

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

MARKET TEST OF EXPERIMENTAL PRODUCT-
GIFT CARDS

Docket No. MT2011-2

NOTICE OF THE UNITED STATES POSTAL SERVICE
OF MARKET TEST OF EXPERIMENTAL PRODUCT - GIFT CARDS
(January 5, 2011)

Pursuant to 39 U.S.C. 3641, the Postal Service hereby gives notice that it intends to conduct a test of an experimental product: Gift Cards. This product will provide postal customers with the ability to purchase a card loaded with a specified sum of money, which can be sent as a gift through the mail. The test will begin on or after May 1, 2011.

Subchapter III of Chapter 36, Title 39, United States Code, establishes authority for the Postal Service to conduct market tests of experimental products. This notice provides the information required by 39 U.S.C. 3641(c).¹ Pursuant to that provision, the Postal Service is also filing notice of this market test in the Federal Register.

¹ As of this filing, the Commission has not established regulations creating specific procedures to implement Section 3641.

Description of Nature and Scope of Experimental Product

Gift cards have become highly popular gifts in recent years.² There is also a nexus between the use of gift cards for gifting purposes and the use of the mails for sending that gift. This provides an opportunity for the Postal Service to increase customer convenience, while enhancing revenue and encouraging the use of the mail for gifting purposes, by selling gift cards at Postal Service retail locations. The Postal Service will conduct a test to gain experience with the product, in order to better understand its costs and the value of the product to postal patrons, in advance of determining whether it should be placed on the competitive product list under 39 U.S.C. 3642.

Initially, the Postal Service will test the sale of “open loop” cards, which are not specific to a particular merchant, but are branded by a Retail Electronic Payments Network (e.g., American Express, Discover, MasterCard or Visa) and can be used by the gift card recipient at any merchant that accepts cards administered by that Network. The Postal Service will enter into an agreement with one (or more) Issuing Bank, Retail Electronic Payments Network, or Service Provider to offer the product. The cards sold will either be the standard cards offered by the supplier(s), or customized, co-branded cards, featuring Postal Service imagery (such as stamp art or the Postal Service corporate signature). The supplier will provide all customer support for cardholders after the cards are

² The National Retail Federation 2010 Consumer Intentions and Actions survey recently found that “gift cards remain the most requested holiday gift, marking the fourth year in a row gift cards have topped consumers’ wish lists,” and that 77.3 percent of consumers will purchase at least one gift card this holiday season (a figure consistent with prior year results). National Retail Federation, “Gift Givers Listening to Recipients as Gift Card Spending Expected to Rise,” available at http://www.nrf.com/modules.php?name=News&op=viewlive&sp_id=1033.

purchased, with the Postal Service operating solely as a sales channel. The Postal Service may also test the sale of closed loop cards (i.e., cards that are specific to a particular merchant) though no plans have been established as of this date.

The Postal Service will test open loop cards with fixed amounts as well as variable amounts. For variable cards, the Postal Service will establish a minimum amount, allowable incremental amounts, and a maximum amount. For both fixed cards and variable cards, the Postal Service will establish limits as to the monetary value of the cards that can be purchased by a customer in a specified timeframe, in order to protect against fraud and money laundering. Currently, the Postal Service plans to sell fixed cards of \$25 and \$50, and to sell variable cards with a minimum allowed value of \$26, and a maximum allowed value of \$100; customers may choose any variable amount within that range in \$1 increments. The Postal Service also intends to set a \$500 daily maximum face value of cards purchased per customer, and a \$3,000 weekly maximum face value of cards purchased per customer.

Initially, the cards will only be available for purchase at Postal Service retail windows, and will not be sold at Automated Postal Centers (APCs) or on USPS.com. A card will be activated by the retail associate when it is purchased. Once activated, the funds loaded onto the card will be immediately available.

The market test is planned for two calendar years. In May 2011, the product will be launched in 2,000 retail locations that currently sell greeting cards, in order to take advantage of the inherent cross-selling opportunity between gift

cards and greeting cards (discussed further below). The test will then expand to up to 3,000 additional locations (including locations without greeting cards) in October 2011 to capture holiday sales.

