers can use to calculate the return-on-investment from moving to intelligent mail. He said a web-based tool will be available. "In the vast amount of cases you can justify investment in IMB without a price incentive. That's the way we look at it," Day said.

The wealth of information the barcode provides, the ability to understand address quality, and to know and respond in real-time to the flow of mail have tremendous value for customers, he said.

The significant value to the Postal Service comes in part from reducing what Day estimates to be the \$2 billion cost to USPS associated with

undeliverable as addressed mail.

"My word of caution to you [is] while you're clearly not hearing of a definitive price increase in May of 2009... but you have to make your business decisions on what I think are good solid business reasons to migrate to the IMB," Day said.

Day said he would be willing to prepare a letter that mailing executives could provide to company CEOs explaining the Postal Service's perception of what the value of the IMB can be for the mailing operation.

Barcode Refinements

Pritha Mehra, newly promoted vice president for business mail entry and payment technologies, outlined the specifications for the IMB, which have evolved:

- reduced height to 0.125" (from 0.134")
- reduced minimum vertical text-to-barcode spacing to 0.028" (from 0.040")
- doubled void spacing from 0.005" to 0.010"
- reduced address block text size minimum height to 0.065" (from 0.080")

Attempting to respond to several frequently asked questions, Mehra said that the ID on the container and the mailpiece can be different and in most cases will be different.

For full-service IMBs change of address information will be provided free of charge but the mailer will be required to use that information to update the mailing. Mehra said a *Federal Register* notice on this issue will come out soon.

On two other points Mehra said that for full-service IMBs mailers will receive the container scan information and that the placard with the IMB label must be located outside shrinkwrap on the container.

Mailer ID Updates

USPS has simplified and clarified the process for obtaining Mailer IDs that are needed as part of the IMB process.

A simplified form must be completed and delivered to the Business Mail Entry Unit (BMEU). The form permits the mail owner to authorize a mail preparer to control the Mailer ID.

Other Deadlines

USPS also announced deadlines for use of the Intelligent Mail Barcode (IMB) for business reply mail.

*IMB will be required on quality business reply mail beginning in 2010

*IMB will be required on reply mail starting in May 2011

Mehra told MTAC that mailers should receive a response via email within 24 hours for a 9-digit ID. She said it may take a bit longer for a 6-digit ID (which are given for volume of 10 million or more) because the Postal Service has to validate the volume. The more information

provided, the faster validation will take place, she said. She said mailers are not limited to a single 6-digit or 9-digit ID but there will be some limitation.

Mehra clarified that the Mailer ID must run across all locations involved.

USPS Defends Monopoly, Suggests Limit to USO Universe

The Postal Service Aug. 1 shot back at Federal Express Corp.'s suggestion of a phase out of the postal monopoly, saying there is broad consensus for continuing the monopoly on the final-mile delivery of letters.

In reply comments that are part of the Postal Regulatory Commission's (PRC) proceeding on the universal service obligation and postal monopoly, USPS said FedEx is almost alone in recommending the letter monopoly be gradually eliminated (*see BMR 07/28/08, p. 5*). USPS was critical of efforts to look to European deregulation as a model because of significant differences in the systems.

But if the PRC were to consider taking this approach, it would need to recognize the competitive pressures USPS already is subject to and the added pressures deregulation would create, USPS said. Other markets have considered alternative ways to fund the universal service obligation along with changes to the postal

monopoly, USPS added.

In its initial comments the Postal Service interpreted the postal reform law to potentially exclude competitive products such as Priority Mail from the universal service obligation. While "the enumerated features of universal service remain 'obligations' with respect to market-dominant products, and particularly with respect to those subject to the 'postal monopoly,' those service features can no longer be deemed obligatory with respect to competitive products," USPS said, "Success in the marketplace and profitability will require the Postal Service to define the service provided to competitive products in response to market forces."

USPS said that if it is not in the market for a given competitive product, alternatives will exist so "there is no reason to impose a universal service obligation on the Postal Service if the same obligation is not imposed on private carriers."