The Postal Service will generate revenue from this test through an activation fee that customers pay at the time of purchase, in addition to the amount of money loaded onto the card. The Postal Service will retain a negotiated percentage of this fee, with the remainder being transferred to the supplier of the card.³ The payment of activation fees for open loop cards is standard in the industry, and the fees typically run between \$2.95 and \$7.95; larger fees are typically charged for variable cards, and for fixed cards with higher dollar amounts. Initially, the Postal Service plans the following fees: \$3.95 for a fixed \$25 card; \$4.95 for a fixed \$50 card; and \$5.95 for a variable card. Throughout the market test, the Postal Service may test different fee points that are competitive with the range discussed above, in order to determine what fees are optimal.⁴

³ Any fees that may apply to card recipients, or to merchants who accept the gift cards, would be set by the card supplier(s), in full compliance with applicable laws, including the Credit Card Accountability, Responsibility, and Disclosure Act of 2009 (Public Law No. 111-24). The Postal Service will not receive any revenue from those fees. The Postal Service is currently in contract negotiations with one supplier whose gift cards will be sold beginning with the launch of the test; that supplier does not charge customers any fees for its gift cards, beyond the initial activation fee.

⁴ If the Postal Service tests closed loop cards, this financial model may change, because activation fees are generally not levied on closed loop cards. Instead, the Postal Service may enter into a revenue share arrangement with the supplier of the closed loop cards, with the purchaser of the cards paying no fee.

Consistency with Section 3641 Criteria

Section 3641 provides the criteria that a market test must meet. As explained below, the Postal Service has determined that the Gift Cards market test would satisfy these requirements:

- Gift cards satisfy the statutory definition of “product” (Section 3641(a)(1)).
- The product is significantly different from all products offered by the Postal Service within the two-year period preceding the start of the test (Section 3641(b)(1)).
- The introduction or continued offering of the product will not create an unfair or otherwise inappropriate competitive advantage for the Postal Service or any mailer, particularly in regard to small business concerns (Section 3641(b)(2)).
- The Postal Service correctly identifies the product as competitive (Section 3641(b)(3)).
- The duration of the market test will not exceed 24 months, unless the Postal Service requests an extension from the Commission (Section 3641(d)(1)).
- The annual revenues received by the Postal Service from this test are not anticipated to exceed \$10,000,000 (as adjusted for inflation) in any fiscal year (Section 3641(e), (g)).⁵

⁵ “Year” as used in Section 3641(e)(1) means “fiscal year.” See 39 U.S.C. 102(10).

Definition of “Product”

Section 3641 allows the Postal Service to conduct “market tests of experimental products.” 39 U.S.C. 3641(a)(1). To be an “experimental product,” the product must be consistent with the statutory definition of “postal service.” See id. at 102(6) (defining “product” as a “postal service with a distinct cost or market characteristic for which a rate or rates are, or may reasonably be, applied”). “Postal service” is defined as “the delivery of letters, printed matter, and mailable packages, including acceptance, collection, sorting, transportation, or other functions ancillary thereto.” Id. at 102(5). The Commission has recognized that this definition encompasses the sale of retail products that bear a close nexus to the mails, including products that allow mailers to connect with others on a personal level (greeting cards), and products that allow mailers to send cash equivalents (money orders). For the same reasons, the sale of gift cards is consistent with the statutory definition.⁶

The sale of gift cards by the Postal Service is designed to support customers’ mailing needs, by providing convenient access to a product that is commonly used as a means of sending a gift easily and economically through the mail. Gift cards serve as an alternative to sending cash as a gift, and are

⁶ The Postal Service recognizes that the Commission has previously described generic stored value cards (including gift cards), as proposed by witness Lance in Docket No. MC2008-1, as being a “nonpostal service.” See Order No. 154 at 47. However, the Commission noted that this determination was based on the state of the record in that proceeding, and that the Commission’s decision “d[id] not foreclose the possibility of the Postal Service offering a card that may, if properly supported, be classified as a postal service.” Id. at 48 n.90. Furthermore, it is relevant to note that no party in that docket opposed the sale by the Postal Service of stored value cards, and the Public Representative endorsed its continuation, noting that “[t]he public benefits from having the convenience of being able to purchase stored value cards for mailing at their local post offices immediately prior to placing them in the mailstream.” See Docket No. MC2008-1, Initial Brief of the Public Representative at 30 (September 10, 2008).

oftentimes more convenient (and more desired by recipients) than purchasing and shipping an article of merchandise.⁷ The sale of gift cards by the Postal Service thus fosters the use of the mail for personal purposes, similar to greeting cards, which the Commission has found to be a “postal service.” See Order No. 154 at 34-35.