Anthrax Back in the News

The recent suicide of Army biodefense researcher Bruce Ivins, the man blamed by federal agents for the 2001 anthrax attacks, brought the issue back to the forefront with the postal industry last week.

In an open letter to all postal employees, Postmaster General Jack Potter noted how that event had profoundly impacted the organization, causing the death of Joseph Curseen and Thomas Morris. The DC Mail Processing and Distribution Center has been renamed in their honor. A number of other postal employees survived after being sickened by the bacteria and many postal employees and their families suffered anxiety over the attack.

There has been some controversy surrounding the FBI's handling of the investigation into Ivins, who worked at the U.S. Army Medical Research Institute for Infectious Diseases in Frederick, MD. Potter told a mailers group last week that "we're not going to make a judgment about what's gone on with this investigation."

He said, though, that the Postal Service would "absolutely not ... pull back on anthrax detection." The centerpiece of USPS detection is the Biohazard Detection System, installed in processing plants across the country, which collects air samples from processing equipment and performs rapid DNA tests for immediate onsite notification.

Financials

Volume, Revenue Decline Accelerates

The Postal Service wrapped up its third quarter in worse financial shape than expected – coming in with a year-to-date net loss of \$1.13 billion through the end of June.

Chief Financial Officer Glen Walker said that the third quarter had seemed on track for the months of April and May, in part, he believes, aided by the national stimulus package. But June was the worst month in some time for the Postal

the balance sheet and the agency expects to have \$7 billion in debt this year. Total debt is capped at \$15 billion with \$3 billion in added debt allowed annually.

Overall volume was 48.5 billion pieces, a 5.5% drop from the same period last year, with both Standard and First Class mail declining. Walker said there are real opportunities in packages and international mail. He said international mail, which is a small percentage of total mail, is seeing double digit revenue increases.

To respond to the spiraling volume, Walker said the agency has gone well beyond its plans for taking out \$1 billion in costs. In fact, it's likely the agency will take between \$2 billion and \$2.5 billion in costs out of the system.

With labor representing 80% of USPS overhead, the big driver has been reducing the number of workhours. The greatest flexibility in this area USPS has is to reduce overtime, Walker said. He noted that headquarters also has a hiring freeze and that voluntary early retirement is being offered to some employees. "But considering the rapid decline in volume we couldn't take out costs fast enough to match it," he said.

Despite fuel and other inflation, the agency kept expenses in check, with a 1% increase in

Income Statement Quarter 3 FY 2008

(data in millions)

	<u>Actual</u>	<u>SPLY</u>	<u>Var</u>	<u>%SPLY</u>
Volume	48,573	51,387	2,850	-5.5%
Revenue	\$17,920	\$18,385	-\$465	-2.5%
Expense	19,018	18,838	180	1.0%
Net Loss	-\$1,098	-\$453	-\$645	

Source: US Postal Service

Service in terms of coming in below projections. Preliminary results for July don't look much better and the Postal Service expects to end the year with more than a billion dollar loss.

Walker assured mailers at the Mailers' Technical Advisory Committee (MTAC) last week that bumping up against statutory debt limits won't be a concern. USPS was debt-free at the end of 2005.

For FY 2007 there was \$4.3 billion in debt on

Fiscal 2008 Mail Volume

	<u>Volume</u> <u>Year to Date</u>	<u>%SPLY</u>	<u>Volume</u> <u>Quarter 3</u>	<u>%SPLY</u>
First Class	70.3B	-4.2%	22.3B	-5.5%
Standard	75.4B	-3.7%	23.2B	-5.5%
Periodicals	6.6B	-2.2%	2.2B	-3.3%
Express	37M	-13.2%	12M	-14.3%
Priority	661M	-5.0%	202M	-5.9%
Package Services	850M	-3.4%	252M	-2.7%
Total All Mail	155.2B	-3.9%	48.5B	-5.5%

Source: US Postal Service

expenses for the quarter, compared with the same period last year.

Walker noted, however, that inflation will mean the Postal Service will have to pay about

\$1 billion in cost of living adjustments (COLA) to employees in September and will likely have another major payment in March of 2009. Last year the COLA was zero, he said.

Steep Penalties Proposed for Move Update Noncompliance

Standard mailings that don't comply with the new Move Update requirements that go into effect Nov. 23 are looking at a penalty of 7 cents per address across the mailing.

Mailers were surprised that the steep penalty is proposed to be assessed on every piece in the mailing. Bob Galaher, manager of business mail acceptance, said the rules say that the single piece rate will apply if Move Update is not run on an address but there was no single piece rate for a Standard mailing so the Postal Service came up with something it thought was reasonable.

Mailers quickly balked at the across-the-mailing penalty when it was raised at last week's Mailers' Technical Advisory Committee (MTAC) meeting. Galaher said this approach is being taken because verification will occur when the mailing is run through the MERLIN verification system. That will evaluate just a sampling of the mail so if the samples show noncompliance, the whole mailing will be found to be noncompliant. Galaher said there will be a grace period before the penalty is assessed. He mentioned something like 60 or 90 days to give mailers the opportunity to go back and address the situation.

Galaher said that when the full-service Intelligent Mail Barcode (IMB) is fully implemented there will be capability to measure individual pieces and assess penalties per piece. With the

full-service IMB the Postal Service then intends to move to assessing penalties when the address that has not been updated through Move Update is used multiple times even after USPS notifies the mailer that it is outdated.

MTAC mailers suggested that the proposed approach is unprecedented because the Move Update requirement is a per-address requirement and the penalty is being assessed on a per-mailing basis. The new requirements, in addition to extending the requirement to run Move Update to Standard mail, also require that the process be run more frequently: within 95 days of a mailing rather than 185 days.

Mailers are particularly concerned about relying on a sampling from MERLIN for such a major penalty against the entire mailing because of tolerance issues with MERLIN. Some have found MERLIN does not accurately read certain fonts, for example.

If USPS is going to judge a whole mailing on a sample it should let industry have a chain of evidence procedure that it can follow as evidence that it has done everything correctly, mailers suggested. Galaher said USPS will entertain that idea and that mailers can appeal a rejection.

He said the intention is not to get a lot of money out of this but to direct mailers to clean up their addresses and to put pressure on list vendors to conduct proper address hygiene.

GAO Sees Improvement in USPS Realignment Effort

The Postal Service has improved planning of its network realignment effort but has yet to set measureable performance goals for its initiatives, the Government Accountability Office (GAO) concludes in prepared remarks on the realignment effort.

USPS's network plan, required by the Postal Accountability and Enhancement Act (PAEA), sets an overall goal of lowering costs, for mailers

and the agency alike, improving service consistency and reducing environmental impacts (*see BMR 06/30/08, p.1*). GAO noted the plan seeks to capture \$1 billion in annual savings.

GAO said that it would like to see more transparency here but that because USPS is required to report each year to Congress on realignment costs and savings this should provide a chance for the Postal Service to clarify its

performance targets and results.

There still is not enough information about what the realigned network will actually look like, GAO said. USPS needs to be effective in this area because of its financial situation and declining volume. "USPS's annual reports to Congress are an opportunity to make its goals and results more transparent and provide information about the effectiveness of its re-alignment efforts," GAO said.

GAO commended the Postal Service for improving its procedures around communication with regard to consolidation and area mail processing (AMP) operations. Specifically, the Postal Service has moved the public input meeting for facility consolidations earlier in the process.

GAO, the investigative arm of Congress, based its remarks on a review of USPS's 2008 Network Plan and revised AMP Communication Plan as well as other information.

Trends

Household Diary Confirms Migration Trend

While it's certainly no news flash, the latest multi-year Household Diary Study confirms email and online bill paying are increasingly affecting mail volumes.

The fiscal year 2007 report says demographics are playing a key role in the decline in correspondence and transactional mail. In FY 2007, 35% of household mail included correspondence and transactions, a figure that was down slightly from the 36% in FY 2005. USPS says the decline in correspondence reflects changing demographics, "Young households both send and receive fewer pieces of correspondence mail, a result of young households' comfort with and use of the Internet and their lower average income level."