In fact, it is commonplace to mail a gift card along with a greeting card. Evidence of this fact can be found in the existence of greeting cards that are specifically designed to hold gift cards. See, e.g., <http://newsroom.hallmark.com/Holiday/Graduation> (noting that graduation cards designed to hold money or gift-cards are top sellers); <http://newsroom.hallmark.com/Product/Christmas-Cards> (noting that Hallmark sells “gift-card holder greeting cards” for Christmas that “feature designs that reflect the types of gifts, stores and services associated with the most popular gift cards”). The Postal Service plans to utilize the natural synergies between gift cards and greeting cards in the market test, by co-locating gift cards with greeting cards in many locations (including the 2,000 locations chosen for the initial launch of the test).

Furthermore, as an alternative to sending cash through the mail, gift cards sold at Post Offices and other postal retail facilities are very similar to money orders, which have long been regarded as a “postal service” on the basis that they are likely to be mailed when purchased. See Order No. 154 at 31 (citing Associated Third Class Mail Users v. U.S. Postal Service, 405 F. Supp. 1109,

⁷ Research by the National Retail Federation research (see footnote 1) has found that two reasons consumers purchase gift cards is because they allow the recipient the flexibility to select their own gift, and because it is more convenient to buy than traditional gifts.

1115 (D.D.C. 1975)), 38. It is logical to believe that gift cards purchased from the Postal Service will also generally be mailed.

Finally, the nexus between gift cards and the mail exists regardless of the specific type of card being sold (i.e., whether the card is open loop or closed loop, or whether it is co-branded with Postal Service imagery). Thus, like greeting cards, the presence, or absence, of Postal Service intellectual property is not relevant to determining whether a gift card is a “postal service.” Cf. Order No. 391 at 23 (noting that greeting cards need not contain Postal Service intellectual property). As a result, all the various cards that may be tested by the Postal Service are consistent with the statutory definition of “product.”

Significantly Different Product

The Postal Service has not sold gift cards or any equivalent product in the 2-year period preceding the start of this test.

Inappropriate Market Disruption

There is no reasonable expectation that the Postal Service’s sale of gift cards would create an “unfair or otherwise inappropriate” competitive advantage for the Postal Service or any mailer, with regard to any other party (including small businesses). Customers who wish to purchase open or closed loop gift cards may do so from a diverse variety of retail locations, including convenience stores, drugstores, grocery stores, big-box stores, and other retail channels (including, for closed loop cards, the specific merchant who will accept the card

as payment). These cards are typically positioned as convenience items located at checkout or in a dedicated gift card rack. The gift cards sold by the Postal Service will offer similar functionality and will be merchandised in a similar manner as the gift cards sold in these other retail channels, and will, like those cards, comply with the Credit Card Accountability, Responsibility, and Disclosure Act of 2009 (Public Law No. 111-24). In addition, the activation fees that will be tested will fall within the standard range of fees charged in the industry.

In addition, the introduction of this product would have a very small impact on the gift card market. In a recent approval of another market test, the Commission noted that inappropriate market disruption was “entirely unlikely and speculative” in a circumstance where the test is expected to generate revenues representing less than three percent of the relevant market. Order No. 617 at 6. Here, the effect would be considerably smaller: based on Postal Service projections concerning sales volume and the average amount of money loaded onto the cards, the total amount of consumer spending on gift cards purchased from the Postal Service will not, in either year of the test, exceed 0.5 percent of the open loop gift card market.

The Postal Service would therefore have no “unfair” or “inappropriate” advantage over other retailers of gift cards, including small businesses.⁸ Rather, the sale of gift cards would provide consumers with the added convenience of

⁸ In addition, with regard to small businesses, the Postal Service would generally be competing with larger retail chains (e.g., pharmacies, grocery stores) in the sale of open loop gift cards. And, as a general matter, small businesses are still a very small part of the overall gift card market. See Cyndia Zwahlen, *Firms Putting Gift Cards On Their Own Wish Lists*, LOS ANGELES TIMES, June 7, 2010, available at <http://articles.latimes.com/2010/jun/07/business/la-fi-0607-smallbiz-giftcards-20100607>. Thus, this product would result in minimal, if any, competition with small businesses.

purchasing a mail-related item at a postal location, similar to greeting cards and other mail-related retail products. Simply because this product is also sold by other retailers is not a basis for finding its sale by the Postal Service to be “unfair or inappropriate,” considering the statute expressly allows the Postal Service to provide products, including experimental products, that are competitive with the private sector.

Characterization as Competitive

The Postal Service identifies this experimental product as competitive, based on the criteria of 39 U.S.C. 3642(b)(1). Section 3642(b)(1) states that:

The market-dominant category of products shall consist of each product in the sale of which the Postal Service exercises sufficient market power that it can effectively set the price of such product substantially above costs, raise prices significantly, decrease quality, or decrease output, without risk of losing a significant level of business to other firms offering similar products. The competitive category of products shall consist of all other products.

As discussed above, the market for the sale of gift cards is highly competitive. Customers who wish to purchase open or closed loop gift cards may do so from a large variety of retail locations. The existence of these alternate providers of gift cards precludes the Postal Service from exercising any sufficient market power to charge excessive fees or provide an inferior product.

Duration

The market test will begin on or after May 1, 2011. While this notice is being provided much sooner than is required for market tests under Section 3641, the Postal Service requests that the Commission issue any decision on

this notice in a timeframe that is commensurate with previous market test proceedings. This is because the Postal Service, in conjunction with its supplier(s), needs to begin making final preparations soon in order to implement in May.

The test will run for two calendar years, unless the Postal Service decides to request an extension for an additional year, decides to establish Gift Cards as a permanent product on a quicker timeline, or terminates the test early. The path that is chosen will depend on the Postal Service's evaluation of the costs incurred and revenues derived from the sale of the product.

Total Revenues from Market Test

Based on expected sales, the total revenue received by the Postal Service should not exceed the \$10,000,000 threshold in any fiscal year, as adjusted for inflation pursuant to Section 3641(g). This test will be conducted between May 2011 and May 2013, meaning it will be conducted in part of FY 2011, all of FY 2012, and part of FY 2013. The Postal Service does not project that it will earn revenue exceeding \$10,000,000 from its portion of the activation fee in any of these fiscal years.

In FY 2012, the gross revenue from this test (i.e., the total revenue generated by the activation fee, before that revenue is split between the Postal Service and the supplier) is expected to slightly exceed the inflation-adjusted threshold applicable in that fiscal year.⁹ However, the statute applies the

⁹ Because the test will only be run in part of FY 2013, the revenue figures are lower for that fiscal year than FY 2012.

threshold to revenue that is “anticipated, or in fact received, by the Postal Service” from the product. In terms of a market test in which the Postal Service has a revenue share arrangement with another party, this language is best interpreted as applying to only that revenue to which the Postal Service is entitled under the arrangement, and should not encompass revenue to which the other party is entitled, even if that revenue may be temporarily in the possession of the Postal Service (due to the fact that the Postal Service collects the revenue from the user of the product). It is only the revenue actually retained by the Postal Service that will, at the end of the day, be booked as Postal Service revenue from the sale of the experimental product.

This interpretation also makes the most sense when one considers the prospect of a market test in which the Postal Service has a revenue share arrangement with another party, but it is that other party who actually receives the revenue from the end user of the product, before transferring a portion of the revenue to the Postal Service. In that case, the only revenue ever “received by” the Postal Service would be its share of the total revenue. There is no logical reason why the statutory threshold should be applied differently in these two instances.

To the extent that the Commission disagrees, and finds the revenue transferred to the card supplier to also be relevant, then the Postal Service requests an exemption from the threshold pursuant to 39 U.S.C. 3641(e)(2) for FY 2012. As noted above, this product satisfies the criteria of Section 3641(e)(2) because 1) the product is likely to benefit the public and meet an expected

demand by providing postal customers with convenient access to a mail-related retail product;¹⁰ 2) the product is expected to provide fee revenue and promote the use of the mail, and therefore contribute to the financial stability of the Postal Service; and 3) the product will not result in unfair or otherwise inappropriate competition.¹¹

Data Collection Plan.

The Postal Service intends to collect data during the market test to better understand (1) the retail costs that it incurs in selling the product; and (2) the value of particular types of cards, card packaging, and card locations to postal consumers. The Postal Service may also test different price points throughout the test. The Postal Service can report this cost, volume, and revenue data to the Commission upon request.

¹⁰ One purpose of any market test is to determine whether there is sufficient demand for a product so that it should be placed on the permanent product lists. If this market test results in gross revenues that exceed the \$10,000,000 threshold, it would be clearly meeting a demand.

¹¹ In addition, the gross revenue that is anticipated in FY 2012 from this test would exceed the threshold by a *de minimis* amount. The Postal Service believes that in applying the criteria of Section 3641(e)(2), the Commission can give due regard to this fact.

Respectfully submitted,

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