The Diary Study indicates transactional mail is also being affected by electronic alternatives such as automatic deduction and Internet bill payment. Over the past five years the percentage of bills paid online has grown from 19% in 2003 to 32% in 2007.

At the same time payments through the mail declined from 74% to 62% of total payments. About 7% of payments are made in person, a percentage that has not changed over the past three years.

Advertising mail continues to be a huge chunk of total household mail, representing more than half of mail received in FY 2007. Of the 100.5 billion pieces of ad mail received in FY 2007, 17% was shipped First Class, 70% was Standard mail regular and

13% was Standard mail nonprofit. Periodicals saw a slight dip in FY 2007, compared with the previous two years, with households receiving 6.6 billion pieces. Newspapers were 19% of the total, with magazines representing 73% of the volume and the remainder was unspecified.

Packages sent grew 11% in FY 2007 compared with FY 2006. Households received 2.5 billion packages and sent 742 million last year. USPS thinks mail order and Internet retailers, as well as online auction sites such as eBay, were key drivers of the increase.

The Household Diary Study collects household information on demographics, mailing behavior, lifestyle and attitudes toward mail and advertising in order to track trends, compare mail use among different types of households and measure mail sent and received by U.S. households.

Household Mail Volume Received and Sent by Market Service

Market	(billions of pieces)		
	2005	2006	2007
Correspondence	16.6	15.3	14.6
Transactions	42.7	42.7	43.3
Advertising	101.9	104.9	100.3
Periodicals	6.7	6.7	6.6
Packages	3.1	3.2	3.1
Unclassified	3.8	5.0	6.2
Total	167.0	170.2	166.2

Source: USPS 2007 Household Diary Study

Briefs

The Postal Service wants to add to its growing stable of negotiated service agreements for international products. The agency last week announced it has entered into three additional Global Expedited Package Services contracts. USPS says the contracts are functionally equivalent to Global Expedited Package Services approved earlier. Functionally equivalent contracts can be expedited without being subject to separate product review under the postal reform law. USPS wants to keep the names of the customers, the contracts themselves and related financial information confidential. The Postal Regulatory Commission is expected to address broader confidentiality issues in the future. But USPS says its ability to negotiate individual contracts would be harmed if this information were disclosed. It also argued that if the names of the parties involved were disclosed USPS's competitors would target them and undercut postal prices.

In other news relating to negotiated service agreements (NSA), the Postal Regulatory Commission (PRC) rejected USPS's request to dismiss the complaint of Capital One Services Inc. Capital One is charging that USPS failed to negotiate an NSA with it on similar terms to those provided to Bank of America. The Postal Service said the complaint was premature as the parties had not completed negotiating while Capital One said issues are at a standstill. The PRC found

there are unresolved questions of fact and law including what constitutes a functionally equivalent agreement and whether Capital One and Bank of America were similarly situated.

William Greene and Adam Longson, two Morgan Stanley & Co. Inc. research experts in shipping stocks say this isn't a good time for investors to get into parcel stocks because of major changes in air shipping patterns stemming from high fuel prices. The analysts are bearish on both FedEx and UPS but think the economic slowdown and high fuel costs are greater risks for FedEx, which could find it more difficult to adjust its air network if air express is seeing a secular drop. In a recent Morgan Stanley research report, Greene and Longson said there is evidence of a "secular shift" in air express, including the 6% drop in UPS domestic Next Day Air volume in the second quarter and FedEx overnight envelope traffic declining 6.5% for the quarter. The analysts said a turnaround for air volume could come from lower fuel costs, an economic resurgence or large-scale outsourcing of USPS ground volume to the private sector.

Beginning Aug. 24 the process for nonprofit groups to apply for, update and use Nonprofit Standard Mail through PostalOne! will be streamlined, the Postal Service announced. Benefits to nonprofit groups include a faster online application process, online access to records to make instant changes and a national authorization number.

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